
EXTERNAL ISSUES

KOREA-U.S. ECONOMIC RELATIONS IN 2006

By Ahn Chong-ghee

Economic relations between Korea and the United States reached new heights in the year 2006 with the launch of negotiations for a bilateral free trade agreement. While the negotiations were initiated on the basis of the decades-long Korea-U.S. alliance, a conclusion of the bilateral free trade negotiations will further strengthen the economic and political cooperation between the two countries.¹

The Korea-U.S. Free Trade Agreement (KORUS FTA) will be the largest-ever free trade deal for Korea, a country that aspires to be the economic hub of Asia through free trade and investment with diverse economies in the region. For the United States, a free trade agreement with Korea will be the most commercially meaningful bilateral trade deal since the North American Free Trade Agreement (NAFTA).

Through increased exports and investment under the bilateral free trade agreement, Korea hopes to increase wealth for its people and join the ranks of the advanced economies in the world. The United States will also be a beneficiary of the free trade deal, which will enhance U.S. interests and presence in Northeast Asia amid the mounting influence of China in the global political and economic arena.

Korea and the United States have been strategic allies for more than a half century. In the past few years, the alliance between the two countries has been highlighted in Korea's commitment in the U.S.-led global war against terror. Korea maintains the third-largest number of troops in Iraq, following the United States and the United Kingdom, and Korean soldiers are working closely with American troops to fight terrorism and help establish democracy in the conflict-ridden

region. A successful conclusion of the Korea-U.S. free trade negotiations will further solidify the two countries' economic, political, and strategic partnership in the future.

Overview of the Korean Economy in 2006

Korea's economic growth accelerated in 2006 largely on the back of robust exports and increased private spending. The country's real gross domestic product (GDP) rose 5 percent in 2006 from a year earlier, compared with a 4.2 percent increase in 2005. Exports of goods surged 12.6 percent in 2006 year on year, up from a rise of 9.7 percent in the preceding year, while private consumption rose by 4.2 percent, compared with an increase of 3.6 percent in 2005. Per capita gross national income surged 11.9 percent to \$18,372 in 2006, from \$16,413 the previous year.

Korea is the third-largest economy in Asia and the 12th largest in the world, with trade as its major growth engine. Despite the strengthening of the *won* against the U.S. dollar, Korea's exports continued to expand, largely led by sales of the country's semiconductors, motor vehicles, mobile phones, and other electronic devices. Strong demand for Korean goods in the global market, particularly in the information technology sector, fueled growth in Korea's manufacturing industry, which rose 8.4 percent in 2006 from the previous year.

A moderate improvement in private spending, which rose by 4.2 percent in 2006, compared with 2005 when private consumption climbed 3.6 percent year on year, also helped boost economic growth in Korea. The rise in private expenditure in 2006 was mostly

1. This article was prepared prior to the conclusion of the negotiations.

attributable to a favorable trend of spending on durables, semidurables, and services, resulting in a drop in the national gross savings ratio to 31.4 percent in 2006 from 32.9 percent in 2005, according to Korea's central bank. Government expenditures rose by 5.8 percent in 2006, compared with 5 percent in 2005, helping the country's total consumption to rise by 4.5 percent in 2006.

An increase in investment in machinery and facilities coupled with a rise in gross fixed capital formation also contributed to Korea's economic growth.

Nevertheless, the pace of economic growth in Korea slowed toward the end of 2006 as many domestic consumers remained cautious about their spending amid the high rate of unemployment among youth and prolonged government efforts to discourage domestic real estate speculation through various tax hikes. Korea's jobless rate in 2006, however, averaged just 3.5 percent, slightly lower than in 2005, although the country's rate of unemployment among youth remained high at 7.9 percent, both the average for the year and the rate in December 2006, according to the National Statistical Office.

Consequently, Korea's year-on-year real GDP growth rate slowed to 4 percent in the fourth quarter of 2006, from 4.8 percent in the third quarter, 5.1 percent in the second quarter, and the first quarter's 6.3 percent. At the same time, the pace of recovery in private consumption also slowed to a rise of 3.7 percent in the fourth quarter of 2006 from an increase of 5.2 percent in the first three months of the year.

Still, many economists forecast the Korean economy will likely grow at a robust pace in 2007 on the basis of continued growth in exports amid a recovery in domestic consumption. Meanwhile, the Korean government's efforts to promote further trade and investment through various free trade negotiations with other countries will surely help enhance the competitiveness of the Korean economy in the future.

Korea-U.S. Economic and Trade Relations

In 2006, the United States was Korea's second-largest trading partner and the largest foreign investor in Korea. Korea continued to be the seventh-largest trad-

ing partner of the United States and the sixth-largest export market for U.S. agricultural exporters. The total volume of trade between Korea and the United States amounted to \$76.8 billion in 2006, up from \$71.9 billion in 2005.

In terms of investment, the United States historically has been the largest foreign investor in Korea. Between 1962 and 2006, the accumulated U.S. investment in Korea amounted to \$36.6 billion, or 28.9 percent of the total amount of foreign investment in the country. The United States was also the second-largest investment destination for Korean companies in 2006, when Korea's total investment in the United States reached \$2.1 billion.

The strong Korea-U.S. economic cooperation was showcased in 2006 with the ground breaking in West Point, Georgia, for a \$1.2 billion Kia Motor Company plant, which will be fully operational by 2009. This automobile plant will produce 300,000 vehicles per year at full capacity and create more than 5,000 new jobs in Georgia. Hyundai has also invested \$1.1 billion in a manufacturing facility in Montgomery, Alabama; and nearly 10 years ago Samsung chose Austin, Texas, for what has become an investment worth \$2.2 billion. Ambassador of Korea to the United States Lee Tae-sik recently said, "Ventures like these, which provide thousands of new jobs for U.S. workers, stand as a symbol of the transformation in Korea-U.S. economic ties—and of our relationship as a whole."

However, the significance of the United States in terms of trade volume has been in relative decline in recent years as China has emerged as one of the fastest-growing economies in the world and has become Korea's largest trading partner. As a result, the United States accounted for 12.1 percent of Korea's total trading volume in 2006, down from 15 percent in 2004.

In addition, although trade disputes between Korea and the United States have significantly decreased in recent years compared with the 1980s and the 1990s, disputes over antidumping issues and countervailing duties still arise. For instance, a new case over antidumping and countervailing duties was brought against some Korean manufacturers of coated free sheet papers by a U.S. paper company at the end of 2006,

while a prolonged investigation by the U.S. Department of Commerce into countervailing duties regarding Hynix Semiconductor Inc., Korea's second-largest memory-chip maker, still draws attention from the authorities and the public in both countries.

Most of these bilateral trade issues between Korea and the United States have been addressed through low-key working-group meetings, a process that has helped the two countries maintain an amicable trade relationship over the past years. Also, in an effort to prevent potential disputes over pending trade issues, consultations between the two countries have been very active at both the government and private levels throughout 2006.

The launch of the Korea-U.S. free trade negotiations in February 2006 opened new possibilities for both countries to expand their economic gains and promote amicable trade relations. The bilateral free trade agreement, if successfully concluded and ratified, will increase Korean exports to the United States and strengthen the competitiveness of Korean industries. It will also enhance Korean and U.S. interests in the Asia-Pacific region amid the mounting political and economic influence of China. Both Korea and the United States also anticipate that the free trade deal will ease potential disputes over trade issues between the two countries in the future.

Korea-U.S. Free Trade Negotiations

On 2 February 2006, Korea and the United States announced the launch of negotiations for a bilateral free trade agreement. During 2006, two rounds of preparatory meetings and six rounds of negotiations took place alternately in the United States and Korea.

Negotiations were held in 17 negotiating groups and 2 working groups to deal with all the trade issues between the two countries. The initial pace of the negotiations was rather swift, in that consolidated text was exchanged after the first round. After four more rounds in 2006, significant progress had been made in most of the negotiating areas. Still, at the end of 2006 many thorny issues remained unresolved.

The end of March 2007 has been considered the de facto deadline for the negotiations because of the constraints imposed by U.S. trade promotion authority

(TPA). The Korean government frequently emphasized that substance will not be compromised by the time constraints, but it is also true that the TPA deadline made negotiators of the two governments work more diligently.

Major Issues of the KORUS FTA

Market Access

Market access for goods is one of the most complex subjects for negotiations because it covers a wide range of products. While both countries hope to achieve a high level of liberalization, in reality political constraints always face the negotiators. For Korea, agriculture and fisheries are very sensitive areas, where both sides will have to find a very fine line of compromise. For the United States, textiles is an area where high protection is in place. Korea wants to widen its market access in textiles by removing tariff and nontariff barriers such as overly strict rules of origin and remedy rules. Korea's textile market share in the United States has declined significantly over the years, and Korea hopes to regain its share through the free trade negotiations.

Automobiles

The U.S. side believes that it should be able to gain significant automobile market access to Korea through the negotiations. Discussions have covered the removal of tariffs as well as nontariff issues such as Korea's engine displacement tax system and environmental and safety standards.

In reality, the Korean automobile market is quite open to foreign competition. In recent years, the market share of foreign cars in Korea has been increasing rapidly. Furthermore, if foreign-owned automobile companies in Korea (for example, GM Daewoo and Renault Samsung) were taken into account, the market share of foreign autos would be greater than 26 percent. Automobiles are one of the most sensitive issues in the U.S. Congress, particularly because the major U.S. companies are currently faced with unprecedented difficulties. Given the sensitivities in both countries and the complex nature of the nontariff issues, the negotiations regarding automotive issues are expected to stretch until the last moment.

Pharmaceuticals

In May 2006, the Korean Ministry of Health and Welfare announced a new drug expenditure rationalization plan to ensure a financially sound national health insurance program. In its implementation, Korea will make sure that transparency is maintained in drug pricing and that foreign pharmaceutical manufacturers will not be discriminated against compared with domestic ones. Providing innovative drugs at a fair price while stabilizing health care-related costs is a top priority for the Korean government.

The free trade agreement working group on pharmaceuticals, established together with the automotive working group, has focused on fair pricing, drug reimbursement, transparency in pricing, and enforcement of pharmaceutical intellectual property rights. Several intersessional meetings between negotiating rounds also took place in an effort to reach a fair compromise on the issue.

Trade Remedies

For the past 20 years, Korean exports to the U.S. market confronted high barriers created by the complicated and sometimes unfair application of trade remedy rules. At present, trade remedy measures are being imposed on Korean exports in 16 cases. In this regard, Korea believes that U.S. trade remedy rules should be improved through the free trade negotiations in order to ensure gains from trade between the two countries.

Trade remedies became one of the toughest areas in the free trade negotiations owing to constraints put in place by the U.S. Congress when it provided trade promotion authority to President George W. Bush in 2002. Although U.S. negotiators are not very forthcoming about changing U.S. domestic regulations, the Korean government is strongly pursuing some improvement in trade remedy rules.

Intellectual Property Rights

Korea has made continuous efforts toward strong intellectual property rights (IPR) protection, as reflected in the positive review in the United States Trade Representative's Special 301 report in 2005, in which

the United States moved Korea from the priority watch list to the watch list. Recognition was given to Korea's efforts to thwart illegal copying of publications, DVDs, and software. Notable Korean efforts include revision of the law that strengthened the enforcement of IPR-related laws.

The United States has asked for continuous efforts toward stronger enforcement of existing laws and the enactment of new regulations for Internet-related intellectual property issues such as temporary copy and online data sharing. Requests were also made to extend the current 50-year copyright protection to 70 years after the author's death.

Owing to many technical issues with regard to IPR—such as copyright, IPR protection on the Internet, and pharmaceutical-related IPR issues—both sides have used the negotiations to understand basic positions and the current status of various issues. Given the wide range of issues, both sides are expected to be engaged in tough negotiations until the last moment.

Kaesong Industrial Complex

The Korean government wants the products from the Kaesong industrial complex to be recognized as products originating from Korea, under certain requirements. In Korea's free trade agreements with countries such as Singapore, the Association of Southeast Asian Nations (ASEAN), and the European Free Trade Association (EFTA), some precedents exist for treating these products as originating from Korea.

Special circumstances on the Korean peninsula give the Kaesong industrial complex a symbolically unique importance in inter-Korean relations. Enhanced inter-Korean cooperation would contribute to the further opening of North Korea and to the enhancement of security on the Korean peninsula and in East Asia.

Telecommunications

The United States has asked for a regulatory approach that allows suppliers of public telecommunications to choose technologies and for the softening of the foreign-ownership cap imposed on facility-based telecommunication carriers. The Korean government

believes it should be able to take measures when necessary to achieve a legitimate public policy goal. Regarding the foreign-ownership limitation, the Korean government has maintained that the level of foreign ownership the Korean government allows is even higher than that of the United States. The ownership cap is one of the thorniest issues in the negotiations.

Beef

In January 2006, after the Korean government conducted an extensive scientific and precautionary review, both countries agreed to an import protocol for U.S. beef. The import protocol stipulated that Korea would import U.S. deboned skeletal muscle meat from cattle under 30 months of age. However, a new U.S. case of bovine spongiform encephalopathy (BSE) in the spring of 2006 forced a temporary suspension of the importation in accordance with the agreed protocol. In the following months, Korean inspectors conducted field inspections of U.S. processing plants, and a further review of scientific data led in September 2006 to another opening for U.S. boneless beef products.

Since the September 2006 announcement, three shipments of U.S. beef have been sent to Korea. These shipments were not cleared to enter the country, however, because of bone fragments contained in the beef. The United States raised complaints over Korea's zero-tolerance policy on bone fragments and also requested the importation of bone-in beef, which had been the main import item in the past.

Beef is not officially a subject of free trade agreement negotiations, but, owing to the huge trade volume in the past and the strong concern of the U.S. Congress, the issue was discussed intensely between the two governments during 2006.

Multilateral Cooperation

WTO Doha Development Agenda

Korea has achieved its economic growth by taking advantage of the liberalized global trading system. Given its high dependence on trade as reflected in GDP (around 70 percent), Korea believes that a successful conclusion of the Doha Development Agenda

(DDA) negotiations would create a stable and favorable trade environment for Korea. Korea's track record is one of strong advocacy for trade liberalization on the multilateral front. Since the beginning of the Doha Round in 2001, Korea has been playing an active role in efforts for the success of the round.

WTO members began 2006 with the ambitious goal of completing the DDA negotiations by the end of the year. However, the major players failed to narrow their differences in the so-called triangle issues—agricultural market access, domestic support in the agricultural sector, and nonagricultural market access. The DDA negotiations almost failed when talks were suspended in July 2006. Although negotiations were resumed in November 2006, the gaps between the positions of the major countries are still wide.

Korea would like to see negotiations concluded with a balanced and highly ambitious outcome in all the negotiating areas. Korea expects the leadership of the major countries to make progress in the negotiations and to conclude the round in a timely manner. Korea will continue to have close and constructive cooperation with major trading partners to contribute to the successful conclusion of negotiations.

APEC in 2006

Members of Asia-Pacific Economic Cooperation (APEC) make up 57 percent of the world's GDP and 46 percent of the world's trade, and they are recipients of 72 percent of Korea's total exports. Both exports and imports from the Asia-Pacific are growing at a faster pace than trade in any other part of the world. Korea believes that APEC has been one of the important vehicles promoting free and fair trade in this dynamic region.

In 2006, the 14th APEC Economic Leaders' Meeting was held under the theme, "Towards One Community: Meet the Challenge, Make the Change," in Hanoi, Vietnam. It built on the tremendous success achieved at the previous APEC meeting in Busan, Korea, in 2005.

Korea and the United States maintained close cooperation in moving forward on key security and economic issues in APEC, including terrorism, avian influenza, natural disasters, and energy security.

Prospects for 2007

Korea-U.S. relations have noticeably evolved over the past half century. The general direction of the evolution has been from one-sided dependency toward a cooperative partnership. As in the past, trade and investment between the two countries will continue to grow this year. The prospective KORUS FTA will significantly solidify the partnership.

If the KORUS FTA is concluded and signed by the end of June 2007, as envisioned, the second part of the year will be devoted to the process of ratification in both countries. Given the importance of the agreement for the future of the bilateral relationship, the free trade agreement would be a must-pass agreement for both countries. Because politicians in both countries are gearing up for presidential and general elections, scheduled to take place in the next two years, both governments will have to cooperate closely to ensure the approval of the agreement.

The free trade agreement is not a guarantee for the strengthening of economic relations; neither is it a panacea for bilateral trade and economic issues. But the expectation is that the KORUS FTA itself will bring tremendous positive effects to the Korean economy and to bilateral relations between the two countries. Also, with the prospect of a free trade agreement, it is expected that both governments will closely cooperate in managing bilateral and multilateral economic issues during 2007.

Mr. Ahn was Economic Counselor at the Republic of Korea's Embassy in Washington, D.C., until March 2007.