ECONOMIC INTERDEPENDENCE BETWEEN KOREA AND THE UNITED STATES

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I. Introduction

Two-way trade between the United States and Korea now tops more than $70 billion a year. The United States is Korea's second-largest trading partner, and Korea is the seventh-largest trading partner of the United States. With the two countries' commitment to the principles of market-oriented reform and free and fair trade, we can leverage our economic interdependence to generate greater synergies between our economies. To that end, on February 2, 2006, Korean and U.S. trade ministers announced that both countries would begin negotiations on a free-trade agreement (FTA). As President George W. Bush said on the occasion of the launch of the FTA: "A Free Trade Agreement with the Republic of Korea will provide important economic, political, and strategic benefits to both countries and build on America's engagement in Asia."

The potential gains of this FTA are significant. For instance, the Korean Institute for International Economic Policy predicts that two-way trade will increase by as much as $20 billion as a result of this agreement. An FTA also will significantly boost investment in both directions, with a concomitant increase in jobs, new technology, and overall competitiveness. In short, if realized, a Korea-U.S. FTA would represent a historic achievement in our economic relationship.

This paper summarizes economic interdependence between the two countries by analyzing bilateral trade and investment relations over several decades. We will also try to analyze the possible impact of a Korea-U.S. FTA on the economic relationship of the two countries.

II. Economic Interdependence between Korea and the United States

Changes in Trade Status with the Major Trading Partners

In 2004, trade between Korea and the United States was $72 billion, making Korea the seventh-largest trading partner of the United States—ahead of France and Italy—and its seventh-largest export market (***Table 1***). For some western U.S. states and U.S. sectors, the Korean market is even more important, ranking number five for California's exporters, number two for Oregon's exporters, and number four overall for U.S. agricultural exporters. Major U.S. exports to Korea include semiconductors, machinery (particularly semiconductor production machinery), aircraft, agricultural products, and beef. Korea is among the largest U.S. markets for agricultural products and beef.

Table 1. **Economic Interdependence as of 2004**

	Total trade	**Export market**	**Source of imports**	**Source of FDI**
For the United States, Korea ranks:	7	7	7	n.a.
For Korea, the United States ranks:	2	2	3	1

Source: KITA various years; author's calculations.

Korea is far more dependent economically on the United States than the United States is on Korea. In 2004, the United States was Korea's number one trading partner and its second-largest export market, third-largest source of imports, and the largest supplier of foreign direct investment (FDI). In 2004, China for the first time displaced the United States from its perennial place as Korea's number one export market. Korea's exports to the United States generally increased from 1980 to 2005, with some exceptions. In 2005, Korean exports to the United States showed a dramatic decrease of 26.1 percent compared with 2004. Total trade between the two countries had ups and downs from 1996 to 2002, primarily because of the Asian financial crisis and the 2001 U.S. recession.

Table 2 shows the value of Korean exports and imports vis-à-vis its major trading partners from 2003 to August 2006. The share of Korean exports to the United States decreased from 17.7 percent in 2003 to 13.6 percent as of August 2006. Korea's share of imports from the United States has declined from 13.9 percent in 2003 to 11.1 percent in 2006. The decline is true in the case of Japan also. In contrast, China has been increasing its presence in the Korean export and import markets. In 2006, the market share of Korea's exports to China is exceeding 21 percent, and the market share of Korea's imports from China is topping 15.1 percent. The difference in the shares of the United States and China in the export market is expected to widen as the Chinese economy continues to expand rapidly.

Even though the United States has not been Korea's largest trading partner since 2004, it is important to consider not only direct trade with the United States but also indirect trade through China.

Table 3 shows U.S. exports and imports by major trading countries from 2003 to July 2006. U.S. exports and imports to Korea increased in absolute value. For the United States, Korea was the seventh-largest export market and the seventh-largest import source from 2003 to July 2006.

Table 2. **Korea's Exports and Imports, by Major Trading Countries, 2003–August 2006, in millions of dollars and percentage**

Country	Korea's exports							
	2003		2004		2005		Jan.–Aug. 2006	
	Value	%	Value	%	Value	%	Value	%
United States	34,219	17.7	42,849	16.9	41,343	14.5	28,278	13.6
China	35,110	18.1	49,763	19.6	61,915	21.8	44,447	21.3
Japan	17,276	8.9	21,706	8.5	24,027	8.4	17,344	8.3
Hong Kong	14,654	7.6	18,127	7.1	15,531	5.5	12,130	5.8
Taiwan	7,045	3.6	9,844	3.9	10,863	3.8	8,133	3.9
Germany	5,603	2.9	8,334	3.3	10,304	3.6	6,389	3.1
	Korea's imports							
	2003		2004		2005		Jan.–Aug. 2006	
	Value	%	Value	%	Value	%	Value	%
U.S.	24,814	13.9	28,783	12.8	30,586	11.7	22,231	11.1
China	21,909	12.3	29,585	13.2	38,648	14.8	30,364	15.1
Japan	36,313	20.3	46,144	20.6	48,403	18.5	33,980	16.9
Hong Kong	2,735	1.5	3,268	1.5	2,043	0.8	1,401	0.7
Taiwan	5,880	3.3	7,312	3.3	8,050	3.1	6,130	3.0
Germany	6,822	3.8	8,486	3.8	9,774	3.7	7,239	3.6

Source: KITA 2003–August 2006.

Table 4 shows that in 1980 Korea's exports to the United States were $4.6 billion and Korea's imports from the United States were about $4.9 billion and that the Korean trade deficit was $283.6 million. By 2004, Korea's exports to the United States had increased ninefold to about $42.8 billion, and Korea's imports to the United States had increased sixfold to about $28.8 billion, which was a trade surplus for Korea of about $14 billion. Since the Asian financial crisis, Korea has been in a trade surplus with the United States.

In terms of percentage share, however, in 1980 the U.S. share of Korea's export market was 26.3 percent, and in 2005 it fell to 14.5 percent. In 1980, the U.S. share of Korea's import market was 21.9 percent, and it fell to 11.7 percent in 2005. Note that the U.S. share in Korea's export and import markets declined over the period from 1980 to 2006.

The above data show a substantial decrease—a decrease of 3.5 percent—in Korea's export growth rate to the United States in 2005 compared with 2004. From 1981 to 1999, the average growth rate of the value of Korean exports to the United States

Table 3. **U.S. Exports and Imports, by Major Trading Countries: 2003–August 2006, in millions of dollars and percentage**

Country	U.S. exports							
	2003		2004		2005		Jan.–July 2006	
	Amount	%	Amount	%	Amount	%	Amount	%
Canada	169,924	23.4	189,880	23.5	211,899	23.4	133,288	22.7
Mexico	97,412	13.4	110,935	13.7	120,365	13.3	77,131	13.1
China	28,368	3.9	34,744	4.3	41,925	4.6	30,834	5.3
Japan	52,005	7.2	54,243	6.7	55,485	6.1	33,945	5.8
Germany	28,832	4.0	31,416	3.9	34,100	3.8	22,900	3.9
England	33,828	4.7	36,000	4.5	n.a.	n.a.	n.a.	n.a.
Korea	24,073	3.3	26,413	3.3	27,670	3.1	18,443	3.1
Taiwan	1,748	2.4	21,744	2.7	22,069	2.4	13,013	2.2
France	17,053	2.4	21,263	2.6	22,410	2.5	14,335	2.4
	U.S. imports							
	2003		2004		2005		Jan.–July 2006	
	Amount	%	Amount	%	Amount	%	Amount	%
Canada	221,595	17.6	256,360	17.4	290,384	17.2	178,099	16.8
Mexico	138,060	11.0	155,902	10.6	170,109	10.2	113,525	10.7
China	152,436	12.1	196,682	13.4	243,470	14.6	152,180	14.4
Japan	118,037	9.4	129,805	8.8	138,004	8.3	84,580	8.0
Germany	68,113	5.4	77,266	5.2	84,800	5.1	51,600	4.9
England	42,795	3.4	46,274	3.1	n.a.	n.a.	n.a.	n.a.
Korea	37,229	3.0	46,168	3.1	43,781	2.6	26,633	2.5
Taiwan	31,599	2.5	34,624	2.4	34,826	2.1	21,528	2.0
France	29,219	2.3	31,606	2.1	33,842	2.0	21,557	2.0

Source: Census Bureau 2006.

was 11.1 percent, and it was 7.0 percent from 2000 to 2005. The decrease in Korea's exports to the U.S. market in 2005 was an exception.

Changes in Investment Relations

Table 5 shows the global ratio of FDI stock to GDP was 5.0 percent in 1980. The number has been increasing since then, reaching 21.7 percent in 2004. FDI to Korea shows similar pattern, with a very low ratio at 8 percent compared with the ratios of other selected developing economies and the global level.

***Table 4.* Korea's Trade with the United States, 1980–2005, in millions of dollars and percentage**

Year	Korea's exports to the United States		Korea's imports from the United States		Trade balance
	Value	%	Value	%	
1980	4,606.6	26.3	4,890.2	21.9	–283.6
1985	10,754.1	35.5	6,489.3	20.8	4,264.8
1990	19,360.0	29.8	16,942.5	24.3	2,417.5
1995	24,131.5	19.3	30,403.5	22.5	–6,272.0
2000	37,610.6	21.8	29,421.6	18.2	8,189.0
2002	32,780.2	20.2	23,008.6	15.1	9,771.6
2003	34,219.4	17.7	24,814.1	13.9	9,405.3
2004	42,849.0	16.9	28,783.0	12.8	14,066.0
2005	41,342.6	14.5	30,585.9	11.7	10,756.7
2006 (January–August)	28,278.4	13.5	22,230.6	11.1	6,047.8

Source: KITA 2006 (September).

***Table 5.* Foreign Direct Investment, by Selected Region and Selected Economy, 1980–2004, ratio of FDI stock to GDP**

Year	World	Developing economies	East Asia (excluding Japan)	Singapore	China	Korea
1980	5.0	5.4	7.8	52.9	0.5	2.1
1990	8.4	9.8	9.7	83.1	5.8	2.1
2000	18.3	26.2	34.8	123.1	17.9	8.1
2003	22.0	27.8	29.1	160.2	16.2	9.0
2004	21.7	26.4	28.4	150.2	14.9	8.1

Source: UNCTAD 2005.

FDI from a range of countries to Korea has increased in recent years. It is evident that the magnitude of annual FDI inflows to Korea has gradually increased, from an average of $500 million in the mid-1980s to $800 million in the late 1980s; the amount accelerated sharply during the late 1990s. Historically, the great bulk of FDI inflows came from Japan, which was responsible for almost 50 percent of all inflows until 1989 (***Table 6***). Since 1989, the United States and the Netherlands have been responsible for between 30 and 50 percent of FDI inflows to Korea, with a strong combined showing from elsewhere in Europe (France, Germany, and the United Kingdom). Following the 1997 crisis, FDI flows increased markedly, soaring from $3.2 billion in 1996 to a peak of $15.2 billion in 2000. FDI then declined significantly, falling to $6.5 billion in 2003 before rising subsequently.

Table 6. **FDI Flows into Korea, by Major Countries, 1962–September 2005, in millions of dollars and percentage**

Period	Total	United States		European Union		Japan		Other	
		Value	%	Value	%	Value	%	Value	%
1962–90	7,874	2,243	29	984	13	3,798	48	848	11
1991	1,396	297	21	749	54	226	16	124	9
1995	1,947	643	33	461	24	424	22	419	22
2000	15,216	2,922	19	4,391	29	2,448	16	5,455	36
2001	11,292	3,889	34	3,062	27	772	7	3,569	32
2002	9,101	4,500	49	1,663	18	1,403	15	1,535	17
2003	6,467	1,240	19	3,061	47	541	8	1,625	25
2004	12,785	4,717	37	3,008	24	2,258	18	2,802	15
2005 (January–September)	7,697	1,350	18	3,778	49	972	13	1,597	21

Source: MOCIE various years.

In 2004, President Roh Moo-hyun's government began a policy of boosting FDI as a source of domestic growth. Since the 1997 crisis, FDI commitments by U.S. companies have totaled nearly $20 billion. ***Table 6*** shows that from 1962 until Sepember 2005, the United States has been a leader in FDI to Korea. The U.S. position is followed by Japan (14 percent), the Netherlands (11 percent), Germany (6 percent), and England (5 percent). The sectoral pattern is similar to some extent to the observed pattern in Taiwan, in which FDI has flowed to newly liberalized sectors of the economy as well as to nontraditional areas such as food. The great bulk of these inflows, however, can be expected to have occurred in the key export-oriented dynamic manufacturing sectors and services that emerged during the most recent structural transformation during the late 1980s as well as more recently in the wake of the Asian crisis. A number of high-profile Korean companies have been taken over by foreign interests, notably the General Motors purchase of Daewoo Motors in 2002. Citigroup's $1.7 billion purchase of KorAm bank in March 2004 was the largest foreign direct investment in Korean history. Table 6 shows that from 1995 to 2002 U.S. FDI steadily increased, until an abrupt fall in 2003, after which it subsequently rose, ending at $ 4.7 billion in 2004. U.S. FDI accounted for 37 percent of the world's FDI flow to Korea.

Korea currently is experiencing a China boom. In 2003, China surpassed the United States as Korea's number one export market. Many, if not most, Korean exports to China are intermediate goods used in the production of finished goods that ultimately are exported from China to other countries, including the United States. Table 6 shows that the United States is still a leading source of FDI to Korea, even though Korea's economic relationship with China has deepened since China obtained membership in the World Trade Organization.

The United States is a major investor in Korea. According to the Bureau of Economic Analysis of the U.S. Department of Commrce, U.S. FDI to Korea is primarily focused on banking (22.1 percent), electronics (15.9 percent), the nonbanking financial sectors (11.9 percent), chemicals (8.2 percent), and wholesale trade (6.3 percent). U.S. FDI in the Korean financial sector accounts for 34 percent of total U.S. FDI to Korea. Although U.S. FDI to Korea's financial sector has been increasing in recent years, U.S. FDI to Korea's manufacturing sector still accounts for a larger share.

Most U.S. FDI to the Korean financial sector is concentrated in the banking institutions. ***Table 7*** shows, however, that the U.S. FDI flow into the nonbanking financial sector in Korea has substantially increased since 2002.

Korea's outward DFI to the United States has fluctuated. The evolution of Korean outflows of FDI after 2000 is shown in ***Table 8.*** These outflows were relatively low until 1987, the year after Korea's first visible trade surplus; after that they increased

Table 7. **U.S. FDI Position to Korea by Financial Sector, 1998–2004, percentage**

Year	Depository institutions	Finance (except depository institutions) and insurance
1998	98.5	1.5
1999	86.8	13.2
2000	86.2	13.8
2001	84.7	15.3
2002	74.9	25.1
2003	62.8	37.2
2004	65.0	35.0

Source: BEA 2005.

steadily until leveling off at around $4.5 billion during the second half of the 1990s (not shown). In absolute terms, these figures are almost comparable with those of Taiwan, a country with around half the population of Korea, although they are slightly inferior in terms of the share of gross fixed capital formation and GDP. Apart from two "lumpy" investments in the Netherlands in 1985 and 2001, the two main destinations for Korean outflows of FDI are the United States and China. The United States has been the principal target for FDI outflows since the early 1980s, and the importance of China increased rapidly after its domestic liberalization and the subsequent normalization of relations with Korea in 1990. The pattern is notable for its dual aspect in that FDI outflows are split relatively evenly between the leading industrialized countries (the United States and Europe) and the industrializing countries, notably China, Indonesia, and Vietnam.

Table 8. **Korea's Flows of Overseas Direct Investment to the Manufacturing Sectors in Major Countries, 2001-06, in millions of dollars**

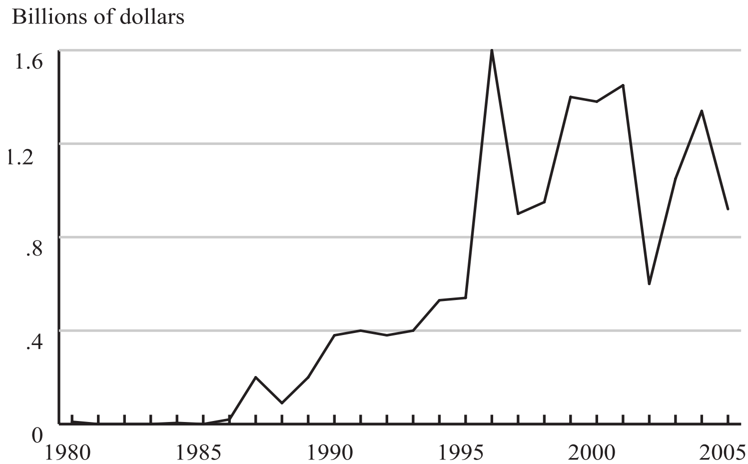
Year	China	United States	European Union	Japan
2001	601.2	975.6	1,735.9	25.1
2002	919.6	165.2	281.3	9.1
2003	1,277.4	332.6	66.1	8.5
2004	2,097.6	470.8	405.8	32.1
2005	2,157.2	232.5	271.6	38.8
2006 (January–August)	1,294.6	120.2	65.6	14.3

Source: Korea Eximbank 2006.

It is difficult to estimate the sectoral pattern of this outward FDI apart from the clear distinction between the advanced and developing markets. At least some part of the impetus for the increased outflows of FDI from Korea, notably in the case of investment in electronics and electrical goods in South Wales, was the increase in domestic real wages in Korea in the late 1980s, which eroded the international competitiveness of some domestic manufacturing and assembly activities. FDI in the industrializing economies of Asia is likely to be targeted at securing domestic supplies of raw materials and export-oriented, labor-intensive manufacturing.

Korea's outward FDI to China has increased. From 1968 to 2004, the United States was Korea's largest outward FDI recipient; the total stock of such FDI the United States has received from Korea is $14.7 billion (***Figure 1*** shows outward FDI to the United States from 1980 until late 2005). The U.S. share of Korea's total outward FDI stock to the world was 25 percent. Following the U.S. share has been China (23 percent), Asia (20 percent), the European Union (16 percent), and Japan (3 percent). However, in 2005, the United States accounted for merely 6.1 percent of Korea's total outward FDI flow. In 2002, China became Korea's largest outward FDI recipient.

Figure 1. **Flow of Outward FDI from Korea to the United States, 1980 September 2005**



Source: Korea Eximbank 2005 (November).

U.S. government data in ***Table 9*** show that Korea has not been a large investor in the United States; in 2005 Korea accounted for just 0.3 percent of the total stock of foreign investment in the United States. From 2000 to 2004, the share remained small and stable.

Korea Eximbank data show that from 2004 to 2006 Korean outward FDI to the United States was most heavily concentrated in manufacturing, wholesale and retail trade, real estate and services, communications, and hotels and restaurants (***Table 10***).

According to Export-Import Bank of Korea data, Korean outward FDI to the United States increased from 1988 to 1995 and reached its maximum of about \$1.6 billion in 1996. Following this high point, Korean FDI to the United States declined in 1997. During the 1995–2006 period, the flow of Korean FDI to the United States fluctuated significantly.

In brief, while Korea's outward FDI to the United States has fluctuated recently, China's significance in Korea's FDI has been increasing.

Table 9. **Worldwide and Korean FDI into the United States on a Historical Cost Basis, 2000–06, in millions of dollars**

Year	FDI from all countries into the U.S	FDI from Korea into the U. S.	
		Value	Percentage of U.S. FDI
2000	1,256,867	3,110	0.2
2001	1,343,987	3,011	0.2
2002	1,327,170	2,932	0.2
2003	1,395,159	1,409	0.1
2004	1,520,729	5,616	0.3
2005	1,635,291	6,203	0.3

Source: BEA 2005.

Table 10. **Korean ODI flow into the United States, by Industry, 2004–2006, in thousands of dollars and percentage**

Year	Manufacturing		Wholesale and retail trade		Real estate and services		Communications		Hotels and restaurants	
	Value	%	Value	%	Value	%	Value	%	Value	%
2004	470,850	36.6	404,000	31.4	335,069	26.1	2,638	0.2	75,279	5.8
2005	232,467	20.1	401,098	34.6	274,601	23.8	125,704	10.9	123,883	10.7
2006	120,181	11.8	529,497	51.9	279,946	27.5	44,690	4.4	44,554	4.4

Source: Korea Eximbank 2006.

III. Conclusion

There have been some changes in trade and investment relations between Korea and the United States over the past five decades. Although trade relations between Korea and the United States seem to have weakened over the decades, in terms of investment relations the United States is still the top investor in Korea. Also, the United States still appears to be the largest final destination for Korean export goods when production and the export chain operated by Korean firms in China are considered.

With the changing trade and investment climate as a backdrop, starting in 2003, Korea launched comprehensive, high-level, and multitrack FTAs with its main trading partners in an effort to advance itself to the next stage of economic development. It is only natural that Korea has chosen the United States as its next FTA partner after concluding FTA negotiations with Chile, Singapore, the European Free Trade Association, and the Association of Southeast Asian Nations. The United States and its economy are very important to Korea's economy: the United States is world's most advanced economy by all measures, it is Korea's most important trading partner, and it is the largest investor in Korea. An FTA with the United States will help Korea achieve its goal of becoming an advanced service economy by accelerating economic reforms and deregulation in essential service sectors on which the Korean economy will rely heavily for its future development and increased productivity, which is now far below developed countries. As Korea looks ahead toward its future, Korea believes an FTA with the United States will help it position itself earlier than other regional competing countries as not only an economic hub but also an FTA hub in the Asia-Pacific region, the fastest growing region at the beginning of the twenty-first century. A Korea-U.S. FTA will make Korea a more desirable and stronger partner for other countries in the region.

An FTA seeking open trade in every sector has been recommended for Korea, an export-driven economy without natural resources, to allow it to remain one of the world's competitive economies. Reducing barriers to trade and investment in services is particularly important because such restrictions can raise production and distribution costs for a broad range of goods and services. The FTA will contribute significantly to the advancement of information and other high-technology industries in Korea and to the goal of making the country an economic hub for Northeast Asia. The United States will also benefit from new export and investment opportunities in goods and services, including farm products and financial services. The objective of the Korea-U.S. FTA is to increase the growth and the standard of living of the people in both countries by opening new opportunities for trade and investment, and that means increasing both exports and imports.

The most important benefit that Korea can gain from an FTA with the United States is the valuable opportunity it would provide to upgrade Korea's social and economic systems. Recent reports from leading international institutions such as the Organization for Economic Cooperation and Development (OECD) and the World Bank indicate that the institutional environment of Korea—the level of corruption, quality of the bureaucracy, and enforcement of the laws—is relatively behind that of other comparable countries such as Singapore, Japan, Australia, and the United States. In addition, the OECD points out that the productivity of the service sector in Korea is about half that of the United States, Japan, and France, mainly because of the extent of government regulation. FTAs with advanced economies such as the United States would help to upgrade Korea's system and institutions so that the efficiency of the economy improves.

It is admitted that an FTA is a second-best option. The multilateral free-trade agreement would be better than a bilateral or regional free-trade agreement in terms of improvements in efficiency and welfare. However, the progress in multilateral talks has not met expectations, and the Doha Development Agenda was officially suspended last July. Without a promising prospect that multilateral talks are to be resumed in the near future, many economies are now turning to more active bilateral or regional free-trade talks. Because FTAs provide special privileges to their members, nonmember countries are at a clear disadvantage in trade and investment opportunities. With more than 190 FTAs currently in effect in the world, active participation in an FTA is necessary for survival and prosperity.

Despite these immense benefits, some people argue that an FTA with the United States without sufficient preparation would put the Korean economy in danger. Some parts of the economy would be in trouble because of the opening of markets and increased competition because liberalization would most likely entail the restructuring of the less competitive sectors. Skeptics also insist that the investment of multinationals should be regulated because foreign capital makes a profit at the expense of local producers and consumers. Stricter regulation of international business is not going to reduce the profits of local businesses, however, because costs will be transferred to consumers. If the skeptics really care for local producers and consumers, they must support efforts to promote an FTA so as to provide larger markets and level playing fields. Disabling markets will give companies new opportunities to make even bigger profits at the expense of economy at large.

It is misguided to argue that everyone is automatically better off when signing an FTA with the United States. Clearly, this is not the case: It is naive to think that FTAs will improve the welfare of everyone in society; instead, we must accept the fact that in the free-market system, particularly in the realm of FTAs, there will always be winners and losers. What the average citizen should understand is that total welfare gain outweighs total welfare loss; therefore, a well designed compensation scheme will improve the overall quality of welfare for all. Further, the resources freed from firms or industrial sectors that do not survive competition should be transferred and reinvested into other sectors that have prospects to grow in the expanded markets.

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