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CONTENTS

FREE TRADE AGREEMENTS AND THE FUTURE OF U.S.-KOREAN TRADE RELATIONS

*Jeffrey J. Schott**

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**Jeffrey J. Schott is a Senior Fellow at the Peterson Institute for International Economics.* *The author would like to thank Jisun Kim for her important contributions to the research of this paper.*

I. Introduction

During the past decade, the United States and Korea have pursued free trade agreements (FTAs) with a number of bilateral trading partners. For the United States, the Korea-U.S. (KORUS) FTA is by far the most significant in economic and political terms. For Korea, the KORUS FTA is matched, at least in commercial terms, by the recently concluded Korea-European Union (KOREU) FTA. Going forward, Korea will likely continue to pursue additional FTAs with its major trading partners, while the United States seems likely to refrain from new bilateral arrangements for at least the near term as Congress and the Barack Obama administration struggle to advance implementing legislation for pending FTAs with Colombia, Panama, and Korea signed in 2006 and 2007.

U.S. and Korean firms will soon have to adapt to the diverse export and investment opportunities created by these newly minted FTAs. The main open question is whether the agent of change will be (1) the KORUS FTA, (2) the KOREU FTA in combination with other Korean FTAs with partners in Asia, or (3) some combination of the two. This short paper examines the implications of these evolving trading arrangements on U.S.-Korea bilateral trade relations. It is organized in three sections: the first section addresses whither the KORUS FTA and why the U.S. legislative logjam may be broken in 2010. The second section examines competitive regionalism and the impact of the KOREU FTA on U.S.-Korea trade. The final section explores two alternative scenarios for the future course of U.S.-Korean trade relations, depending on whether the KORUS FTA is ratified.

II. Whither the KORUS FTA?

Korea and the United States signed their historic bilateral trade accord in June 2007, but neither country has yet completed the ratification process. In Korea, the agreement has passed a key committee in the National Assembly, but further action is likely to await comparable progress in the U.S. Congress. In the United States, the KORUS FTA qualifies for fast-track implementing procedures, but neither the Obama administration nor congressional leaders seem anxious to start the legislative process.[1] No U.S. action was taken in 2009 because the fractious domestic political debate over health care reform blocked consideration of all

1 Because the KORUS FTA was signed before the expiration of Trade Promotion Authority (TPA) on 30 June 2007, the agreement essentially is grandfathered under the TPA's fast-track provisions that require expedited consideration of implementing legislation submitted by the president to the House Ways and Means Committee. The draft bill cannot be amended and is subject to a simple majority vote in each chamber. As a practical matter, the U.S. Trade Representative negotiates the terms of the draft bill with members of Congress before submitting the executive branch proposal; amendments are effectively introduced in these "pre-markup sessions." For detailed analysis of these fast-track procedures, see Destler (2005).

other controversial initiatives, including the KORUS FTA. After his summit with Korean President Lee Myung-bak in Seoul on 19 November 2009, President Barack Obama said (White House 2009), "I am committed to seeing the two countries work together to move this agreement forward. There are still issues that are being discussed and worked on and we have put our teams in place to make sure that we are covering all the issues that might be a barrier to final ratification of the agreement."

Why is U.S. implementing legislation for the KORUS FTA so contentious? Looking at it from both foreign policy and commercial perspectives, the deal looks like a clear winner for U.S. trade and investment. The U.S. International Trade Commission (USITC) analyzed the KORUS FTA soon after its signing and concluded that the pact, if enacted, would likely increase U.S. GDP by $10.1–$11.9 billion as a result of tariff and tariff-rate quota (TRQ) provisions related to goods market access (Christ et al. 2007). U.S. merchandise exports to Korea would likely increase by an estimated $9.7–$10.9 billion, and U.S. merchandise imports from Korea would likely increase by about $6.4–$6.9 billion as a result of tariff and TRQ provisions included in the pact.[2] The USITC report also estimated that U.S. services exports would increase somewhat as a result of FTA provisions on market access, national treatment, and regulatory transparency although the overall impact of service liberalization on U.S. output would not be significant given the relatively small size of U.S. services trade with Korea.

Almost all U.S. agricultural lobbies have praised the pact for opening new export opportunities; rice was the only notable exclusion from the liberalization schedules. Some farm groups delayed blessing the deal out of solidarity with beef exporters seeking resolution of market access problems unrelated to FTA provisions (discussed below). When the implementing bill is finally brought to a vote, however, the farm groups are expected to strongly support the deal. That is why most members of Congress believe that the KORUS FTA will be ratified when a vote is taken; indeed, it is inconceivable that Congress would say no to such an important U.S. ally. The challenge therefore is to unblock congressional deliberations so that the decision can be taken and Congress can say yes.

Despite the broad benefits that would accrue to both countries from implementing the KORUS FTA, and the boost to U.S. exports in particular, Democratic leaders in Congress and in the Obama administration continue to cite old political talking points about unfair auto trade, beef restrictions, and other relatively minor trade

2 KIEP (2007) estimated that Korean GDP would increase by 0.32 to 5.97 percent as a result of liberalization pursuant to the KORUS FTA.

issues that ignore the significant changes that have occurred since the pact was signed more than two years ago. To be blunt, the U.S. public debate over the KORUS FTA is in a time warp. The following subsections examine what has happened in six key areas: the global economic crisis, decline in the U.S. share of Korean trade, exchange rate movements, changes in auto production and trade, beef trade, and political developments regarding North Korea. I believe that when these developments are better understood, U.S. policymakers will be in a better position to evaluate the need for moving forward with the KORUS FTA, for both economic and political reasons.

Global Economic Crisis

Clearly, the global economic crisis that struck in late 2008—roiling financial markets, curtailing international trade and investment, and throwing most industrial economies into a deep tailspin with surging unemployment—has been the most important development since the signing of the KORUS FTA. Both the U.S. and Korean economies have suffered sharp losses in output and employment during the course of the 2008–09 recession. Both have worked steadfastly together to craft remedial programs and to strengthen global economic governance going forward. Unlike in the past, however, Korean leaders have taken leadership responsibilities for managing the economic crisis, and they have worked closely with the United States and other Group of 20 (G-20) officials to resist new protectionism and to coordinate national policies that lay the basis for a durable economic recovery.

Working together on the G-20 crisis management has strengthened the U.S.-Korea economic partnership and contributed importantly to global economic governance. Korea accepted the responsibility of coordinating efforts by the major industrial and developing economies to combat the worst economic crisis since the Great Depression eight decades ago as part of the leadership troika of the newly established G-20 forum. Korean officials have been forceful and influential advocates at G-20 meetings for resisting protectionism amid the global economic crisis, for seeking the rollback of trade-restrictive measures, and for reviving and concluding the Doha Round of multilateral trade negotiations by the end of 2010. And the close interactions of U.S. and Korean officials during the global crisis have spurred cooperation in other areas such as climate change, where both countries have a strong interest in pursuing green growth strategies that sharply reduce greenhouse gas emissions, and may encourage the adoption of a new global climate change treaty.

Through their actions, Korean officials have earned their place in the decision-making councils of the global economy. That is why it was no surprise when, at the G-20 summit held in Pittsburgh in September 2009, Korea was asked to chair G-20 meetings in 2010 and host the G-20 summit in November 2010. And that is also why the United States should recognize that the spirit of cooperation reinforced in the negotiation of the KORUS FTA has yielded dividends that go well beyond bilateral trade and investment and, thus, should not be jeopardized by further delay in the ratification process.

Decline in the U.S. Share of Korean Trade

Buoyed by the USITC projections noted above, U.S. officials hoped that the KORUS FTA would boost U.S. exports of goods and services. Although the KORUS FTA holds the promise of increased bilateral trade and investment, because of the extensive delay in implementing the pact, neither side has been able to reap the benefits. Instead, bilateral trade stagnated in 2008 and has fallen sharply amid the global recession of 2009.

Although each country remains one of the largest trading partners of the other, the U.S. share of Korean trade has sharply declined during the past few years. In 2000, the United States was the second-largest exporter—after Japan—of merchandise goods to Korea, accounting for about 18 percent of total Korean imports. In 2008, the United States was the fourth-largest exporter to Korea after China, Japan, and the European Union-25, accounting for only approximately 9 percent of total Korean imports (***Table 1***). U.S. exports to Korea grew by only $9 billion over the 2000–08 period, while the overall size of the Korean import market was expanding from $160 billion to $433 billion, or by 170 percent.

What happened? In a word, China. China became Korea's most important trading partner. Korea-China merchandise trade soared from $31 billion in 2000 to $190 billion in 2008, accounting for about 22 percent of total Korean trade.

China, however, is not the only partner to sharply expand trade with Korea in recent years. In 2000, EU-25 trade with Korea totaled $41 billion, compared to $67 billion for Korea-U.S. trade. By 2008, EU-Korea trade had grown to $93 billion, and both EU exports to and imports from Korea exceeded the value of Korea's trade with the United States. In light of the KOREU FTA, the U.S. share of the Korean import market is likely to fall further in the next decade if the KOREU FTA preferences are not offset by similar KORUS FTA benefits.

***Table 1:* Korea's Trade with Major Trading Partners, 2000–08, in millions of U.S. dollars**

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Korea's exports to:									
United States	37,806	31,358	32,943	34,369	43,027	41,500	43,321	45,884	45,294
China	18,455	18,190	23,754	35,110	49,763	61,915	69,459	81,985	106,624
European Union-25	24,715	21,154	23,768	27,030	37,894	43,773	48,541	55,030	51,788
Japan	20,466	16,506	15,143	17,276	21,701	24,027	26,534	26,370	26,794
Hong Kong	10,708	9,452	10,146	14,654	18,127	15,531	18,979	18,655	13,763
World	172,692	151,039	163,143	201,854	254,363	285,484	326,361	373,737	417,355
Korea's imports from:									
United States	29,286	22,431	23,111	24,935	28,919	30,788	33,797	37,393	38,288
China	12,799	13,303	17,400	21,909	29,585	38,648	48,557	63,028	83,146
European Union-25	16,168	15,274	17,498	19,817	24,196	27,304	30,087	36,717	41,479
Japan	31,828	26,633	29,856	36,313	46,145	48,403	51,926	56,250	65,385
Hong Kong	1,261	1,228	1,695	2,735	3,268	2,043	2,101	2,142	7,009
World	160,482	141,099	152,127	182,974	224,462	261,238	309,382	356,847	433,366

Source: Direction of Trade Statistics, International Monetary Fund, August 2009.

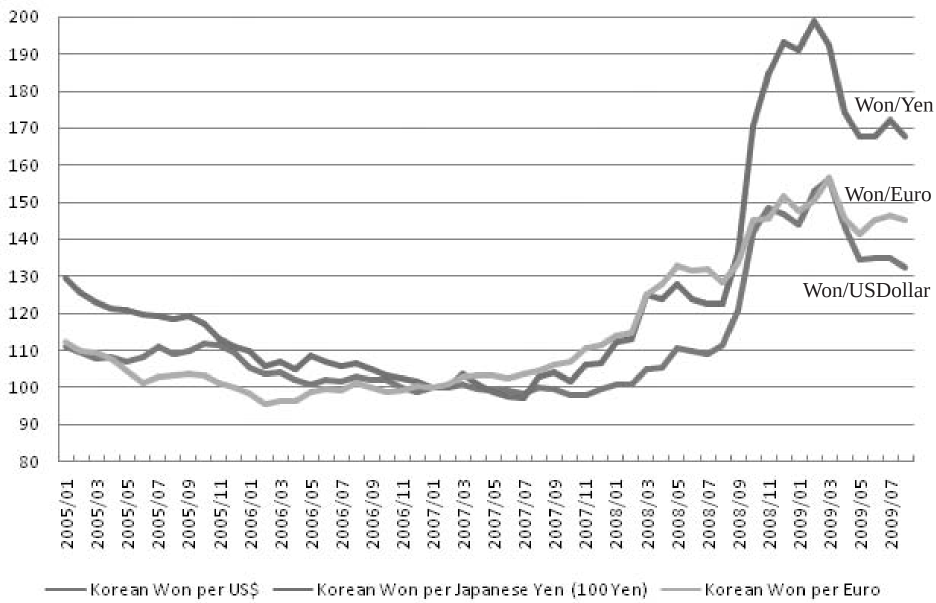
Exchange Rate Changes

Since the KORUS FTA was signed in June 2007, the Korean *won* has depreciated sharply against the Japanese *yen*, the euro, and the U.S. dollar—by 77 percent, 41 percent, and 38 percent, respectively, between July 2007 and July 2009 (***Figure 1***). The depreciation of the Korean *won* against these major currencies helped sustain Korean exports in 2007–08, at least until the bottom fell out of global demand in late 2008, and buoyed Korea's economic recovery since the summer of 2009. In particular, the sharp depreciation of the Korean *won* against the Japanese *yen* has given Korean automakers significant export advantage against competing Japanese automakers shipping to the U.S. and Chinese markets. The big shift in the *won*-euro exchange rate also has been an important driver of EU-Korea trade and Korean investment in auto assembly plants in eastern Europe.

Auto Production and Trade

Autos and light trucks account for a significant share of bilateral U.S.-Korea merchandise trade, and Korea has run a large surplus in auto trade, which now exceeds $10 billion annually. The liberalization of this trade was a crucial and

Figure 1: **Real Exchange Rates for the Korean *Won* against the U.S. Dollar, Japanese *Yen,* and Euro, 2005–09**



Source: Author’s data.
Note: January 2007 = 100.

controversial component of the KORUS FTA negotiations, and it remains the most contentious in the ratification debate. In some ways, the economic crisis, which has hit hardest in U.S. states home to many Big Three auto plants, has further hardened political resistance to the KORUS provisions on autos. In other ways, however, the crisis may open new avenues for new bilateral initiatives that could propel production and employment in the auto sectors of both countries.

Both countries have suffered sharp contractions in output and employment in the auto sector. In 2009, U.S. auto sales totaled about 10.4 million units, sharply down from the 16.5 million unit sales of a few years ago (***Table 2***). Compared with 2008, U.S. sales of domestically produced vehicles in 2009 were down 22 percent, while imports fell 19 percent. Ford, General Motors (GM), and Chrysler are a big part of this story, with sales down about 27 percent compared with 2008. In contrast, Hyundai and Kia have recorded sizable increases this year in their sales in the U.S. market.

In Korea, although domestic sales were down only a bit in 2009, domestic production fell sharply owing to weak demand in Korea’s export markets. According to the Korea Automobile Manufacturers Association, Korea’s automobile exports decreased from 2.7 million in 2008 to 2.1 million in 2009.

***Table 2:* U.S. Auto (Light Vehicle) Sales by Company, 2006–09, by number of units sold**

Names of autos and groups	2006	2007	2008	2009 (Jan.–Aug.)	2009 (Annualized)
Chrysler Group	2,142,505	2,076,062	1,447,736	650,496	975,744
Ford	2,849,604	2,436,530	1,942,041	1,105,803	1,658,705
GM	4,067,554	3,824,550	2,955,860	1,381,583	2,072,375
International (Navistar)			851	138	207
Big Three total	**9,059,663**	**8,337,142**	**6,346,488**	**3,138,020**	**4,707,030**
Honda	1,509,358	1,551,542	1,428,765	806,907	1,210,361
Hyundai	455,520	467,009	401,742	310,706	466,059
Isuzu	13,543	11,448	7,262	1,076	1,614
Kia	294,302	305,473	273,397	216,947	325,421
Mazda	268,786	296,110	263,949	145,955	218,933
Mitsubishi	118,558	128,993	97,257	38,127	57,191
Nissan	1,019,481	1,068,517	951,446	524,903	787,355
Subaru	200,703	187,208	187,699	143,828	215,742
Suzuki	100,990	101,884	84,865	31,664	47,496
Tata		65,233	44,198	23,953	35,930
Toyota	2,542,524	2,620,825	2,217,660	1,170,409	1,755,614
Asia total	**6,523,765**	**6,804,242**	**5,958,240**	**3,414,475**	**5,121,713**
BMW	313,603	335,840	303,190	160,044	240,066
Daimler	247,886	253,225	249,722	130,201	195,302
Porsche	34,227	34,693	26,035	12,729	19,094
Volkswagen	325,256	324,080	310,888	194,730	292,095
Europe total	**920,972**	**947,838**	**889,835**	**497,704**	**746,556**
Domestic light vehicles[1]	12,812,886	12,336,074	9,847,728	5,131,969	7,697,954
Imported light vehicles[2]	3,691,514	3,753,148	3,346,835	1,918,230	2,877,345
Total light vehicles	**16,504,400**	**16,089,222**	**13,194,563**	**7,050,199**	**10,575,299**

Source: Ward's AutoInfoBank, http://wardsauto.com.
1 Domestics are from United States, Canada, and Mexico.
2 Imports are from overseas.
Note: Light vehicles are defined as cars and light trucks (GVW classes 1–3, less than 14,001 pounds)

Auto issues have been a major stumbling block to congressional ratification of the KORUS FTA. The matter is important for both countries. For Korea, maintaining good access to the large U.S. market and gaining a small price advantage over U.S. producers and importers as a result of the elimination of the 2.5 percent U.S. auto tariff is a key benefit of the overall pact. The 10-year phaseout of the 25 percent U.S. tariff on light trucks and sport-utility vehicles (SUVs) also had been considered important to spur investment in Korea production of these vehicles but is less crucial now, given the sharp drop in demand for such gas guzzlers. For the United States, the elimination of the larger 8 percent Korean auto tariff was seen as opening the door to increased U.S. exports of luxury vehicles well beyond the very limited sales that have averaged about 5,000 units annually.

Some U.S. automakers (notably Ford and Chrysler) argue that U.S. tariff cuts would spur even greater Korean penetration of the U.S. car and SUV markets, while the elimination of the Korean tariff would not make much difference to U.S. car exports given the pervasive nontariff barriers (NTBs) in the form of discriminatory tax policies and fuel, emission, and safety standards that they claim impede import and distribution of foreign cars in Korea. Although the KORUS FTA provides greater transparency and access to regulatory agencies and promises to remove many of the discriminatory practices, U.S. critics question whether Korea will faithfully implement the agreed reforms. This skepticism reflects a residue of mistrust generated by haphazard Korean enforcement in the 1990s of two previous bilateral memoranda of understanding on auto trade.

The criticism of the KORUS FTA provisions on autos is exaggerated on several counts. First, U.S. automakers exaggerate the potential for U.S. sales in Korea of cars produced in U.S. assembly plants. U.S. automakers generally do not export many cars from U.S. plants beyond the neighborhood NAFTA market; instead, they produce abroad to supply foreign markets (as GM is doing in Korea through GM-Daewoo, which produced about 900,000 cars in Korea in 2008 and sold more than 100,000 to Korean customers). Second, the Korean car market is small—about one-tenth the size of the U.S. market—and luxury imports (the cars U.S. firms want to sell in Korea) face relatively stiff competition from Japanese and European imports. Third, demand for SUVs declined sharply after the large increase in gas prices in 2008, and SUVs seem unlikely to recover their dominant share of U.S. vehicle sales. The elimination of the oversized U.S. tariff is thus no longer important as a spur to Korean production. Fourth, congressional charges of unfair Korean trade practices ring less clearly in the aftermath of massive U.S. financial support for the ailing U.S. auto industry in 2009, which gave GM and Chrysler, in particular, competitive advantages vis-à-vis domestic and foreign suppliers.

While the elimination of NTBs is important to demonstrate open access and opportunity for trade and investment in each market, U.S. officials should not expect U.S. exports to jump 10-fold or the U.S.-Korea bilateral auto trade balance to shift significantly in response to such reforms. In the near future, the United States is likely to continue to run a large bilateral deficit with Korea in autos, just as Korea will continue to run large deficits in services and in agriculture. Resolving the auto trade and regulatory problems that have stalled the congressional debate on the ratification of the KORUS FTA will require additional efforts that go beyond

Table 3: **Monthly Exports of Beef from the United States to South Korea, 2003, 2007–09**

	Quantity (metric tons)				Value (thousands of U.S. dollars)			
	2003	**2007**	**2008**	**2009**	**2003**	**2007**	**2008**	**2009**
January	15,013	17	111	6,946	46,618	59	338	27,153
February	16,704	19	31	5,835	53,366	57	99	21,925
March	16,033	1	14	3,677	52,304	3	92	12,887
April	15,166	55	38	1,805	50,733	150	103	7,225
May	15,107	975	1	2,506	54,017	4,109	12	10,838
June	22,246	2,142	49	3,032	83,037	10,163	356	13,304
July	23,201	11,040	1,489	2,674	85,107	47,949	5,461	12,484
August	23,571	1,915	12,404	3,408	85,685	10,562	62,752	14,233
September	13,484	6,076	16,642	2,690	50,949	33,453	89,249	10,773
October	18,832	1,989	13,827		66,285	10,026	79,039	
November	17,755	47	5,937		61,530	250	32,597	
December	16,336	64	3,193		60,870	538	14,928	
Total	**213,448**	**24,340**	**53,736**	**32,573**	**750,501**	**117,319**	**285,026**	**130,822**
Monthly average	17,787	2,028	4,478	3,619[a]	62,542	9,777	23,752	14,536[a]
U.S. exports to world	859,736	464,301	626,985	445,74[a]	3,150,232	2,004,652	2,819,946	1,902,395[a]

Source: U.S. Meat Export Federation, www.usmef.org/TradeLibrary/Statistics.asp.
a For nine months (January–September 2009.

traditional market access issues. For example, I would suggest that, following the mandate set out by President Obama and President Lee in November 2009, senior officials should seek to establish new bilateral arrangements—in areas such as hybrid engines and electric battery technologies—that can bolster the global competitiveness of both U.S. and Korean manufacturers and create new opportunities for production and employment in both countries.

Beef Trade

During the past few years, separate bilateral negotiations have removed most of the impediments to U.S. beef exports to Korea. Nonetheless, U.S. shipments to Korea remain far below the level of exports before the Korean ban on U.S. imports imposed for health reasons in December 2003. U.S. beef exports averaged almost 18,000 metric tons per month in 2003; in 2009, U.S. shipments averaged less than 4,000 metric tons per month, and the total value of U.S. beef exports to Korea fell from $750 million in 2003 to less than $200 million in 2009 (***Table 3***). That is why the Senate Finance Committee chairman, Max Baucus (D-Mont.), and his Montana cattle ranchers continue to be unhappy—even though the KORUS FTA itself has little to do with the falloff in U.S. exports.

In 2009, Korea was the fourth-largest market for U.S. beef exports (fresh, chilled, and frozen) after Mexico, Canada, and Japan. But the volume of U.S. shipments has not reached the levels achieved in 2003; the multiyear ban on U.S. exports allowed other suppliers, notably Australia, to gain market share that will be difficult to fully recoup. In 2003, Australia accounted for 21 percent of Korean beef imports by volume; the U.S. share was 69 percent. In the latest 12 months of data (October 2008–September 2009), according to Korea Agricultural Trade Information, the import market shares were reversed, with U.S. shipments accounting for only 27 percent of Korean imports compared with 58 percent for Australia.

In short, U.S. beef exporters face two problems. The smaller issue is the resolution of the remaining Korean import ban on cattle more than 30 months old that affects a very small share of potential U.S. shipments—a problem that should be resolved under the guidelines set by the World Organization for Animal Health. The larger problem is that the long hiatus from the Korean beef market during the bovine spongiform encephalopathy (BSE) crisis has given U.S. competitors in Australia a dominant share of the market, which will be difficult to dislodge.

North Korea

The conclusion of the KORUS FTA has profound implications not only for commercial relations but also for long-standing partnership. When the KORUS FTA was negotiated, the main concern related to North Korea was whether goods produced in the Kaesong industrial complex would be eligible for FTA preferences. The pact essentially said no, but it established procedures for revisiting this matter after the FTA enters into force. Since then, however, North Korea has taken a number of provocative actions—especially conducting an underground nuclear test and launching offensive missiles—that underscore the importance of a strong and durable alliance between the United States and South Korea. This lesson has been made very clear in the numerous meetings that President Obama and President Lee have had during the past six months. It does not make any sense to have a small commercial matter about a few provisions in a major trade agreement create friction in an incredibly important bilateral alliance. That’s the issue, in my opinion, that will tilt congressional opinion in favor of supporting the KORUS FTA.

III. Whither Competitive Regionalism

Although the KORUS FTA stalled in Congress, Korea and the European Union (EU) moved forward with their own FTA that closely resembles the U.S.-Korea deal. After the KOREU FTA enters into force, U.S. exporters will be worse off than at present as European firms benefit from tariff preferences in the Korean market largely comparable with those that had been expected to have been already available to U.S. firms.

Ironically, it was the initial U.S.-Korea talks that spurred the EU to emulate the KORUS FTA with its own so as to not disadvantage European companies in the European market. The U.S.-Korea announcement in February 2006 that the two countries would begin FTA negotiations provoked the European Commission to consider its own deal with Korea. Six weeks after actual U.S.-Korea talks began in June 2006, the EU and Korean officials began preparatory consultations for the KOREU FTA. Five weeks after U.S. and Korean officials shook hands on the KORUS FTA, formal negotiations began on the KOREU FTA. Two years later, on 13 July 2009, both sides announced the substantial completion of negotiations and initialed the deal on 15 October 2009. The KOREU FTA is expected to be signed in the first half of 2010 and then will be subject to ratification by the 27 members of the EU and by the Korean National Assembly. On this timetable, the KOREU FTA could take effect during the fourth quarter of 2010—probably *before* Congress considers the U.S. pact signed in 2007.

Whatever first-mover benefits the United States gained from securing its deal with Korea in June 2007 are being rapidly dissipated as Korea prepares to sign its own comprehensive pact with the EU. Just as the EU leapfrogged the United States as one of Korea's most important trading partners, it is now doing the same with a trade accord that could further dislodge U.S. suppliers from the Korean market.

The KOREU FTA is a significant deal that could significantly affect U.S. trade and investment interests in the partner countries. The EU was Korea's second-largest trading partner—after China—with two-way trade of about $93 billion in 2008 (see Table 1) while Korea was the EU's eighth-largest trading partner in 2008. Perhaps even more important, the EU is the single largest foreign investor in Korea, accounting for about 45 percent of foreign direct investment inflows into Korea in 2006 (EC 2009).

In broad terms, the KOREU FTA was modeled on the KORUS FTA, and many of its provisions borrow from U.S.-Korea precedents. The KOREU FTA calls for the elimination of tariffs on about 99 percent of EU industrial goods and 96 percent of Korean goods within three years, which will eventually be expanded to all industrial goods within five years. By comparison, the Korea-U.S. FTA, if implemented, will eliminate about 91 percent of tariffs on U.S. industrial goods

***Table 4:* Comparison of Tariff Concessions (for Industrial Tariffs) of the Proposed Korea–European Union Free Trade Agreement and the Korea-U.S. Free Trade Agreement**

	Korea-EU FTA				**Korea-U.S. FTA**			
	Korea		**European Union**		**Korea**		**United States**	
Staging category	**Number of tariff lines (%)**	**Import value (%)**	**Number of tariff lines (%)**	**Import value (%)**	**Number of tariff lines (%)**	**Import value (%)**	**Number of tariff lines (%)**	**Import value (%)**
Entry into force	90.7	69.4	97.3	76.7	89.9	81	87.3	85.5
3 years	5.1	22.4	2.1	16.6	6.3	13.2	4.1	6.9
Subtotal	95.8	91.8	99.4	93.3	96.2	94.3	91.4	92.4
5 years	3.7	6.9	0.6	6.7	1.9	1.5	4.0	3.4
7 years	0.5	1.3						
10 years					1.9	4.2	4.6	4.2
Total	100	100	100	100	100	100	100	100

Source: "Detailed Explanations of Korea-EU FTA [in Korean]," Ministry of Foreign Affairs and Trade, Seoul, www.fta.go.kr/user/fta_korea/kor_eu.asp?country_idx=21.

and 96 percent of Korean goods within three years. Although the Korea-EU deal will eliminate all industrial tariffs within seven years in both entities, some industrial tariffs under the Korea-U.S. FTA will be subject to phaseout periods as long as 10 years for politically sensitive U.S. products (***Table 4***).

According to the KOTRA (2009), Korean automakers will be a major beneficiary of the pact. Currently, the EU imposes a 10 percent tariff on Korean cars, and Korea imposes an 8 percent tariff on European cars. Both sides agreed to remove tariffs on cars with engine displacement of 1,500 cc or larger within three years and on cars with engine displacement of less than 1,500 cc within five years.[3] This liberalization remains contentious among European producers. As in the U.S. ratification debate, auto trade reforms will be the focus of much of the domestic criticism of the pact, particularly the duty drawback provisions that allow the tariffs paid on parts used to manufacture a product to be refunded when the final product is exported. Korea and the EU agreed to put a 5 percent cap on refunds, but the European Automobile Manufacturers' Association contested the drawback terms in a letter to the EU Commission and argued that the drawback would place European firms at a severe competitive disadvantage against Korean subsidiaries in Europe (ACEA 2009). In large measure, the

3 For comparison, under the KORUS FTA, Korea and the United States agreed to remove tariffs immediately on cars with engine displacement of less than 3,000 cc and on cars with engine displacement of more than 3,000 cc within three years. Currently, the United States imposes a 2.5 percent tariff on imported cars.

opposition from automakers in the EU echoes complaints against the KORUS FTA by Ford and Chrysler. The difference is that EU officials decided that the pact was too important to be delayed or derailed by specific terms of the deal on autos, and they are going forward with the ratification process despite opposition from European interest groups.

The KOREU FTA is a prime example of what I call "competitive regionalism"—one country emulating the trading arrangements of other trading partners to offset the discrimination against its own firms generated by the trade preferences in other FTAs in which they are not a party. But competitive regionalism is not a one-off process; it usually triggers an ongoing series of reactions by other countries potentially vulnerable to trade and investment diversion. In the case of both the KORUS and the KOREU FTAs, among the countries most likely to suffer from the implementation of one or both of the Korean pacts with the transatlantic powers is Japan. Many Japanese firms—especially those in the auto and electronics sectors—are competing with Korean (and U.S.) firms in European markets. Japanese business organizations have recently urged their government to initiate talks with the EU; such recommendations seem more urgent than similar proposals issued frequently during the past two decades for consideration of a U.S.-Japan FTA. I suspect that the signing of the Korea-EU FTA will also revive demands for a resumption of Korea-Japan FTA talks that started in 2003 but have been essentially frozen since December 2004.

Although the KOREU FTA is the most significant trade pact negotiated by Korea since the conclusion of the KORUS FTA, it is not the only deal inked by Korean trade officials. Indeed, Korea has pursued FTAs with most of its major trading partners. ***Table 5*** shows the roster of current and prospective Korea FTA partners as of September 2009 and their bilateral merchandise trade with Korea. If one includes all the countries with which Korea has concluded FTA negotiations (status A, B, and C in Table 5), the pacts covered $323 billion in two-way trade in 2008, or 38 percent of total Korean trade. However, if one adds together all the countries with which Korea has started negotiating FTAs (including Japan), the trade coverage swells to $542 billion, or 64 percent of Korea's trade. If China joins the roster of active negotiations, then about 86 percent of the total two-way Korean merchandise trade potentially would be subject to FTA preferences.

To put this into perspective for U.S.-Korea trade relations, if the United States continues to delay ratification of the KORUS FTA, countries that account for 54 percent of Korea's current trade could soon benefit from FTA preferences in the Korean market, giving them a competitive advantage over U.S. (and Chinese) firms. The key, of course, is what happens with Japan and China as the North-

Table 5: Bilateral Free Trade Agreement Partners of Korea as of September 2009

FTA status	Country or region	2008 GDP (billions of U.S. dollars)	Korean merchandise trade (billions of U.S. dollars)			
			Exports to	Imports from	Trade balance	Total trade
A	Chile	169.6	2.8	4.6	(1.8)	7.4
A	Singapore	181.9	16.4	13.5	2.9	29.9
A	EFTA-4[b]	966.4	1.5	3.9	(2.4)	5.4
A	ASEAN-10[c]	1,505.8	47.5	42.7	4.8	90.2
B	United States	14,264.6	45.3	38.3	7.0	83.6
B	India	1,209.7	7.5	5.3	2.2	12.8
C	European Union (27)	18,394.0	51.8	41.5	10.3	93.3
D	Canada	1,511.0	5.6	4.0	1.6	9.6
D	Mexico	1,088.1	8.5	1.2	7.3	9.7
D	GCC[d]	1,076.0	12.9	68.9	(56.0)	81.8
D	Australia	1,010.7	5.5	16.7	(11.2)	22.2
D	New Zealand	128.5	0.9	1.1	(0.2)	2.0
D	Peru	127.6	0.5	1.2	(0.7)	1.7
D	Japan	4,923.8	26.8	65.4	(38.6)	92.2
E	China	4,401.6	106.6	83.2	23.4	189.8
Subtotal[e]		50,959.3	340.1	391.5	(51.4)	731.6
Korea (world trade totals)		947.0	417.3	433.3	(16.0)	850.6

Sources: World Economic Outlook database, International Monetary Fund, April 2009; Direction of Trade Statistics (CD ROM), International Monetary Fund, August 2009.
Notes:
a. A = in effect; B = signed; C = negotiations completed; D = under negotiation; E= in preparation.
b. EFTA-4: Iceland, Liechtenstein, Norway, and Switzerland. Owing to data unavailability, figures for EFTA-4 do not include the contribution from Liechtenstein.
c. ASEAN-10: Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam.
d. GCC: Bahrain, Saudi Arabia, the sultanate of Oman, Kuwait, Qatar, and the United Arab Emirates.
e. Owing to its inclusion in ASEAN-10, Singapore is counted twice in these subtotals.

east Asian powers together account for one-third of Korea's trade. Korea-Japan talks could soon revive as part of the new Asia-centric focus of Japanese trade policy. Talks between Korea and China will likely continue to evolve at a more measured pace although the groundwork is already being laid in the numerous consultations and studies conducted on the potential for either a China-Korea or a Northeast Asian FTA.

IV. Future Scenarios

At the start of 2010, U.S.-Korea trade relations remain in limbo, even as the overall bilateral economic partnership has been bolstered by the joint efforts of the two countries in the G-20 to combat the global economic crisis and lay the foundation for a durable recovery. Congressional deliberation on implementing legislation for the KORUS FTA has not yet begun. Meanwhile, Korea is moving forward with trade pacts with other important trading partners, such as the EU, the ASEAN, and India, that could erode U.S. market share in Korea if KORUS FTA ratification is further delayed.

Whither U.S.-Korea trade relations? The answer depends importantly on what happens with the KORUS FTA. If the U.S. policy inertia of the first year of the Obama administration continues and Congress does not address the KORUS FTA in 2010, then events in Asia will increasingly dominate the Korean policy agenda. In other words, the trend of the past decade, which has recorded a steady decline in the U.S. share of Korean trade, will deepen. In this scenario, Korea would then pursue closer ties with its Asian partners, especially China and Japan. Korean trade priorities would focus on building a Northeast Asian FTA with China and Japan, as well as harmonizing the pacts that each of them has concluded with the ASEAN; in other words, the emphasis would be on creating a more substantive "Ten plus Three" arrangement linking Northeast and Southeast Asia instead of engaging with the United States in other trade initiatives in East Asia, including nascent efforts to build a trans-Pacific partnership (TPP). More important, the lack of U.S. follow-through on the KORUS FTA would cast doubts about the overall U.S. commitment to its alliance with Korea. All in all, this scenario means increased tension in U.S.-Korea relations, lost opportunities for U.S. exporters and investors, and possibly new discrimination across the major markets of Asia.

But the bleak scenario of U.S. policy inertia has an equally optimistic counterpart. If the impasse over implementing the KORUS FTA can be broken and the agreement ratified in 2010, then the stage will be set for expanded bilateral trade ties and broader bilateral cooperation on regional economic integration. Simply put, ratifying the KORUS FTA would refocus attention on how Asian countries engage with the United States and redirect efforts toward Asia-Pacific initiatives.

In a sense, this scenario foresees a continuation of the competitive regionalism that has dominated Asian policy for the past decade, but with one notable difference: the active participation of the United States. With the KORUS FTA in hand, U.S. officials would be better positioned to advance other initiatives in the region, including the TPP. The idea of a TPP harks back to the original concepts that George Yeo, then Singapore's trade minister, propounded more than a decade ago about the importance of regional integration and using the building blocks of existing bilateral and regional pacts to create a broad Asia-Pacific regime. This vision took root in the P-4 pact among Singapore, New Zealand, Brunei, and Chile that was signed in 2005. The countries currently participating in TPP talks include the original P-4 signatories plus four countries that have agreed to try to integrate and possibly expand the scope of their own bilateral deals in the region: the United States, Australia, Vietnam, and Peru.

For Korea, participating in the TPP would be a natural extension of its large network of bilateral and regional deals in Asia and across the Pacific. Indeed, as Table 5 shows, Korea already has deals in place or in the works with six of the eight countries negotiating the TPP. So, too, do other important countries in the Asia-Pacific region, including Mexico and Canada in North America and Japan and China in Northeast Asia. In short order, the small P-4 could evolve into a blockbuster Asia-Pacific enterprise if participants show flexibility in terms of the breadth and scope of the integration arrangement. Both the United States and Korea may find it easier to engage in trade talks with countries like Japan and China in a regional setting rather than in bilateral talks that inevitably focus political attention on sensitive economic and foreign policy issues. In that sense, the TPP could become a channel for extending the bilateral U.S.-Korea trade relationship, as elaborated in the KORUS FTA, into a broader association with each country's partners in the Asia-Pacific region.

In sum, the future course of U.S.-Korea trade relations will depend in large measure on what each country does with its FTAs with each other and with other trading partners. Ratifying and implementing the KORUS FTA would reinforce the economic partnership that has yielded large dividends for both countries; at the same time, it would create a strong foundation for bilateral cooperation on economic integration in the Asia-Pacific region. Delaying action on the KORUS FTA would raise concerns about the U.S. commitment to the economic partnership and would likely provoke Korea and other U.S. partners in Asia to reevaluate their efforts to support Asia-Pacific economic arrangements.

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