

Shifting Strategic & Diplomatic Relations with the Koreans

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CAN THE UNITED STATES AND SOUTH KOREA SING WITHOUT KORUS? THE ECONOMIC AND STRATEGIC EFFECTS OF THE KORUS FTA

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I. Introduction

On 30 June 2007, U.S. and South Korean trade officials signed the U.S.-Korea Free Trade Agreement (KORUS FTA). The two countries reached the agreement after 10 months of very tense negotiations that reflected the difficult issues the two countries confront and the importance they both place on the agreement. South Korea and the United States took a major gamble when they launched the KORUS FTA negotiations in February 2006. The U.S. Trade Promotion Authority statute required that they could not officially begin the actual negotiations until June 2006 and had to complete the negotiations by 1 April 2007. That left them only 10 months to address difficult issues relating to agriculture, autos, services, intellectual property rights, and the Kaesong industrial complex in North Korea, among others. Many of these issues had been plaguing the bilateral economic relationship for years, but the two countries had to resolve them somehow if they were going to reach a meaningful free trade agreement (FTA). Other negotiations on less complex FTAs, such as the U.S.-Australia FTA, took longer than 10 months. The United States and South Korea were arguably also putting the future of their alliance on the line, an alliance that at the time the FTA was launched had been showing signs of fraying.

It has been more than a year since South Korea and the United States signed the KORUS FTA. Before the agreement can enter into force, the U.S. Congress and the Korean National Assembly must approve it. Both former President George W. Bush and President Lee Myung-bak have urged their respective legislatures to take up and pass the implementing legislation for KORUS FTA. Incoming President Barack Obama and a number of members of Congress have, however, expressed concerns about the adequacy of the KORUS FTA to address market access issues in the South Korean market, particularly for U.S.-made cars, as well as issues regarding the plight of U.S. labor. Those concerns have made the timing and even the likelihood of congressional consideration uncertain. In South Korea, some popular opposition to President Lee's handling of a dispute over imports of U.S. beef and discontent with governing style have made members of the National Assembly reluctant to consider the agreement for the time being.

The future of the KORUS FTA is one of the most important issues that the United States and South Korea face in their relationship at this time. On one hand, if enacted, it would be the largest FTA that the United States has entered into since NAFTA in 1994 and would be the largest FTA for South Korea based on market size. The KORUS FTA also has potential implications for the U.S.-South Korean alliance as a whole, as both countries have viewed it as a vehicle for deepening that relationship, at least in a symbolic way. On the other hand,

opponents argue that because the KORUS FTA does not address some critical issues regarding market access in South Korea and issues regarding labor, it should not be approved in its current form.

At the same time, the importance of the KORUS FTA to the alliance should not be exaggerated. Trade and investment between the United States and South Korea will continue regardless of the future of the KORUS FTA as their respective economic interests require. Moreover, the KORUS FTA need not be seen as a necessary, let alone sufficient, condition for enhancing the U.S.-ROK alliance. Mutual interests on critical issues pertaining to North Korea and the rest of the region will continue to require close cooperation between the two countries in the national security sphere. Indeed, in many respects, the KORUS FTA's fate may have more profound implications for U.S. trade policy and East Asia policy than for U.S.-South Korea relations.

II. U.S.-South Korea Economic Relations

Economic ties are one of the most critical factors that bind the U.S.-South Korea relationship. Those ties have strengthened during the decades since the 1960s and have grown in absolute terms. Their importance has declined somewhat in relative terms during the past decade.

U.S.-South Korea Trade and the Ties That Bind

An important element of the economic relationship has been the growth of bilateral merchandise trade. South Korea is a major economic partner for the United States, and vice versa. In 2007, two-way trade between the two countries was close to \$80 billion, making South Korea the seventh-largest trading partner of the United States (see **Table 1**). In 2007, the United States was South Korea's third-largest trading partner as a whole, the second-largest export market, and the third-largest source of imports.

A number of factors have been driving the two countries' economies together. One is the seeming complementarity of their respective comparative advantages in trade. The United States, for example, is well endowed with arable land and is a major producer and exporter of agricultural products, especially grains and meats. South Korea, by contrast, is resource poor and is highly dependent on imported food. South Korea's limited agricultural sector is notoriously inefficient and survives through subsidies, protectionist trade policies, and South Koreans' sense of cultural heritage. In 2007, the United States was South Korea's largest

supplier of imported grains, accounting for 49 percent of those imports. In the same year, it was the second-largest supplier of imported meat and accounted for 17 percent of imports. Prior to the imposition of the South Korean ban at the end of 2003 on imported U.S. beef after the discovery of a BSE-infected cattle, the United States was the largest source of imported beef, far ahead of second-place Australia (GTI various years). Machinery products dominate U.S.–South Korea bilateral trade, both exports and imports. This pattern is another sign of the complementarity of U.S.–South Korea trade as a factor that binds the relationship. In 2007, 45 percent of U.S. exports to South Korea and 67 percent of U.S. imports from South Korea were in machinery, suggesting a large amount of intra-industry trade and trade within production networks.¹

Table 1: Annual U.S.–South Korea Merchandise Trade, Selected Years billions of U.S. dollars

Year	U.S. Exports	U.S. Imports	Trade balance for United States	Total trade
1990	14.4	18.5	-4.1	32.9
1995	25.4	24.2	1.2	49.6
2000	26.3	39.8	-13.5	66.1
2003	22.5	36.9	-14.4	59.5
2004	25.0	45.1	-20.1	70.1
2005	26.2	43.2	-17.0	69.4
2006	30.8	44.7	-13.9	75.5
2007	33.0	45.4	-12.4	78.4

Source: Global Trade Information Services. World Trade Atlas.

Two more factors have contributed to the complementarity of the U.S.–South Korea trade relationship. One is the orientation of U.S. and South Korean economies and policies during recent decades. Since the 1960s, successive South Korean governments have employed export-oriented economic growth policies. Understandably, South Korean policymakers determined that, for a resource-poor economy such as theirs to grow, it would have to emphasize manufacturing, and, because Korea's economy is a small one, it would have to promote exporting in order to take advantage of economies of scale. These policies have largely worked, but they have required foreign markets that are receptive to Korea's exports. Other advanced East Asian developing countries were in the same situation as South Korea and were employing similar export-oriented policies, making them unlikely consumers of South Korean exports. Japanese regulations and trade practices to limit import penetration and Japan's

1. Figures are derived from U.S. Department of Commerce data maintained by the U.S. International Trade Commission (USITC) in a database.

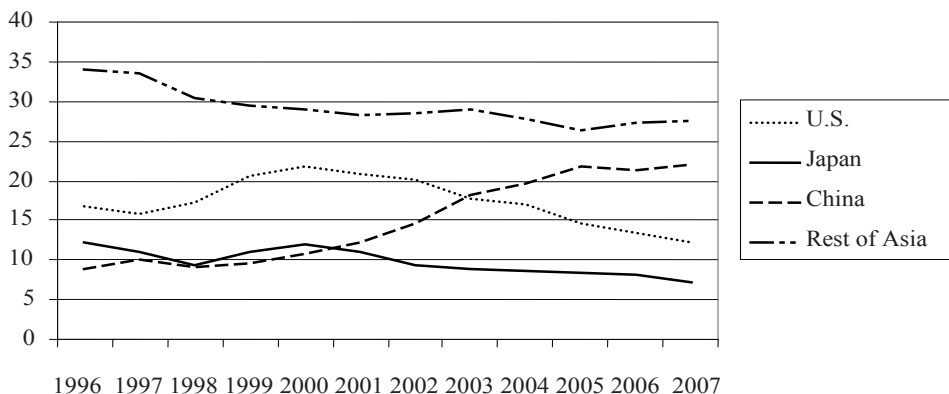
emphasis on savings over consumption have limited Japan's role as a market for South Korea's exports. The United States, in contrast, with its relatively open economy and high consumption rates has played a significant role in South Korean trade and South Korea's economic success.

In addition to commercial and other economic factors, some political and national security interests have driven the economic relationship. The United States and South Korea have built a strong alliance rooted in the experiences of the Korean conflict and in mutual security needs in East Asia. During the 1980s, trade disputes frequently erupted between the two countries, especially over South Korea's practices and policies that the United States alleged were denying market access to U.S. exports. While the United States threatened to impose sanctions against South Korea, many analysts have argued the importance of maintaining the health of the overall alliance helped to temper the tensions. Some U.S. exporters complained, though, that too often U.S. policymakers sacrificed their interests in the name of the alliance.

The Declining Relative Importance of U.S.-ROK Trade Relations

U.S.–South Korea merchandise trade remains significant for both countries, but that significance has been decreasing during the past decade (**Figure 1**). Other countries, particularly China, have emerged as major trading partners. In 1996, the United States accounted for 16.7 percent of the value of South Korean exports, but that share dropped to 12.3 percent by 2007. In 1996, Japan accounted for 12.2 percent of the value of South Korean exports but for only

Figure 1: Exports from South Korea to the United States, Japan, China, and the Rest of Asia, 1996–2007, percentage



Source: Global Trade Information Services, Inc. World Trade Atlas.

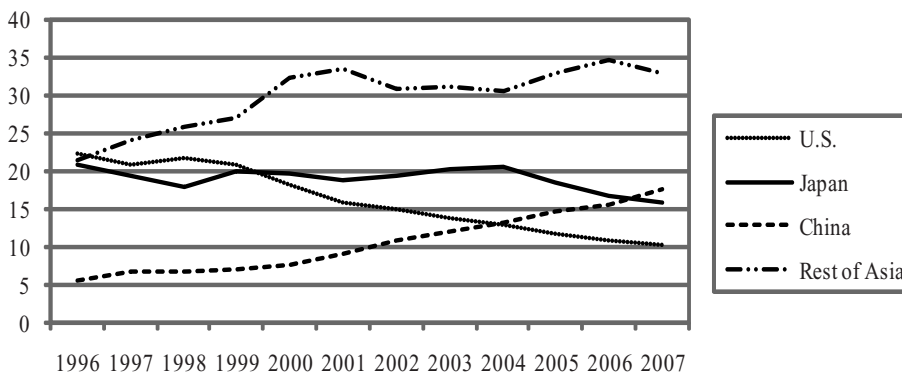
Note: Trade in terms of value

7.1 percent by 2007. In contrast, in 1996 China accounted for 8.8 percent of the value of South Korea's exports but for 22.1 percent in 2007. In addition, the rest of Asia (Asia excluding Japan and China) has lost importance as a market for South Korean exports, with its share of the market in terms of value declining from 34.0 percent in 1996 to 27.5 percent in 2007.

Similarly, the United States and Japan have lost position to China as sources of South Korea's imports (*Figure 2*). In 1996, the United States accounted for 22.2 percent of the value of South Korea's imports and was South Korea's number one source for imports. In 2007, the U.S. share had dropped to 10.3 percent in terms of value, and the United States had declined to the third-largest source of South Korea's imports. In 1996, Japan was the second-largest source of South Korea's imports, with a 20.9 percent share in terms of value. In 2007 it was still number two, but its share had decreased to 15.8 percent. China, in contrast, in 1996 ranked third as a source of South Korea's imports, with a 5.7 percent share, but it ranked first in 2007 with a 17.7 percent share. The rest of Asia has increased in importance as a source of South Korea's imports, with its share rising from 21.5 percent in 1996 to 32.9 percent in 2007, although that figure was a decrease from its peak of 34.6 percent in 2006.

In addition, South Korea has become a less important partner to the United States in merchandise trade (*Figure 3*). South Korea's shares of U.S. exports have declined during the past decade. In 1996, South Korea accounted for 4.3 percent of the value of U.S. exports and ranked ninth as a U.S. export market.

Figure 2: Imports into South Korea from the United States, Japan, China, and the Rest of Asia, 1996–2007, percentage

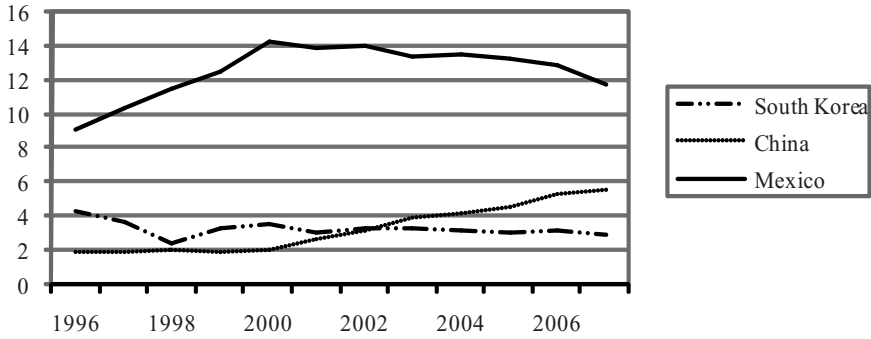


Source: Global Trade Information Services, Inc. World Trade Atlas.

Note: Trade in terms of value.

In 2007, South Korea ranked seventh as a U.S. export market, but its share had declined to 3.0 percent.

Figure 3: Exports from United States to South Korea, China, and Mexico 1996–2007 percentage

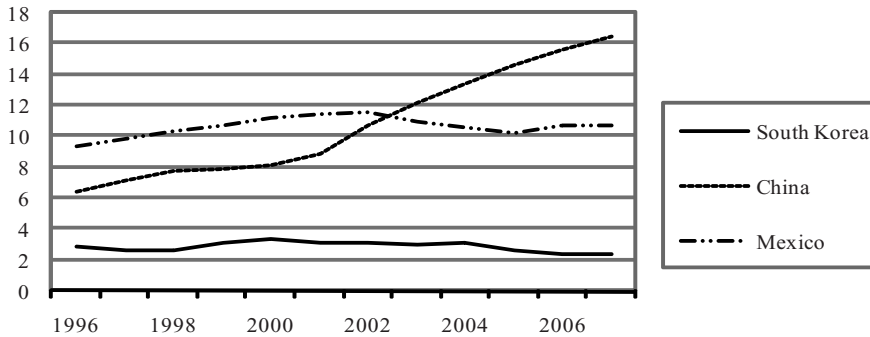


Source: Global Trade Information Services, Inc. World Trade Atlas.

Note: Trade in terms of value.

Furthermore, South Korea's shares of U.S. imports in terms of value have decreased somewhat over the years, from 2.9 percent in 1996 to 2.4 percent in 2007 (**Figure 4**).

Figure 4: Imports into the United States from South Korea, China, and Mexico 1996–2007, percentage



Source: GTI (Global Trade Information Services, Inc.). Various years. www.gtis.com/english/.

Note: Trade in terms of value.

Many analysts have suggested that, because of the reported shift of South Korean production from its home base to China from where products are shipped to the United States, the relative decline in the significance of U.S.–South Korea bilateral trade may not be as great as the bilateral data show. Data showing such triangular trade trends are difficult to develop although the explanation is certainly plausible. If Richard Katz's findings (2008) elsewhere in this volume

are an accurate reflection of reality, a substantial portion of South Korean exports to China may indeed hinge upon Chinese exports to the United States.

Other Trends in the Bilateral Economic Relationship

While the significance of the United States and South Korea as partners in merchandise trade has slipped somewhat, their bilateral economic relationship has tightened in other areas, including services trade and foreign investment. It could be these areas that prove to have greater importance in the long term. The United States is a leading producer of services. From 1999 to 2007, the share of services in U.S. exports to South Korea increased from 24 percent to 29 percent. During that period, services' share of imports remained relatively the same, increasing from 15 percent to 16 percent.

Another trend in the bilateral economic relationship has been the growth in foreign direct investment (FDI). Because FDI usually involves investment in manufacturing facilities and other hard assets, it connotes a long-term commitment. Therefore, FDI trends can be considered an indicator of a firm economic relationship. The stock of U.S. direct investment in South Korea soared more than 260 percent between 1999 and 2007, from \$7.5 billion to \$27.2 billion, according to U.S. data.² This increase followed South Korea's 1997 financial crisis, which led to a devaluation of the Korean *won* and to market-oriented economic reforms. Similarly, the stock of South Korean direct investment in the United States increased 385 percent during the same period, from \$2.7 billion to \$13.1 billion.³ Although South Korea accounts for a small share of FDI into the United States, the United States is the most significant source of the stock of FDI in South Korea. By 2007, it accounted for 29 percent of accumulated FDI in South Korea, ahead of Japan (15 percent) (*Figure 5*).⁴

III. KORUS FTA and the U.S.–South Korea Economic Relationship

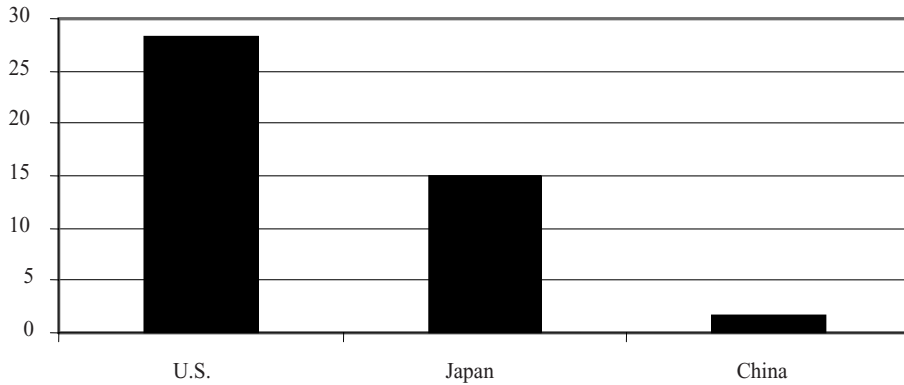
A major U.S. and South Korean objective in concluding the KORUS FTA was to deepen the bilateral economic relationship by eliminating tariffs, reducing other

2. Authors' calculations based on data from the U.S. Department of Commerce, Bureau of Economic Analysis. <www.bea.gov>.

3. Authors' calculations based on data from the U.S. Department of Commerce, Bureau of Economic Analysis. www.bea.gov.

4. CRS calculations based on data from the Republic of Korea, Ministry of Knowledge Economy.

Figure 5: Foreign Direct Investment into South Korea from the United States, Japan, and China, 1962–2007 (cumulative), percentage



Source: Republic of Korea, Ministry of Knowledge Economy.

Note: South Korean data for foreign direct investment are based on notifications of intended investments and therefore may not accurately reflect actual investments in place.

trade barriers, establishing rules on foreign investment, ensuring protection of intellectual property rights, and improving market access for trade in services. The two countries also sought to strengthen the relationship by resolving politically difficult issues that have lingered for decades and that have prevented the two countries from forging even closer ties. For the United States these issues have included the huge and growing imbalance in trade in autos and perceived South Korea's barriers to auto imports and to high tariffs and other South Korea restrictions on agricultural imports. For South Korea, these difficult issues have included perceived U.S. discrimination toward South Korea's imports in the application of trade remedies and treatment of products made at the Kaesong industrial complex in North Korea.

The KORUS FTA appears to have addressed many of these issues. In agriculture, for example, the United States obtained South Korean concessions to eliminate tariffs on most agricultural products, including sensitive goods such as dairy products, beef, and citrus fruits, either immediately or over time in stages. For its part, the United States acceded to South Korean wishes to allow it to maintain restrictions on rice. In 2007, U.S. rice exports accounted for 0.1 percent of total U.S. exports to South Korea. (South Korea is already committed to eliminating these restrictions under a multilateral agreement under the World Trade Organization [WTO].) Also, each country made concessions in auto trade. The United States agreed to eliminate its 2.5 percent tariff on South Korean passenger vehicles and to phase out the 25 percent tariff on pickup trucks. South Korea agreed to eliminate its 8 percent tariff on U.S. passenger cars, reduce

the discriminatory effects of its engine displacement taxes, amend emissions standards for some U.S.-exported cars, and allow the United States to return to or “snap back” tariffs on cars to their original most-favored-nation level if South Korea does not abide by its commitments on auto trade under the KORUS FTA. Currently, the U.S. auto industry and automotive unions feel these provisions are insufficient.

Furthermore, under the KORUS FTA the United States and South Korea agreed to liberalize trade in services. The KORUS FTA, like some other U.S. FTAs, adopts the “negative list” approach to services; that is, the assumption is that a service would be covered under the agreement unless it is specifically listed as an exception, making trade liberalization the default. This approach is in contrast with the “positive list” used in the WTO’s General Agreement on Trade in Services (GATS), where the assumption is that a service is not covered for liberalization unless it is specifically listed. This step required concessions more from South Korea than from the United States as the U.S. market is largely open. But it means that the United States could realize opportunities in South Korea’s burgeoning market for financial and professional services. Some representatives of U.S. services providers consider the KORUS FTA a model for future FTAs.

The U.S.–South Korea Economic Relationship with a KORUS FTA

Estimates indicate that the United States and South Korea on balance would benefit as a whole economically from the KORUS FTA. A congressionally mandated study by the United States International Trade Commission (USITC) of the impact of the agreement on the United States concluded that the U.S. gross domestic product (GDP) would increase approximately 0.1 percent when the KORUS FTA is fully implemented (USITC 2007, xvii–xviii). The USITC based this estimate primarily on the removal of tariffs and tariff-rate quotas, that is, barriers that can be relatively easily quantified. The significance of the agreement would likely be felt more by those specific sectors that stand to gain the most from trade liberalization. The USITC study concluded that U.S. exports of goods would likely increase by \$9.7 billion to \$10.9 billion primarily in agricultural products, machinery, electronics, and transportation equipment, including passenger vehicles and parts. U.S. imports would increase from \$6.4 billion to \$6.9 billion, primarily in textiles, apparel, leather products, footwear, machinery, electronics, and passenger vehicles and parts.

The estimates do not take into account the impact of the reduction of barriers to trade in services and to foreign investment flows and the impact of changes in regulations as a result of the KORUS FTA. However, the study notes that U.S.

exports in services would increase as a result of South Korean commitments under the KORUS FTA and that changes in the regulatory environment in both countries would also help to increase bilateral trade and investment flows.

A Korea Institute for International Economic Policy (KIEP) study (Lee and Lee 2005, 86) published before the KORUS FTA negotiations had been completed measured the potential economic impact of the FTA on South Korea alone. The study estimated some of the dynamic, or long-run, economic effects in addition to the static, or one-time, effects. The study concluded that the FTA would eventually lead to a 0.42–0.59 percent increase in South Korea's GDP according to a static analysis and a 1.99–2.27 percent increase according to a dynamic analysis.

It is these potential long-run dynamic effects that tend to be emphasized by South Korean officials and other South Korean proponents of the KORUS FTA. They stress that an influx of U.S. investment and increased competition with U.S. firms would increase the allocative efficiency of the South Korean economy, particularly in the services industries. For some South Korean officials, the country's economic future hinges on carrying out this type of transformation. Ongoing competitive pressure from Japanese firms, increased competition from Chinese enterprises, and the rapid aging of the South Korean workforce has heightened the sense of urgency about boosting national competitiveness. Continuing along this line of argument, former South Korean prime minister Han Duk-soo has said (MOFE 2006) that a failure to adopt significant economic changes will mean that "Korea's long-term growth potential is likely to deteriorate." Likewise, President Lee Myung-bak has championed the KORUS FTA—as well as the other FTA negotiations Seoul has initiated—as part of a larger program to promote South Korean economic growth.

As with most trade agreements, the initial effects of the KORUS FTA would be small relative to the size of each of the economies, and they would be concentrated in certain sectors of each economy. Also, while some sectors would be expected to gain from the agreement, other import-sensitive sectors would see adverse effects, forcing them to make adjustments. U.S. opponents of the KORUS FTA have argued that it fails to resolve critical issues regarding market access in South Korea. Some U.S. auto manufacturers have stated that the KORUS FTA should not be approved in its current form because it does not adequately address South Korean barriers to auto imports and that the agreement would not guarantee that U.S. exports of cars would increase. The U.S. steel industry has asserted that the provisions in the KORUS FTA that deal with trade remedies would weaken the ability of the United States to deal with South

Korean dumping and subsidy infractions and therefore should not be approved. Major automotive and steel labor unions, along with many of their backers in Congress, have opposed the agreement.

The exact impact that FTAs in general have upon trade flows is difficult to discern. For example, the U.S.-Chile FTA went into effect on 1 January 2004. In 2003, the U.S. share of Chile's imports was 14.5 percent and later rose to 17.0 percent in 2007. The South Korea–Chile FTA went into effect in February 2003. According to an undated document by the Chilean embassy in South Korea, South Korea's share of Chile's imports in 2003 was 2.8 percent, a percentage that increased to 6.6 percent in 2007. However, China's share of Chile's imports also increased during that period, from 7.3 percent in 2004 to 11.4 percent in 2007. The U.S. share of Mexico's imports declined significantly after 1 January 1994, when the NAFTA went into effect, from 74.4 percent in 1995 and to 49.5 percent in 2007, even though U.S. exports to Mexico increased 160 percent during that period. These trends indicate that other factors besides trade liberalization—for example, relative growth rates and exchange rates—have been playing a role in determining trade volumes and patterns.

It seems likely that any effects, negative or positive, of the KORUS FTA will be more micro in nature; that is, they will be within specific sectors or industries and even among firms. The effects are likely to be manifested in the business environments in which the economic players operate and not captured by trade data. As a result of the U.S.-Singapore FTA, for example, U.S. imports of pharmaceuticals have increased rapidly since 2004 because the intellectual property rights (IPR) provisions of the agreement forced Singapore to improve IPR protection, which in turn encouraged foreign pharmaceutical firms to invest in Singapore and export from there. Indeed, when asked by one of the authors to comment about the effects of the U.S.-Singapore FTA, a Singaporean official replied, "We wish you had forced us to improve our IPR regime sooner!"

The U.S.–South Korea Economic Relationship without a KORUS FTA

At this writing the prospects for the KORUS FTA are unclear at best. The U.S. Congress and the Korean National Assembly must each approve the agreement for it to enter into force. Some members of Congress, as well as incoming President Obama, have raised objections to the agreement as written because, they assert, it does not adequately address issues of market access for U.S. exports of cars and other goods. Other members opposed any congressional consideration of the KORUS FTA until South Korea agreed to lift restrictions on imports of

U.S. beef.⁵ The White House has indicated that it would consider acting on the FTAs only in the order in which they were signed. According to this position, Congress would first have to act on FTAs with Colombia and Panama before considering the one with South Korea.

Beyond these procedural concerns, the fate of the KORUS FTA faces a growing skepticism in the United States toward freer trade that became grist for the 2008 U.S. presidential and congressional campaigns. The nominees of the two major political parties for the office of U.S. president also expressed differing views on the KORUS FTA. The Republican Party nominee, Senator John McCain, supported the agreement as a way to expand trade and jobs. The Democratic Party nominee, Senator Barack Obama, opposed the agreement as written because, he said, it does not pay sufficient attention to the needs of key U.S. industries and agriculture and U.S. labor.

The South Korean National Assembly has delayed consideration of the KORUS FTA as well. President Lee Myung-bak has said he had hoped to have the South Korean National Assembly pass the agreement before its legislative session ended in May 2008. However, an uproar in South Korea over the an agreement whereby South Korea resumed imports of U.S. beef, a rapid decline in Lee's popular support, and a seeming increase in anti-U.S. feelings in South Korea have made the timing of National Assembly action uncertain.

This uncertainty in both countries suggests that the KORUS FTA's approval will be delayed for some time if it is approved at all. Such a delay will likely affect U.S.–South Korea economic ties, and the scope and depth of that impact will depend on the length of the delay and on how policymakers in each country react to it.

In the proverbial short term, a delay in the suggested of KORUS FTA would likely have minimal impact on trade and investment flows between the two countries. Tariffs would remain the same, as would other restrictions and procedures. The complementary needs of the two economies would encourage trade and investment flows to continue, barring any shocks. In a political sense, a delay could prove beneficial for the agreement's ultimate prospects. It could give the two countries time to resolve their differences, presumably short of renegotiating the FTA, on auto trade, which have impeded the approval process so far. Economist Jeffrey Schott (2008, 91) has suggested that the U.S. government

5. The United States and South Korea reached an agreement on this issue, and South Korea has resumed imports of U.S. beef.

could change tax and expenditure policies that would provide favorable treatment to the U.S. auto industry and make it more competitive. A delay could also allow the United States to work through the inevitable political uncertainty caused by the November 2008 elections and for the new administration and new Congress to define and develop their respective policies and strategies on trade policy that will inevitably affect the future of the KORUS FTA. At the same time, opponents of the KORUS FTA could use the delay to strengthen their positions, or to obtain changes that they require, or both.

The impact of a delay in the KORUS FTA approval would likely become more evident as the delay gets longer and if it begins to look more likely to be indefinite, if not an outright rejection. A long delay or a rejection of the KORUS FTA would have an adverse, albeit modest, macroeconomic impact on both countries. Economic theory suggests that freer trade and investment permit economic resources to be used more efficiently, increasing economic growth. Therefore, a delay or rejection of the KORUS FTA would impede the gains in economic efficiency.

The most evident effect of a delay or rejection would be on the size and patterns of trade and investment flows. Overall bilateral trade and investment would continue, probably at robust rates barring any shocks. The longer a delay in approval ensues, however, the longer would be the delay in the implementation of the reduction and elimination of tariffs. Although its impact on overall trade flows would be modest, the delay's impact would be greater on those sectors that were primed to gain the most. In the United States, agriculture would feel the impact as high South Korean tariffs on fruits and vegetables and quotas on dairy products and meats would continue. The reduction in South Korean restrictions on financial, professional, and other services would stall, affecting U.S. providers' efforts to increase their presence in that market. For South Korea, the U.S. tariffs on autos and auto parts would remain, setting back the opportunity for South Korean manufacturers to gain an advantage over their Japanese counterparts in the U.S. market. For some industries, however—for example, some parts of the Korean beef sector and the U.S. auto industry—a delay or rejection of the KORUS FTA might be seen as a gain as it would limit foreign competition.

The effects could become greater if either country pursues FTAs with other trading partners. South Korea is in the midst of FTA negotiations with Canada, the European Union, and other countries. If completed, the agreements would provide U.S. competitors in those areas a competitive advantage in the South Korean market. In addition to the impact on trade and investment flows, a long delay or rejection of the KORUS FTA could heighten tensions in the bilateral economic relationship.

KORUS FTA was intended as a mechanism to address or resolve issues that have hampered the relationship for many years and as a forum to handle future economic issues before they threaten the overall relationship. It can certainly be argued that the desire to successfully complete the KORUS FTA spurred the South Korean leadership in 2006 to take the first steps toward lifting the beef ban and encouraged them to reduce the “screen quota” mandating a minimum number of hours South Korean theaters must show domestic movies. Similarly, the KORUS FTA helped to spur the United States to resolve the visa-waiver issue for South Korea. If the KORUS FTA collapses, the political environment surrounding U.S.–South Korea economic relations could sour, making it more difficult for issues to be addressed and resolved. In private, some U.S. business officials worry that a failure to pass the KORUS FTA would lead South Korean officials to effectively penalize U.S. companies in future regulatory decisions or in moves to privatize state-run enterprises. In addition, as Lee Jae-min (2008) suggests elsewhere in this volume, if the KORUS FTA collapses, the two countries would not benefit from the dispute settlement provisions of the KORUS FTA, which could provide a more workable framework for the two countries to manage trade disputes.

Should KORUS be rejected or delayed indefinitely, the United States and South Korea would have a number of options on the economic diplomacy front. One is that they could treat trade issues on an ad hoc basis, essentially reacting to disputes as they arise, without creating any formal institutions to channel disagreements. A second is they could reconstitute the working-level “trade action agenda” meetings that were held every quarter from 2001 until the FTA talks were launched. Some credit the meetings with creating a more constructive dialogue by serving as “action-forcing” events. They helped keep trade disputes from becoming as acrimonious as they were in the 1980s and 1990s. A third option would be to attempt to negotiate sectoral bilateral agreements on, for instance, trade in services or telecommunications. This, however, may prove difficult. As was often found in the sector-specific negotiations between the United States and Japan in the 1990s, focusing on only one sector often reduces the chances for reaching an agreement because political leaders are unable to achieve concessions across sectors, thus limiting the opportunities to negotiate. Another option would be for the United States and South Korea to resurrect their negotiations on a bilateral investment treaty; earlier negotiations broke down in 2001 over the screen quota issue.

IV. The KORUS FTA's Strategic Dimension

The U.S.-ROK Strategic Relationship under a KORUS FTA

At the time the KORUS FTA was launched, many analysts in both countries saw the agreement as a means to restore the health of a critical foreign policy and national security alliance. The KORUS FTA sometimes was discussed as a possible counterweight to the bilateral friction that was occurring over issues such as how to manage relations with North Korea. These tensions decreased markedly in 2007, following the Bush administration's decision to place greater emphasis on engagement and negotiations with North Korea. Additionally, the reaching of agreements on the operational control of U.S. and ROK forces and the relocation of U.S. troops reduced these sources of strategic tension during the latter years of the Roh Moo-hyun administration. Now, although difficulties remain in implementing these agreements, under the Lee administration the talk is about how to expand and broaden the alliance. Thus, with the alliance apparently on firmer ground, the KORUS FTA—and U.S.-ROK trade relations generally—no longer appear as exceptional areas of bilateral cooperation.

Although the FTA's utility as an acute salve for the alliance has been reduced, many have argued that during the medium and longer term it could help to boost the alliance by deepening bilateral economic and political ties. Some South Korean proponents of an FTA believe that successfully negotiating an agreement could lessen disagreements between Washington and Seoul generally, by compelling "politicians and officials in each nation toward a deeper understanding of the broad forces at play in the other," although in concrete terms it is unclear how this meeting of minds would take place (Lee and Lee 2005, 139). In announcing the launch of the FTA, for instance, Trade Minister Kim Hyun-chong stated that the FTA launch was "the most important event" in the history of the alliance, one that would take the U.S.-South Korea relationship "to the next tier, the next level" although that level was never defined (USTR 2006).

Some even go further by implying that the KORUS FTA would help reorient the alliance to the changes on the Korean peninsula and in East Asia. Here the arguments touting the strategic value of the KORUS FTA are primarily symbolic. With questions about the utility of the alliance rising over the past decade, many argue an FTA will help provide a "new basis" for the alliance, with something to "stand for" rather than "stand against." Since the late 1990s, even as Americans have come to feel that the danger from North Korea has increased, South Koreans' perception of a threat from North Korea has declined markedly (Marshall 2006). This has led some to question the purpose of the U.S.-South

Korea alliance, which is predicated upon deterring an attack by North Korea. With the central rationale for the alliance increasingly open to question in South Korea—and this gap would likely grow if North Korea were to suddenly collapse or if North Korean conventional forces continue to deteriorate—and with many South Koreans opposed to allowing U.S. troops in South Korea to deploy to other parts of Asia (such as the Taiwan Strait) in the event of a crisis there, the future utility and form of the U.S.–South Korea alliance could be debated once again in Washington. Having a KORUS FTA, the only FTA the United States would have in Northeast Asia, would symbolize that U.S.-ROK ties are in some way special.

That said, in concrete terms, it is hard to see how the KORUS FTA would make a significant difference in the strategic relationship. This FTA is unlikely to alter either country's interests on the peninsula or in Northeast Asia. It is difficult to see how the existence of a KORUS FTA during the past several years would have affected the 2002 protests over the killing of the Korean schoolchildren, President Roh's decision to send troops to Iraq, the move to include Korea in the U.S. visa-waiver program, or the decision by the United States to draw down its troop presence and relocate its troops in Korea. Likewise, would an FTA have made a difference in the current debate in Seoul over whether South Korea should send troops to Afghanistan? Although some South Korean proponents of an FTA believe that successfully negotiating an agreement could lessen disagreements between Washington and Seoul over North Korea policy, this is unlikely to be the case given the importance of North Korea in the foreign policies of both countries. Although the various committees and dispute resolution bodies created by the KORUS FTA would expose policymakers on both sides to each other, it is hard to see how these interactions, with the possible exception of the open processing zone committee discussed below, would have more than a marginal impact.

U.S.-ROK Strategic Relations without an FTA

Although the passage of the KORUS FTA is unlikely to have a major substantive impact on the strategic relationship, a collapse of the FTA would likely have a profound symbolic effect, particularly on the way South Koreans view the alliance. Symbolism matters. If the FTA is rejected or subjected to a prolonged delay by the United States, it would be a major psychological blow to many South Korean policymakers who would likely see it as a betrayal. This would be particularly true since, in their eyes, they made politically costly concessions on autos, beef, labor, and the environment to help ensure the agreement would be more favorably received in the U.S. Congress. The KORUS FTA's failure in the United States, according to some Korean politicians and policymakers,

would lend credence to arguments in South Korea that the United States is a selfish, self-interested partner whose commitment to Korea and Northeast Asia is declining. If these perceptions take hold, it would increase the political costs of South Korean leaders' taking unpopular decisions on behalf of the alliance; one concrete example might be South Koreans' debate over whether to increase payments for relocating U.S. troops on the peninsula.

The symbolic impact of the KORUS FTA appears to have been inflated beyond its concrete, substantive importance by the way the agreement has been and is likely to be sold to the two publics. In South Korea, the Lee administration has positioned the FTA as a critical part of his vision of expanding the nature of the alliance. In the United States, many expect the FTA's biggest selling point will be its strategic, rather than economic, value. If the Obama administration decides to introduce the FTA to Congress, it is expected to argue that the FTA is a key to the future role of the United States on the peninsula and in East Asia. Although raising the stakes may increase the agreement's chances of passage in Congress and the National Assembly, it also increases the symbolic costs if the agreement is not ratified.

Thus, if the KORUS FTA is rejected or delayed, U.S. and South Korean policymakers may want to take concrete steps to either deepen or reorient aspects of their strategic relationship to mitigate the negative symbolic effects on the alliance. A number of options are available:

- Accelerate efforts on existing bilateral moves to adjust the alliance structure, such as pushing forward construction at Pyongtaek, which now appears headed toward another postponement;
- Elevate the U.S.-ROK alliance to the level of other alliances, such as by creating a "two-plus-two forum" (an annual meeting of the defense and foreign ministers) as takes place in the U.S.-Japan alliance;
- Deepen bilateral discussions on planning for various North Korean contingencies, such as a sudden collapse or change in regime;
- Open high-level discussions between the two militaries about post-reunification roles and responsibilities;
- Reconstitute the Trilateral Coordination and Oversight Group (TCOG) meetings with Japan to coordinate North Korea policy among the three countries; and

- Continue to discuss ways to globalize the alliance; for example, how South Korea could contribute to efforts of the U.S. allies in Afghanistan, to the Proliferation Security Initiative, and to coordination of policies for official development assistance.

These items have been proposed or discussed for years and could be undertaken regardless of the KORUS FTA's fate, an argument that the FTA's opponents might make if the agreement is submitted to Congress. Arguably, taking these steps would do more to transform the alliance than would the passage of the FTA. The point is that the KORUS FTA need not be seen as a necessary, let alone sufficient, condition for repositioning the alliance for the changing situation in Northeast Asia.

After the feelings of shock and betrayal from the failure of the KORUS FTA wear off, leadership in both countries could reveal an appetite among policymakers to take some of these steps anyway. Many members of Congress might be interested in burnishing their national security credentials by showing that their qualms about the FTA were about trade, not security. In the National Assembly, many members of the ruling Grand National Party likely would have an interest in compensating for the demise of the KORUS FTA. In this rosy scenario, a failure of the FTA to pass could be used as an opportunity to work on the strategic side of the relationship, much as the adversity of the 1995 rape of an Okinawan teenager by U.S. soldiers was used to galvanize support for the "Nye initiative" that helped modernize the U.S.-Japan alliance. The key would be leadership, particularly on the Korean side, where the hard feelings and budgetary costs would be felt much more keenly.

KORUS FTA's Implications for U.S.-ROK Coordination over North Korea Policy

Although the fate of the KORUS FTA is unlikely to fundamentally alter either country's interests regarding North Korea, the existence or absence of an FTA could have some marginal effects. Most of these would come by virtue of the binational committee that KORUS would establish to study the possibility of eventually including products from "outward processing zones," particularly the Kaesong industrial complex (KIC), inside North Korea sometime in the future. Here, the KORUS FTA's impact is likely to be ambiguous. Far more important will be the course of events in North Korea itself.

On the one hand, the existence of an outward processing zone committee could provide the two countries with a preexisting forum for discussing the U.S. role in

the event South-North economic integration takes a big step forward. This could be particularly valuable if there are any sudden changes on the peninsula. In this scenario, the KORUS FTA could become one more vehicle through which the two countries could work out a collaborative policy toward North Korea. As is true with other aspects of U.S.-ROK strategic relations, however, the presence of an FTA would only facilitate these discussions, which could take place even without an FTA in place.

On the other hand, the existence of such a committee could create more tension than would otherwise exist. The United States currently treats products made in the KIC the same as it does all products originating from North Korea; they are not given most-favored-nation treatment (that is, they are subject to higher tariffs) and are subject to the variety of sanctions the United States still maintains on North Korea. As the KIC expands, South Korean companies' and policymakers' interest in obtaining nondiscriminatory access to the U.S. market will also grow. The danger to bilateral relations comes from heightened but unrealistic expectations; if the KORUS FTA goes into effect, the outward processing zone committee could raise South Koreans' expectations that the United States would look favorably on KIC-made products, something that is unlikely absent major changes in the North Korean regime. This is particularly the case if, as implied by the text of the KORUS FTA and explicitly stated by Bush administration officials, Congress is given a voice in any decision made to include North Korea-based outward processing zones in the FTA.

Perhaps one of the few unambiguous effects of the success or failure of the KORUS FTA on the way the two allies treat North Korea is that the presence of an FTA would guarantee the United States a marginally bigger say in South Korea's economic policy toward North Korea. This could be particularly important to U.S. policymakers if they felt South Korean economic engagement—channeled through outward processing zones—were proceeding too rapidly. The committee could provide a vehicle by which the United States could slow down any major developments, although any efforts toward this end would likely raise tensions with Seoul.

V. Conclusion: Broader Implications of the KORUS FTA

As widely expected, that the KORUS FTA was not introduced in—let alone debated by—the U.S. Congress during 2008. Likewise, the National Assembly did not vote on the measure in 2008, as many observers predicted after the massive beef protests earlier in the year. Thus, it is probable that that agreement will not be in effect in the near-to-medium term.

Should this scenario prove to be the case, the largest economic effects are likely to be felt at the microeconomic level, in such areas as agriculture and services. At the macroeconomic level and in the short-to-medium term, the agreement is expected to have a minimal, though not insignificant, impact on trade and investment flows. The economic complementarities that have driven the bilateral economic relationship will continue to be in place; a KORUS FTA is likely to affect the pace, rather than the direction, at which U.S.–South Korea economic ties expand. It is only in the longer run that the agreement would be likely to have a larger impact, primarily by virtue of dynamic effects it would be expected to have on the South Korean economy.

It is also important not to exaggerate the KORUS FTA's potential strategic effects on the U.S.–South Korea relationship. In concrete, practical terms, it is hard to see how the FTA would transform the strategic relationship. Similarly, the absence or presence of an FTA need not be a determinant of whether the two countries expand their military and strategic relations into new areas. Indeed, leadership in these areas could help to mitigate the negative symbolic effects—which would likely be profound—if the KORUS FTA collapses.

Looking beyond U.S.–South Korea relations magnifies the KORUS FTA's importance, primarily because the fate of the FTA will be seen as an indicator of broader U.S. policy: it would be harder for the United States to take concrete steps regionally to minimize the negative effects in the event the KORUS FTA is rejected or indefinitely delayed. Additionally, the KORUS FTA has become something of a symbol of the depth of the U.S. commitment to the U.S.–South Korea alliance and to the U.S. forward presence in East Asia. Right or wrong, many Asians believe that the United States is disengaging from the region. If the South Korean National Assembly approves the pact and the FTA is either rejected or not introduced in the United States, many Koreans and Asians may regard this as an additional sign of U.S. disengagement at a time when other great powers like Japan and China are increasing their economic diplomacy.

On the economic front, a delay or rejection of the KORUS FTA could have wider implications for U.S. trade policy, which is now in a period of reevaluation. In addition to the KORUS FTA, U.S. FTAs with Colombia and Panama are not likely to receive consideration before the conclusion of the 110th Congress, leaving it to a new Congress and administration to decide their fates. The Doha Development Agenda round in the WTO is for all intents and purposes on life support, if not already dead, raising questions in the minds of U.S. policymakers and other experts regarding the future role of the WTO and multilateral negotiations in shaping the international trading framework.

KORUS FTA will likely play a role in the reevaluation of trade policy. For better or worse, its rejection or indefinite delay might call into question the viability of FTAs as a serious U.S. tool to strengthen economic ties with major trading partners. The KORUS FTA is the first FTA that the United States has entered into with a major trading partner since the conclusion of NAFTA. Some might argue that if, for example, the United States cannot accept an FTA with South Korea, how could it hope to achieve an FTA with Japan or the EU, two trading partners with which the United States has even more complex trade issues, to say nothing of the broader Free Trade Agreement of the Asia Pacific (FTAAP) that the Bush administration has proposed.

Similarly, the fate of the KORUS FTA could have an impact on U.S. efforts to institutionalize its economic presence in East Asia. The United States has been using FTAs to try to accomplish this since the initiative with the 21-member Asian Pacific Economic Cooperation (APEC) forum has stalled, if not collapsed. The FTAs are also in response to proposals among East Asian countries to form an East Asian Free Trade Area consisting of the 10 members of ASEAN, Japan, China, South Korea, India, Australia, and New Zealand but excluding the United States.

In addition to the KORUS FTA, the United States has an FTA with Singapore. It has been negotiating with Malaysia and Thailand, but these negotiations have been slow or dormant. In September 2008, the United States announced it would launch negotiations to join the Trans-Pacific Strategic Economic Partnership Agreement (also called the P-4 agreement), a trade liberalization arrangement among Brunei, Chile, New Zealand, and Singapore. Failure of the KORUS FTA could be viewed as a serious blow to this “competitive liberalization” strategy. With FTAs throughout East Asia proliferating, this would mean that over time the United States could be shut out of important regional economic groupings.

In contrast, the ratification of the KORUS FTA not only could be interpreted as a sign of U.S. commitment to East Asia but also it could provide a demonstration effect to jump-start other FTA negotiations. Many Japanese officials and business leaders, in particular, might feel a need to accelerate their stalled FTA talks with Korea and perhaps push the United States to open talks on a U.S.-Japan FTA. Thus, if the proponents of the competitive liberalization argument are to be believed, the fate of KORUS could play an important role in accelerating or decelerating the move to open market regionalism in East Asia.

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