

Korea's Economy 2008

Korea's Economic Achievements and Prospects

The Graying of Korea: Addressing the Challenges of Aging

Financial Asia Rising: Asian Stock Markets in the New Millennium

Korea's Money Market

Ingredients for a Well-functioning Capital Market

The Capital Market Consolidation Act and the Korean Financial Market

Progress in Corporate Governance

Tax Issues Affecting Foreign Invested Companies and Foreign Investors

U.S.-Korea Economic Relations: View from Seoul

U.S.-Korea Economic Relations: A Washington Perspective

Peering into the Future: Korea's Response to the New Trading Landscape

North Korea's External Resources and Constraints

The Roles of China and South Korea in North Korean Economic Change

Realistic Expectations of the Future Role of the IFIs on the Peninsula

a publication of
the Korea Economic
Institute and the
Korea Institute for
International
Economic Policy

Volume 24

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

By Jordan Heiber

On 30 June 2007, United States Trade Representative Susan C. Schwab and Republic of Korea Trade Minister Kim Hyun-chong signed the United States-Korea Free Trade Agreement (KORUS FTA), an encompassing economic deal with broad implications for the U.S.-ROK alliance and U.S. engagement in Asia. Noting the occasion, President Bush issued a statement highlighting these dual roles: On the economic front, the president said, the KORUS FTA will promote growth by “generat(ing) export opportunities for U.S. farmers, ranchers, manufacturers, and service suppliers.” Stressing its geopolitical significance, President Bush affirmed that the “agreement will also further enhance the strong United States-Korea partnership, which has served as a force for stability and prosperity in Asia.”

It was only through the immense efforts of both governments that signature of the FTA was successfully achieved. With the expiration of President Bush’s Trade Promotion Authority (TPA) looming as a firm deadline at the end of April 2007, teams of negotiators met regularly over a 10-month period. As expected, challenges arose in a range of sensitive sectors, and the process was not without controversy and setbacks. To their credit, the U.S. and Korean negotiators both recognized that, while neither side would get 100 percent of what it sought, achieving consensus on a comprehensive, high-quality agreement would ultimately benefit both countries.

Economic Win-Win

Since completion of formal KORUS FTA negotiations, a great deal of attention has been given to the economic benefits of the deal—and with good reason. The KORUS FTA represents a new standard for bilateral trade liberalization between economies of such size,

as the United States and South Korea are the world’s largest and 11th-largest economies, respectively. In purely dollar terms, the KORUS FTA is the most significant trade deal for the United States in nearly 15 years. It is both the largest bilateral trade accord ever for South Korea and the largest such agreement ever for any country in Asia. When implemented, the KORUS FTA will effectively become the third-largest free trade area in the world—eclipsed only by the European Union and NAFTA.

South Korea is currently the seventh largest trading partner of the United States, with more than \$80 billion in two-way trade in goods in 2007. According to the U.S. Department of Commerce, this figure represents more than 64 percent of the total trade volume between the United States and all 11 partners with whom the United States has implemented FTAs since 2000. According to the U.S. International Trade Commission study, the FTA is likely to increase U.S. exports to Korea by an estimated \$9.7 to 10.9 billion and U.S. imports from Korea by \$6.4 to 6.9 billion.¹ More specifically, this agreement will provide U.S. exporters with access to 49 million consumers who earn a per capita income of roughly \$20,000 a year. Nearly 95 percent of bilateral trade in consumer and industrial products will become duty-free within three years of entry into force of the FTA. More than half—or \$1.6 billion—of current U.S. farm exports will become duty-free immediately.

The agreement includes unprecedented commitments by Korea on market access for services, including financial services and telecommunications. The FTA contains state-of-the-art rights and protections for investors, cutting-edge competition law provisions, and protections for intellectual property rights that go beyond those contained in any previous U.S. free

1. Nannette Christ et al., *U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects*, Investigation no. TA-2104-24, USITC publication no. 3949 (Washington, D.C.: United States International Trade Commission, September 2007), www.usitc.gov/publications/pub3949.pdf.

trade agreement. It includes labor and environmental safeguards that are stronger than have been included in previous U.S. FTAs.

The agreement contains strong and unprecedented provisions that level the playing field for U.S. automakers in a market in which it has been especially difficult for them to compete. In addition to other provisions, the agreement:

- Eliminates immediately Korea's 8 percent tariff on U.S. vehicles;
- Eliminates discriminatory aspects of Korean auto taxes on the basis of engine size that disproportionately affect U.S. autos, and ensures that Korea will not impose any new engine displacement taxes;
- Ensures that Korea will not adopt technical regulations that create unnecessary barriers to trade and will cooperate with the United States to harmonize standards;
- Creates an autos-specific expedited dispute settlement mechanism, under which the U.S. tariffs on Korean cars—about \$220 million in 2006—will snap back into place if Korea violates the FTA's auto provisions or if expected FTA benefits are nullified or impaired; and
- Establishes an autos-specific working group to review and discuss potential new Korean regulations affecting U.S. auto manufacturers and to address future regulatory issues in Korea that may arise.

For those who might question the tangible economic benefits of establishing free trade, one need look no farther than the previously ratified U.S. agreements. The U.S. trade surplus with Singapore tripled the first year after the implementation of the U.S.-Singapore FTA, while U.S. exports to Singapore rose by more than \$8 billion. With implementation of the U.S.-Chile trade accord in 2004, the United States saw its exports rise by 150 percent in 2006, and the United States became Chile's largest trading partner. Within two years of the U.S.-Australia FTA's going into effect, the U.S. trade surplus with Australia grew to \$9.6 billion. Given the historically high level of protection Korea affords its agricultural sector, as well as the range of nontariff barriers currently facing the agriculture,

manufacture, and service industries, leveling the playing field through ratification of the KORUS FTA may have an even greater impact on U.S. companies than was witnessed with the trade arrangements with Singapore, Chile, Australia, and elsewhere.

For South Korea, the FTA provides a unique set of benefits, beginning with unparalleled access to the world's largest economy. This will give Korean companies an important advantage over their competitors, especially significant considering Korean companies face the unique challenge of being situated between Japan's advanced technology and China's cheaper labor. Nonetheless, what may prove even more consequential for South Korea is that the KORUS FTA should act as a catalyst for ongoing efforts to reform its economy and promote its overall global competitiveness. South Korea has become one of the world's great economic success stories, achieving prosperity in a matter of decades through commitment to market principles and active engagement in the global economy. Moving forward, Korean officials have established the goal of becoming East Asia's international economic hub, while the incoming president, Lee Myung-bak, has set a goal of implementing reforms that will double per capita income to \$40,000. The KORUS FTA will encourage Korea to take the difficult but necessary steps to ensure the institutional framework of its economy is compatible with these objectives.

Strengthening the Alliance

While the KORUS FTA is an economic win-win for the United States and South Korea, the foreign policy implications of this deal are equally compelling. The durability of the U.S.-Korea alliance over the decades, our common objectives in promoting peace and prosperity on the Korean peninsula and throughout the world, and the deep commitment of the United States to East Asia's continued development all make the KORUS FTA a strategic imperative.

South Korea has been a steadfast ally of the United States for more than 50 years. Since the signing of the Mutual Defense Treaty in 1954 and continuing through times of both peace and war, our military alliance has existed as the bedrock of this bilateral relationship. Today more than 28,000 U.S. troops are stationed in South Korea, almost equal to the number of U.S. soldiers killed during the Korean War. Koreans have

not forgotten that sacrifice, and South Korean troops have stood side by side with their U.S. counterparts in almost every significant military operation since the Korean War, including in Vietnam, Lebanon, and Afghanistan. Korea is also the third-largest contributor of troops to the coalition forces in Iraq.

For the United States, a strong political alliance accompanying these military ties is critical, especially considering ongoing challenges posed by North Korea. To this end, the United States and South Korea are coordinating closely through the six-party talks to confront the issue of North Korea's nuclear program. As we move forward in this process, it will become increasingly important to go beyond the goal of denuclearizing the peninsula and focus efforts on establishing a peace regime and creating stronger multilateral arrangements for problem solving in the region. In this regard, South Korean and U.S. interests remain very much aligned.

Our bilateral relationship has grown to encompass far more than just this military and political partnership. In a December 2007 speech, General B. B. Bell, commander of the U.S. Forces Korea and Korea-U.S. Combined Forces Command, stated that "our Alliance is strong and . . . growing stronger. I am a strong advocate that both countries, the Republic of Korea and the United States, stand on the threshold of a lasting partnership based not just on the North Korean threat, but also based on mutual security, economic, cultural, and trade interests that should forever bind us together." In the area of education, Korean students now represent one of the largest foreign student populations in the United States, and the incoming Korean president, Lee Myung-bak, recently announced that bringing thousands of new teachers of English to Korea, many from the United States, will be a top priority for his administration.

Implementation of the KORUS FTA will ensure that our bilateral economic ties continue to expand in conjunction with our broadening cultural, political, and military ties, enabling the alliance to thrive as a vital force for stability during a period of great change in Asia. The agreement will demonstrate to Korean and U.S. citizens, and to the world, that the United States and South Korea are committed not only to maintaining our alliance but to expanding and modernizing it, demonstrating that our countries and citizens are

bound by shared interests and values. Addressing members of the U.S. Congress last year, Christopher R. Hill, assistant secretary of state for East Asian and Pacific Affairs, noted that the KORUS FTA will "serve as a pillar for the alliance in the twenty-first century as the Mutual Defense Treaty did during the last half century."

Regional Benefits...

The impact of the KORUS FTA reaches well beyond our bilateral relationship with South Korea. Implementing the KORUS FTA—widely viewed as a "gold-standard" agreement—could serve as a successful template for other trade agreements in Northeast Asia. Furthermore, by ensuring preferential access to the Korean economy, the KORUS FTA will help to ensure that the United States maintains a solid commercial footprint in Asia at a time when others have demonstrated eagerness to replace the United States as the preeminent economic power in the region.

Advancing reform in Korea benefits both U.S. and Korean businesses and workers and offers a model for other Asian economies to emulate, chiefly by creating a powerful incentive for others to open their markets to the United States via similar trade arrangements. The KORUS FTA is an especially important tool for increasing trade liberalization in Asia in a manner that ensures that the United States and U.S. firms keep our "seats at the table" at a time when our competitors are actively seeking to lock East Asia's fast-growing economies into relationships that often exclude the United States.

We are already seeing a change in the economic rhetoric of Korea's neighbors, including Japan, as these countries recognize that once the KORUS FTA is implemented they will also need to lower tariffs, increase transparency, and create more hospitable environments for foreign investment to maintain high levels of access to the world's largest economy and compete effectively in the global marketplace. Ratification of this agreement will help to ensure that U.S. engagement with the world's fastest-growing region supports our fundamental security interests.

Although nobody would advocate the KORUS FTA as a panacea for U.S. challenges in Asia, it is important to stress that the manner in which we engage South

Korea will have a tremendous ripple effect throughout the region. Ratification of the KORUS FTA will show our commitment to a valued partner. It will create an incentive for other countries to follow Korea's lead and make similarly difficult—although ultimately beneficial—choices as Korea did in concluding this deal.

...And the Cost of Not Ratifying

Abandoning the KORUS FTA would likewise be viewed as a broader abandonment of Asia. It would create the perception of a downgraded relationship with our South Korean allies and enable our competitors to expand their engagement with South Korea at the expense of U.S. companies. More broadly, if the United States lacks the necessary political will to implement agreements with major emerging-market economies like South Korea, the inevitable and unfortunate consequence will be a shifting of the region's attention away from strengthening ties with the United States to doing deals with other major trading partners.

Failure to ratify the FTA would also have a lasting and damaging impact on U.S. relations with Korea. The Korean public would note that the KORUS FTA was the first FTA that the United States had signed but did not approve—and would question the depth of U.S. commitment to a bilateral partnership. The impact on Korea's leadership would be equally negative. Negotiation of the KORUS FTA was initially very controversial within Korea, and it was accompanied by massive Korean protests that lasted throughout the course of the negotiations. Despite this public pressure, the Korean government persevered, confident that the final agreement was the right thing for Korea and for the U.S.-Korea alliance. This was a politically risky, and courageous, road to take. If the United States were to fail to ratify the FTA, it would not just send a sobering message to Korean leaders about the wisdom of taking risks for the sake of the U.S.-Korea alliance, but it would also be particularly problematic at this critical moment in our countries' efforts to address challenges to security and stability on the Korean peninsula. While polls show strong Korean support for the U.S.-Korea alliance, there are always some arguing for closer ties with nearby powers, and those voices would be strengthened by the failure of the United States to ratify the KORUS FTA.

Without the KORUS FTA in place, U.S. industry would also suffer. If U.S. companies fail to gain preferential access to Korea's markets, U.S. competitors in Europe and Asia will secure their own preferential trade deals with the South Koreans. The ROK is currently negotiating an FTA with the European Union (which based many of its strategies on its knowledge of the U.S. negotiating playbook) and is looking at restarting trade talks with Japan and negotiating deals with other partners in Asia and Latin America. The KORUS FTA is needed to counter the disadvantage that U.S. exporters and investors would face if global economic integration continues with us on the sidelines.

The third issue is one of credibility. Failing to ratify the KORUS FTA would reinforce the broader view that the United States lacks commitment to Asia, and other Asian economies would see little reason to negotiate similar trade deals with the United States in the future. With trends in Asia pointing to rising pan-Asian economic integration, the relative position of the United States in East Asia is increasingly being challenged. Whereas implementation of the KORUS FTA will allow U.S. firms to participate in and benefit from this expanding regional trade, failure to pass the agreement will have the opposite effect. The United States must continue to compete with all of its major trading partners, each of which is working to enhance its competitive position in the region.

Conclusions

With the FTA currently awaiting approval in the legislatures of both the United States and the Republic of Korea, the task will increasingly fall on the KORUS FTA's advocates and beneficiaries to join the debate and ensure that policymakers take a far-sighted approach to this agreement, looking beyond election-year political constraints and liabilities to the long-term economic and strategic interests of the United States. In a statement in May 2007, U.S. Secretary of State Condoleezza Rice summarized that the KORUS FTA represents "an opportunity for the U.S. to anchor trans-Pacific visions for the 21st century," appropriately framing the FTA as far more than a bilateral economic arrangement. It was negotiated as an economic trade agreement of historic size and significance. Equally important, the KORUS FTA represents an unprecedented opportunity for the United States to strengthen ties with a valued ally and ensure that the United States

continues to be an effective advocate for security and prosperity in Asia.

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