

U.S.-REPUBLIC OF KOREA ECONOMIC RELATIONS: A WASHINGTON PERSPECTIVE

By Jordan Heiber

The U.S.-ROK bilateral economic relationship entered a new era 1 April 2007 when President George W. Bush notified the U.S. Congress of his intent to enter into a free trade agreement (FTA) with the Republic of Korea. Assuming it is approved by the U.S. Congress and Korean National Assembly, the Korea-United States Free Trade Agreement (KORUS FTA)—the most commercially significant U.S. FTA since the North American Free Trade Agreement and Korea's largest FTA ever—will add a significant new dimension to the U.S.-ROK alliance. More broadly, the KORUS FTA should serve as an impetus for increased trade liberalization throughout the Asia-Pacific region and worldwide. The negotiations that led to this FTA demonstrate that two countries with large, complex, and dynamic economies can work through challenges to negotiate a high-quality, comprehensive FTA.

The KORUS FTA was the product of eight rounds of formal negotiations between June 2006 and March 2007, plus high-level endgame negotiations, concluding in Seoul on 1 April. To qualify for fast-track approval procedures pursuant to the Bipartisan Trade Promotion Authority Act (TPA Act), which applies to agreements entered into before 1 July 2007, the president is required to notify Congress of an intent to enter into a trade agreement at least 90 days before signing the agreement.

Although the FTA is an agreement about trade and investment between the United States and Korea, its implications for the overall relationship between the two countries will be much broader. Some assert it could be the one of the most important events in the bilateral relationship since the signing of the U.S.-Korea Mutual Defense Treaty in 1953. The KORUS FTA is the first such agreement the United States has completed with a major industrialized Asian trading partner. Its successful conclusion has created a template for other partners in the years to come, in Asia and elsewhere, and may serve to stimulate trade liberalization within the Asia-Pacific region and around the world.

FTA to Contribute to Expanding Web of Bilateral Ties

The KORUS FTA will serve to further deepen and expand the complex and ever-widening web of connections between the United States and the Republic of Korea, connections that are anchored in shared values and goals. These range from daily interpersonal contacts between Koreans and Americans to close coordination between the two countries' governments on global policies.

People-to-people connections. The Korean Embassy estimates that more than 2 million Koreans and Korean-Americans live in the United States. Another 700,000 visit the United States each year, making Korea the fifth-largest source of foreign visitors to the United States. The U.S. embassy in Seoul processed nearly 460,000 nonimmigrant visa applications in 2006, top among U.S. visa-issuing posts. More than 8,000 Koreans applied for immigrant visas. Korea is the largest source of foreign students in the United States, according to U.S. Immigration and Customs Enforcement, with more than 90,000 students in the United States as of December 2006. More than 106,000 U.S. citizens live in Korea, of whom just under 40,000 are U.S. government and armed forces personnel and their dependents. Another 66,000 Americans visit Korea each year, according to the U.S. embassy.

Government-to-government connections. Despite occasional differences between the administrations in Seoul and Washington, which are often exaggerated by the press on both sides, cooperation on foreign policy and strategic issues has deepened in recent years. The U.S.-ROK defense treaty remains a cornerstone of U.S. security strategy in Northeast Asia. The military alliance will only grow stronger with implementation of agreements reached in 2004 on restructuring U.S. forces in Korea to meet the challenges of today's world. Washington and Seoul continue to coordinate closely within the six-party talks

aimed at the denuclearization of the Korean peninsula, and they are working together to implement the September 2005 Joint Statement of the Fourth Round of the Six-Party Talks and the 13 February Initial Actions for the Implementation of the Joint Statement. Indeed, developments involving North Korea have dramatically illustrated how critical our engagement with South Korea is for the peace and stability of the region. Beyond Northeast Asia, Korea has been the third-largest troop contributor to coalition efforts in Iraq as well as a major supporter of reconstruction efforts in both Iraq and Afghanistan.

Cultural connections. Media aimed at the burgeoning Asian-American community are creating a growing audience for Korean drama and K-pop music. Korean speech and popular press are laced with Konglish (English loan words written in Korean *hangul* script). Korean films are now available at suburban Washington Blockbuster outlets and online at Netflix. Professional and networking groups, such as the Sejong Society in Washington, have started bringing together young professionals with common interests in Korean society and politics. Koreans follow with interest the careers of Korean-American sports heroes Hines Ward and Michelle Wie as well as the growing number of Koreans playing on U.S. major league baseball teams. All of these examples demonstrate how young Koreans and Americans, though living on opposite sides of the globe, increasingly share a common cultural sphere.

The Road to the FTA

On 2 February 2006, the U.S. and ROK governments announced their intention to commence negotiations for the FTA. The U.S. administration formally notified Congress that same day of its intent to enter FTA talks with Korea, starting the countdown under TPA Act procedures for the negotiations to begin. The TPA Act provides for Congress to vote up or down (no amendments allowed) on any bill approving and implementing trade agreements and, in return, calls for the administration to consult Congress throughout the process and be guided by the objectives, parameters, and procedures set out in the law.

The idea of free trade negotiations between the United States and Korea would have been considered strictly academic only a few years ago. Indeed, bilateral trade

discussions in the 1980s and 1990s were frequently contentious. Although bilateral trade was robust, frequent disputes in particular sectors highlighted differences in business and bureaucratic cultures. U.S. exporters and investors complained of high tariffs and many nontariff barriers, including insufficient protection of intellectual property, a general lack of predictability and transparency in setting and applying rules affecting trade and investment, and a lingering industrial-policy mind-set in some parts of the Korean government. Negotiations for a bilateral investment treaty failed because of Korea's refusal to liberalize its restrictions on the screening of foreign films.

An improved tone in the bilateral trade dialogue in recent years facilitated important progress on—and in some cases resolution of—long-standing issues that allowed several potential flashpoints to be defused. This, together with a new emphasis on bilateral FTAs by the Korean government starting in 2004 and a readiness to commit to the liberalization that would entail, led trade negotiators on both sides in mid-2004 to begin seriously considering the idea of an FTA. In October of that year, when then-U.S. trade representative Robert Zoellick and Korea's trade minister, Kim Hyun-chong, met at the Asia-Pacific Economic Cooperation (APEC) meetings in Santiago, Chile, they agreed to a series of working-level meetings to assess the feasibility and desirability of a bilateral FTA.

Three rounds of FTA review discussions were held in early 2005, at which the two sides explained their respective legal procedures for negotiating FTAs and obtaining legislative approval, described the contents of their existing FTAs, and reviewed academic literature on the potential economic impact of a U.S.-ROK FTA. The consensus of those studies was that removal of barriers would expand bilateral trade significantly and produce economic gains for both countries.

The Negotiations

Announcing the launch of the negotiations in February 2006, Rob Portman, then U.S. trade representative, stated: “. . . this is the most commercially significant free trade negotiation we have embarked on in 15 years . . . few countries better represent the promise of open markets, democracy and economic reform than Korea. Our countries have been allies for

over a half century, and with this agreement, we can strengthen our alliance, reaffirm our commitment to remain vigorously engaged in Asia, and create new opportunities for prosperity and peace for the people of both our countries.” Of course, negotiating the FTA presented significant challenges to both countries because of the size and complexity of the bilateral trade relationship and because of the time constraints imposed by TPA’s expiration in July 2007. At the outset, the negotiations were divided into 17 negotiating groups and 2 working groups, one on automotives and the other on pharmaceuticals and medical devices.

Between June 2006 and April 2007, eight rounds of negotiations were held in various locations in Korea and the United States. Between rounds, ongoing communication between the Korean and U.S. negotiating teams and among the interagency communities in Washington and Seoul ensured that progress continued. At the end of the eighth round, although a number of sensitive issues remained unresolved, negotiations moved into the endgame; intensive discussions rose to the most senior levels of both governments. On 17 March, Ambassador Kim Jong-hoon, Korea’s head negotiator, and a relatively small Korean delegation arrived in Washington for several days of high-level talks, and the following week Deputy U.S. Trade Representative Karan Bhatia led a U.S. team of approximately 30 members to Seoul for ministerial-level talks to wrap up the deal.

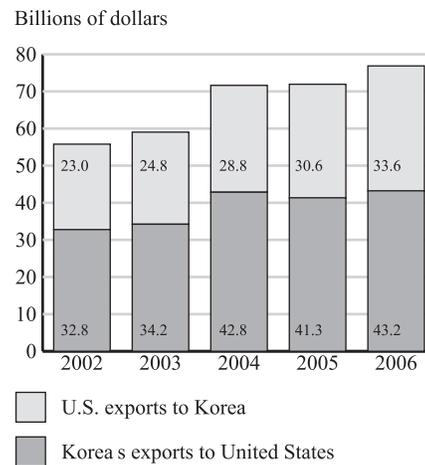
After an intensive seven days marked by round-the-clock negotiating sessions, cabinet-level phone calls, and even a phone call between President Bush and President Roh Moo-hyun, the two sides managed to hammer out a final package on 1 April 2007. On that same day, President Bush notified the U.S. Congress of his intention to enter into the FTA, stating that the agreement:

... will generate export opportunities for U.S. farmers, ranchers, manufacturers, and service suppliers, promote economic growth and the creation of better paying jobs in the United States, and help American consumers save money while offering them greater choices. The Agreement will also further enhance the strong United States-Korea partnership, which has served as a force for stability and prosperity in Asia.

Trade and Investment Trends in 2006

Even without an FTA, Korea was the seventh-largest U.S. trading partner in 2006, based on the value of two-way trade—a position Korea has held since 2000. Two-way merchandise trade in 2006 totaled \$78 billion, up from \$72 billion in 2005 (*Figure 1*). U.S. exports to Korea in 2006 grew 17.0 percent to \$33.6 billion, while imports from Korea were up 4.6 percent to \$43.2 billion. Thus, the U.S. merchandise trade deficit with Korea shrank 17 percent to \$13.4 billion, falling for the second straight year despite a widening U.S. trade deficit with the world as a whole. The United States was Korea’s third-largest single-country trading partner in 2006, after China and Japan. Preliminary estimates suggest that implementing the KORUS FTA could increase bilateral trade by \$20 billion.

Figure 1: Korea-U.S. Trade, 2002–06

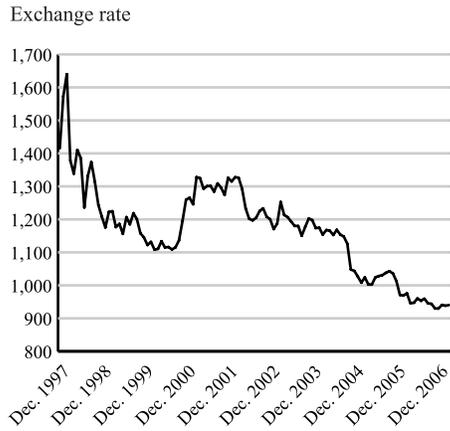


U.S. exports of private services to Korea in 2005 (the most recent data available) grew 11 percent to \$10.3 billion. Imports of private services from Korea were up 31 percent to \$6.3 billion. The U.S. surplus on bilateral private services trade thus shrank from \$4.5 billion to \$4.0 billion. Although no estimates are available, the FTA should lead to a substantial increase in services trade.

The continued appreciation of the *won* likely contributed to the improvement in the U.S. trade balance with Korea in 2006. The *won* appreciated sharply against the dollar in the first and fourth quarters of

2006 and ended the year up 8.6 percent (*Figure 2*). In December 2006, the *won* traded as low as 922 to the dollar, the strongest *won*-dollar exchange rate since before the 1997 Asian financial crisis.

Figure 2: Korean Won–U.S. Dollar Exchange Rate since the Asian Financial Crisis



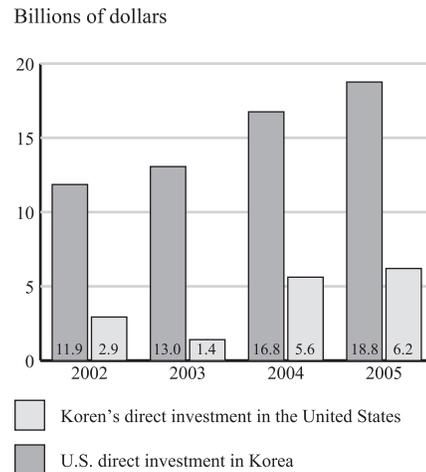
According to the U.S. Department of Commerce, the U.S. direct investment position in Korea on a historical cost basis stood at \$18.8 billion at the end of 2005, (the latest year for which data are available) (*Figure 3*). This was an increase of 12 percent from the end of 2004. The United States remained the largest single-country foreign investor in Korea. The corresponding stock of Korean investment in the United States was \$6.2 billion at the end of 2005, up 10 percent from a year earlier. Note that a Hyundai automobile plant began operation in Alabama in 2005, and Samsung expanded its semiconductor plant in Texas.

Korea has taken significant steps to open up its economy to foreign investment since the 1997–98 Asian financial crisis. The FTA addresses many of the remaining investment restrictions, such as the cap on foreign equity ownership in the telecommunications sector, in addition to providing greater security for U.S. investors through the obligations of its investment chapter. Two-way investment flows can therefore be expected to grow as a result.

The Prize at the End of the Road

As was to be expected given the magnitude and importance of the Undertaking, negotiating the KORUS FTA was not without its challenges.

Figure 3: U.S.-Korea Direct Investment on a Historical Cost Basis, 2002–05



Nonetheless, it was precisely this importance—in terms of both the specific economic relationship and the broader relationship—that motivated Korean and U.S. negotiators to remain committed to overcoming obstacles and reaching a compromise. The prize at the end of the road is an agreement that creates significant new economic opportunities and choices for companies, workers, families, farmers, inventors, and innovators in both countries. In addition, beyond economics, the FTA demonstrates both countries’ continued commitment to our bilateral partnership. As President Bush said in a statement the day the talks were announced:

The United States and the Republic of Korea have a strong alliance and are bound together by common values and a deep desire to expand freedom, peace, and prosperity throughout Asia and the world . . . 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 KORUS FTA will help define Korea’s place in the trans-Pacific and global economy in the twenty-first century and provide a new pillar for an alliance that has tied the United States and Korea together for the past half century. It will also keep the United States

firmly anchored in the dynamic economy of North-east Asia and maintain momentum for global trade liberalization.

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