

Joint U.S.-Korea Academic Studies

**NAVIGATING
TURBULENCE**

IN NORTHEAST ASIA:

**THE FUTURE OF THE
U.S.-ROK ALLIANCE**



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WHITHER THE KORUS FTA? THE MOMENT OF TRUTH

*Choi Byung-il**

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I. Introduction

Two years and nine months have passed since Korea and the United States put their signatures on the Korea-U.S. Free Trade Agreement (KORUS FTA). Neither Korea nor the United States has yet ratified the agreement. Nonetheless, the countries' trajectories leading to the present have been significantly different. In spite of political opposition and fierce protest, the Korean governing party has been taking painful steps toward ratification in the National Assembly. Through thunder and storm, the ratification bill cleared the first hurdle of the Committee of Foreign Affairs, Trade, and Reunification in December 2008. No such comparable effort has even begun in the United States.

The nature of the majority of the governing party in the National Assembly means that ratification in Korea is not a matter of whether, but of when. The fate of the KORUS FTA in the United States is less and less debated in political circles, thereby causing suspicion about the U.S. commitment to free trade. Delayed ratification in Washington was not entirely unpredictable when the KORUS FTA was entered into agreement in June 2007. The House of Representative of the U.S. Congress was then controlled by the Democrats, who were openly critical of the Bush administration's drive for an FTA. However, few would have predicted this much prolonged delay and inaction.

In 2008, while the Democratic Party's presidential candidates in the United States were busy bashing the KORUS FTA as unfair, the newly elected Korean president was trying to carry out the former Korean president's commitment to the unrestricted import of the U.S. beef, as he placed the highest priority in global affairs on the Korea-U.S. alliance. As it turns out, political naiveté and Internet politics almost blew away his presidency in his very first year.

Now with a Democratic president in the White House and Congress dominated by the Democratic Party, free and open trade has taken a back seat. President Barack Obama's track record in keeping the U.S. commitment to free trade has been disappointing. He succumbed to pressure from labor unions and sided with them at the expense of Mexican trucking services and Chinese tires. Even though Obama and his staff do not continue to assail the KORUS FTA as unfair, as they did during the election campaign, it is equally true that they do not seem to have any clue how to move the KORUS FTA forward. And it is not just the KORUS FTA but two other FTAs—one with Panama and the other with Columbia—concluded by the Bush administration as well as the Doha Round of multilateral trade negotiations launched in November 2001 for which the Obama administration has failed to develop a strategic plan to move

forward. In Washington, it is no longer a secret that the U.S. initiative of free and open trade, which helped to create and maintain the global trading system, is an endangered species.¹

Although U.S. domestic politics is embroiled in other important domestic business such as health care reform, climate change, and Afghanistan, Korea has been vigorously pursuing FTAs. During the unfolding global economic crisis, this Korean drive is all the more remarkable. In July 2009, Korea struck a deal with the European Union (EU) to create an FTA between Korea and 27 members of the EU. Korea also concluded an FTA with India, and it became effective. Korea's negotiations with Australia and New Zealand are also moving along. These developments imply that delayed ratification of the KORUS FTA is most costly. Nonetheless, U.S. politicians seem oblivious to this.

II. Why Renegotiation Is Such a Flawed Idea²

The major opposition to the KORUS FTA comes from the United Auto Workers (UAW) and some U.S. automobile manufacturers. They argue that the KORUS FTA will not be effective in improving their access to the Korean market. It is noteworthy that they have taken this position prior to the beginning of the negotiations and continue to repeat the same argument even after they have seen the agreed outcome (Choi and Choi 2008).

A closer analysis of the KORUS FTA reveals that the auto chapter in the agreement is fairly well balanced and tried to answer all the U.S. concerns about market access to Korea. Korea has agreed to an immediate elimination of the 8 percent tariff on automobile imports. The United States, in contrast, will eliminate the 2.5 percent tariff on automobile imports immediately for small to mid-sized cars with engines smaller than 3000 cc only, and eliminate the tariff in three years for the rest. The 25 percent tariff on pickups will be eliminated over a period of 10 years. Furthermore, at the insistence of the United States, a special dispute resolution procedure was included in the FTA—speedy resolution of disputes and reinstating the 2.5 percent U.S. tariff on passenger cars for all vehicles imported from Korea in the event Korea might fail to implement its auto-related FTA obligations. The Korean government has also agreed to streamline its domestic taxation system on automobiles.

Since the Democratic Party won the White House and gained control of the Congress after the 2008 election, there has been rampant speculation that the

¹ Barfield and Levy (2009) are critical of this sorry state of free and open trade in Washington.

² Renegotiation means reopening the agreed-upon text with the aim of revising it.

United States might seek renegotiation of the KORUS FTA in order to take care of opposition from the auto-related sector. After every effort was made to address U.S. concern about formal and informal barriers in the automobile trade, it is unreasonable for the United States to reopen the agreement for renegotiation.

There are several more reasons why renegotiating the KORUS FTA is a flawed idea.³

First, the perception that the automobile trade between Korea and the United States is “unfair” is far from the market reality. The U.S. trade deficit against Korea in the automobile industry is not the result of the Korean government discriminating against U.S. imports; instead, it is due to the lack of U.S. competitiveness. Thanks to the vast domestic market, the Big Three from Detroit have not paid much attention to the market dynamics of foreign markets, which has led to the growing U.S. deficit in automobile trade worldwide, with foreign consumers preferring German or Japanese imports.

Sales of imported vehicles in Korea have grown dramatically in recent years. The driving force behind this growth has been the surge of imports from Germany and Japan. German auto imports increased 9-fold between 2000 and 2007, and Japanese auto imports increased 18-fold. During that same period, U.S. imports also increased by a factor of five, but this growth is less stellar when compared with the performance of autos from Germany and Japan. The disappointing performance of the Big Three can be attributed to the Big Three themselves for failing to compete with other foreign imports; it is not due to the Korean market being closed to imports.

Populist politics continue to paint the Korean market as an impenetrable fortress against U.S. cars.⁴ If Detroit were to pick a fight with anyone, it should have been Europe or Japan, whose imports have long been squeezing the Big Three in the U.S. market. Targeting Korea is a glaring example of a scapegoat driven by local politics.

With the benefit of hindsight, we can see that Detroit was in bad shape even before the KORUS FTA talks. Management failed to come up with fuel-efficient vehicles, labor unions fought to maintain salaries and pensions in excess of workers’ productivity, and politicians currying favor for votes helped keep the

³ The four main arguments against renegotiation of the KORUS FTA draw on Choi (2009).

⁴ The market share of imported autos in Korea was below 1 percent in the 1990s, when U.S. politicians complained about the closedness of the Korean market. As of 2009 imported autos account for 7 percent of the Korean market. Choi (2009) offers an in-depth analysis of the Korean market.

inefficient and unproductive automobile industry afloat past its prime. It is easier to blame trading partners for being unfair than it is to admit that the reason for trouble lies at home.

The trade imbalance in autos between Korea and the United States does not represent the protectionism of Korea but, rather, illustrates the failure of U.S. automobile manufacturers to compete in the global market. To pick at the auto provisions of the FTA and demand renegotiation would delude the U.S. public into believing that U.S. car sales can be improved by changing agreement texts instead of by changing company management.

Second, demanding to renegotiate a certain section of an FTA that has already been concluded and signed is to ignore the principle of good faith in international negotiations. Renegotiation of one section of the FTA would upset the careful balance that has been struck through a long series of negotiations. In its essence, an FTA puts the trade of all goods and services on the table and aims to remove barriers through trade-offs between the various sectors. These trade-offs are made on the basis of considerations of the comparative advantage and political sensitivities of each side. Negotiations can be concluded when both parties perceive the trade-offs to have reached a balance in interests. Thus, a concluded and signed treaty implies that both parties have made the political decision to accept the results of the negotiations. The KORUS FTA was the result of such a process. A unilateral demand for renegotiations based on the dissatisfaction of one sector is simply improper and unfair.

Third, the KORUS FTA negotiations were carried out under the Trade Promotion Authority (TPA) of the United States. TPA is a promise between the U.S. executive and legislative branches that any trade agreement signed by the U.S. government before June 30, 2007, would be put to an up-or-down vote on the treaty text as is, without allowing any amendments to be made by Congress. This was the assumption under which the U.S. and Korean governments carried out the negotiations. If a member of Congress is not happy with the auto chapter in the KORUS FTA, that member is free to vote against the ratification. If the member of Congress decides that the KORUS FTA in its entirety is acceptable, despite alleged problems in the auto chapter, then the member may vote for the ratification. Demanding renegotiation of one section of the agreement is a breach of the assumption upon which the negotiations had been based.

Renegotiating the automobile provision is a flawed idea in terms of economics, the international code of conduct, and consequences to future negotiations. If the United States were to ask for a renegotiation in the automobile sector, it would

open a Pandora's box. Korea would be brought to demand concessions in other sectors in order to maintain an equitable balance. During the course of this process, it is highly likely that the debate will spill beyond the strict boundaries of technicalities of trade negotiations and fuel broader conflicts in Korean society. Political instability in Korea may do harm to the Korea-U.S. alliance. Korea and the United States should refrain from renegotiating the agreed-upon text. Instead, they should look for a mutually acceptable course of action because saving the KORUS FTA is in the interests of Korea and the United States.

III. Costs of Delay

Economic Costs

As a country that relies on trade for approximately 90 percent of its gross domestic product, Korea is in constant need to upgrade terms and conditions of market access to foreign countries. As the Korean products lose their price competitiveness in the global marketplace because of the fast rise in Korean workers' wage rates and intensified competition from emerging economies, Korea's market share in the United States has undergone a steady and slow decrease. U.S. products have also experienced this trend of decreasing market share in the Korean market. The KORUS FTA is a strategy to overturn this trend.

Korea is in need of attracting high-quality foreign investment. The bilateral investment treaty (BIT) initiatives of the Kim Dae-jung government in the wake of the 1997 Asian financial crisis composed a strategy to enhance Korea's national credibility in the international community. There has been steady inflow of U.S. investment into Korea. Service industries proved to be major business opportunities to the United States: the United States increased its investments in textiles, chemicals, pharmaceuticals, transportation equipment, foods and lodging, real estate and leasing, electricity, gas, water, construction, and, in particular, the financial services industry. Since 2005, the total U.S. investment to Korea and the percentage of U.S. foreign direct investment compared with Korea's total inward foreign direct investment have exhibited a slow decrease. The KORUS FTA may turn this trend around. In the KORUS FTA, the Korean government committed to reduce investment barriers in legal services, accounting services, and communications services and put in place more expeditious investment-related dispute settlement procedures.

As the ratification of the KORUS FTA is dragging on, two kinds of economic risks have emerged. First is the risk of trade creation loss. Because of the delay, benefits of preferential market access for goods, services, and investment are not

materializing. All these benefits are just on paper. The economic opportunities of both Korea and the United States are being hurt.⁵

Second is the risk of trade diversion. Since the KORUS FTA was signed in June 2007, Korea has entered into a series of high-profile FTAs with large trading partners. The biggest one is the FTA with the EU, which was struck in July 2009 and is in the process of getting ratified with a goal of becoming effective in the later part of 2010. Korea's FTAs with India and with the 10 members of ASEAN are also noteworthy. The Korea-EU FTA poses a serious and substantial threat to the commercial interests of the United States, including automobiles, legal services, and accounting services.

The U.S. side also needs to pay attention to ongoing FTA talks between Korea and Australia as well as Korea and New Zealand. If the ratification of the KORUS FTA is delayed beyond 2010, these countries, which have agricultural products in competition with U.S. agricultural products in the Korean market, may catch up with the KORUS FTA.

From the standpoint of the United States, Korea's FTAs with these economies imply the increasing likelihood of trade moving away from U.S. products, services, and investment. This is likely to be severe and to the disadvantage of the U.S. side because the delay is getting longer.

In a nutshell, the delayed ratification of the KORUS FTA is bad news for both Korea and the United States, causing substantial economic costs. It is more costly in these turbulent times of the global recession. Between Korea and the United States, the negative effect resonates more severely on the U.S. side because of Korea's vigorous FTA initiatives with the EU, India, and ASEAN.

Political Costs

Korea has paid dearly to negotiate the KORUS FTA. When Korea decided to launch Korea-U.S. talks in early 2006, the decision-making process was kept in the dark so that only a few in the administration were informed of the president's decision. Such secrecy was political because President Roh Moo-hyun was keenly aware of the political ramifications of the KORUS FTA for his power base, which consisted of left-leaning members of civil society, farmers, and labor unions. In Roh's effort to bring the reluctant United States to the negotiating table, he made concessions in some important areas such as resuming U.S. beef imports (albeit under some restricted conditions) and reducing the screen

⁵ USITC (2007) assesses the economic effects of the KORUS FTA on the basis of the agreed text.

quota (which broke down the Korea-U.S. BIT talks that had been initiated by his predecessor, Kim Dae-jung).

President Roh's hunch was confirmed before long. Korean left-wing groups forged a grand coalition and campaigned against the KORUS FTA throughout the whole negotiation process. They organized a massive, sometimes violent, rally where the negotiations were taking place. They claimed that the KORUS FTA would pave a road to serfdom to U.S. imperialism and the brutal forces of financial capitalism.⁶ Their influence was visible in the Korean media's coverage of the KORUS FTA. Throughout the whole negotiation process, the entire country was sharply divided. To counter this negative and often unfair perception and dispel misinformation spread systematically by the opposition group, the Korean president and his administration had to allocate a tremendous amount of economic and political resources.

Even when the talks were concluded in April 2007, the United States requested another round of additional talks simply because of its domestic logjam in trade politics.⁷ This new trade policy accommodated the concerns of the Democratic Party on the consequences of trade in labor and the environment. These concerns are targeted to the Latin American countries, not Korea. Nonetheless, U.S. negotiators asked that the same template be added to the agreed text of the FTA between Korea and the United States. Hence, the Korean side had to sit down again at the bargaining table with the United States in order to save the KORUS FTA.

In the process leading to ratification, the Korean side had to pay more political costs. The U.S. Congress pressed the Korean side hard, claiming that ratification would not be obtained without full imports of U.S. beef to Korea. Korean trade officials were accepting the argument that "resolving the beef dispute is imperative for obtaining ratification in the United States." President Roh, who had verbally committed to the full import of U.S. beef, did not implement his pledge before he left office. Responsibility fell squarely on the shoulders of incoming President Lee. And the world witnessed months of Korean citizens holding candlelight vigils protesting against the decision to fully import U.S. beef.

6 Such a grand public campaign against the KORUS FTA is not so much against market opening but is a manifestation of anti-Americanism, as analyzed in detail by Choi (2010). No active campaigns such as this was seen in the case of Korea-EU FTA.

7 The United States produced its so-called new trade policy in May 2007. This was a compromise between the Bush administration and the Democratic Party, which controlled the House of Representatives.

Because of all the political assets expended for the KORUS FTA by the Korean side, the delayed ratification of the KORUS FTA simply because of U.S. domestic politics runs the risk of backfiring in Korea. When the U.S. presidential election in 2008 turned to the KORUS FTA and leading Democratic Party candidates assailed it for its alleged unfairness in automobile trade, anti-KORUS FTA groups and politicians in Korea welcomed the U.S. development. They took it as a golden opportunity to up the ante against the new Korean administration and regain the political ground they had lost in their landslide defeat in the Korean presidential election in December 2007 and the National Assembly election in April 2008.

Any U.S. attempt to renegotiate the KORUS FTA would disrupt the Korean political landscape, causing additional schisms that will dry up the political assets of the Korean government. Even though eventually the United States may decide not to renegotiate, while the delay is getting longer it will cause political difficulties on the Korean side.

The current Korean administration attaches the utmost priority to the Korea-U.S. alliance in its global strategy for peace and stability. The KORUS FTA is considered to be a cornerstone of this alliance: commitment to free and open trade, a market economy, and the rule of law. As the delay is becoming longer, the Korean side may become more and more doubtful about the U.S. ability to deliver on its international commitment. For all these reasons, the political costs of delay for the U.S. side could become considerable.

Strategic Costs

Korea, located at the end of the peninsula of the Asian continent, has as its destiny to confront forces from both land and ocean. For Korea—a relatively small country compared with China, Japan, Russia, and the United States—to survive, Korea needs a strategy that can utilize the competition among those neighboring countries to its advantage. Mindful of its geopolitical location, Korea developed a blueprint of increasing its economic ties with major economies and took on the role of a global hub for FTAs. In this big picture, the EU, China, Japan, and the United States were ultimate FTA partners. The biggest obstacle to achieving this goal was market opening in the agriculture sector. Without a strategy for addressing farmers' protests and a well-thought-out plan for dealing with structural weakness in the Korean agricultural sector, any meaningful FTA with any of these major economies would be inconceivable.

From the U.S. perspective, the KORUS FTA offers a golden opportunity to reclaim its commitment to Northeast Asia after a decade of declining influence. The Korea-U.S. alliance has been undergoing tumultuous times during the most recent decade. During the time span of a decade, China has overtaken the status of the United States and emerged as the largest trade and investment partner of Korea. A left-leaning government, elected on the wave of anti-American sentiment, sought a lesser U.S. military presence in Korea. As North Korea went down the path to nuclearization, China's leverage in Northeast Asia increased greatly because of its close economic and military relations with North Korea. This development was not welcomed by the United States, which considered China a potential competitor and ultimate threat. The United States worried that, if this trend went unchecked, the political gravity could shift from the United States to China.

For the United States, the KORUS FTA is a golden opportunity to overturn this trend and reclaim the U.S. commitment in Northeast Asia. During the eight years of the George W. Bush administration, the United States completed three FTAs with Asian countries: Singapore, Australia, and Korea. The United States delivered two FTAs. If the United States fails to deliver its FTA with Korea within a reasonable period of time, it will send the wrong signal to its partners.

For Korea, the KORUS FTA will play the role of slowing down Korea's rapid integration with China in trade and investment. The KORUS FTA will enhance Korea's negotiating leverage in Northeast Asia and the international arena. Three examples substantiate this argument:

Example 1: The EU, traditionally lukewarm about an FTA outside EU territory, approached Korea for an FTA because of its concern about trade diversion as the KORUS FTA became an increasing possibility.

Example 2: Immediately after the conclusion of the KORUS FTA, top Chinese political leaders expressed a strong interest in pursuing an FTA with Korea.

Example 3: Japan is concerned that its exports to Korea may be substantially replaced by U.S. products and services because of the KORUS FTA. To minimize the negative effect, Japanese business leaders and politicians are voicing their demand for resuming the Korea-Japan FTA talks, which have been suspended since November 2004.

As the ratification process of the KORUS FTA continues to be delayed, China's interest and sense of urgency in creating an FTA with Korea are decreasing.

Delayed ratification also means a setback for Korea's global FTA strategy. If delay is prolonged beyond 2010, it may create a situation where Korea may have to reassess its global FTA strategy. In the new picture, the United States may not occupy, at least economically, the center stage as it does in Korea's current global FTA strategy.

IV. How to Save the KORUS FTA

The cost of delaying the KORUS FTA is severe in economic, political, and strategic terms. The longer the delay becomes, the higher the cost to both Korea and the United States. Korea and the United States share an interest in the eventual ratification of the KORUS FTA, yet stumbling blocks exist on the path to ratification.

Although the Obama administration places a high value on the KORUS FTA in terms of its enormous economic opportunities, the strengthening of the Korea-U.S. alliance, and improving the leverage of the United States in Northeast Asia, the FTA is unlikely to move forward without addressing the concerns about automobiles. The Korean government, however, has made it clear that it will not renegotiate the auto provisions of the KORUS FTA. It does not want to reopen the KORUS FTA because it believes the current agreement reflects a well-balanced interest between the two countries.

Ratification of an international treaty is dominated by domestic politics: delay is just a reflection of political stalemate. Precisely because of this, political leadership is a dire necessity on the U.S. side. Prolonged delay beyond a reasonable period of patience—such as a delay into 2011 after the U.S. midterm elections—will send a signal to the global community that the United States has dismally failed to deliver on its promise with an important strategic ally in a geopolitically unstable region. Drift without sense of direction is not an option.

How can the KORUS FTA be saved?⁸

Because it is in the interest of both Korea and the United States to ratify the KORUS FTA within a reasonably early time frame, both governments need to develop a common strategic blueprint, share it, and implement it.

The first step in this blueprint is sequencing. In light of domestic politics, Korea can ratify the KORUS FTA ahead of the United States, and Korea should go ahead and do this. There are three positive effects that Korea may bring about

⁸ The argument below for this question draws on Choi (2009).

by ratifying first. First, such an action shows Korea's willingness to put into action an idea accepted around the world that protectionism is not the solution to the global recession. Second, the Korean government can focus on other pressing issues by declaring an end to the domestic KORUS FTA debate. Third, by ratifying ahead of the United States, Korea throws the ball into the U.S. court, telling U.S. politicians to take it or leave it in its entirety pursuant to the U.S. fast-track procedure. Once ratified in Korea, re-ratification of the KORUS FTA in the eventuality of renegotiation is tantamount to political suicide.⁹

If Korea does not strategically utilize the opportunity to ratify first when it can, U.S. politicians will take this as Korea's willingness to renegotiate the existing agreement as a remedy to the complaints of the automobile industry. In this sense, Korea might be digging its own grave and lead the United States to request renegotiation. If the United States requests renegotiation, Korea, to balance the negotiation, would have no choice but to bring other issues to the table as well. In deciding which subjects to reopen, heated debate would be rekindled in Korean politics and would generate additional heated political frictions in Korea.

The second step is U.S. political leadership. The history of ratification of high-profile trade agreements in the United States shows that it has always been the administration, and the president himself, who has initiated the process and launched a massive public campaign for ratification. The North American Free Trade Agreement (NAFTA) ratification in 1993 is a prominent example (Mayer 1998). To counter the emotional opposition to NAFTA that claimed NAFTA would result in "a giant sucking sound," an expression implying a massive dislocation of jobs from the U.S. South to Mexico, President Bill Clinton and his staff reached out to the public, arguing that more well-paid jobs would be created. Clinton persuaded fence-sitting politicians, mostly from his own party, to vote in favor of NAFTA. Without presidential leadership, NAFTA ratification would have been lost. Granting permanent normal trading relations (PNTR, meaning most-favored-nation status) to China in 2000 is another example. Against strong opposition in the name of human rights, the U.S. administration launched a public campaign of embracing China for economic opportunities and engagement. Support of PNTR prevailed. Interestingly enough, these hotly contested votes

in the U.S. Congress took place when the president came from the Democratic Party. Something similar should be happening to the KORUS FTA.

⁹ Some may criticize that Korea's first move would remove its room for being flexible. Becoming inflexible is precisely the key. Otherwise, it would not have any strategic value, as any game-theorist would predict.

If Korea completes its ratification procedure ahead of the United States, Obama's job in persuading Congress would be a bit easier. He could point out to members of Congress that the United States will have to forgo renegotiation in light of Korean political sensitivity. The fact that Korea has concluded an FTA with the EU would also help Obama ask Congress to take the ratification of the KORUS FTA more seriously.¹⁰ Delay would mean ever-increasing costs, to the disadvantage of the U.S. side. Whether and when Obama rises to this challenge is a critical test of presidential leadership.

V. Conclusion

If the United States would like to address some complaints from the UAW and domestic auto manufacturers through the renegotiation of the agreed-upon text of the KORUS FTA or through another form of managed trade, it would be bad economics and short-sighted politics. Managed trade is not a way forward. If Korea and the United States have a common interest in advancing the KORUS FTA for ratification, both governments should map out a concerted strategic blueprint.

The world community has been patiently waiting for a decision from Washington regarding the pending FTAs and the Doha Round. If somehow the United States fails to ratify the KORUS FTA in 2010, there is a danger that the KORUS FTA could become increasingly irrelevant. This is mainly because the Korea-EU FTA is likely to go into effect in the second part of 2010. From the viewpoint of forging a strong alliance, such prolonged inaction cannot be a right course of action.

Although Seoul is making progress with various FTAs, the KORUS FTA is still at the core of Korea's vision of FTA networking. If, however, Korea continues to use the KORUS FTA as the cornerstone of its FTA networking, this policy could backfire because of the uncertain future in Washington of the KORUS FTA. The moment of truth for the KORUS FTA is approaching rapidly. Whither the KORUS FTA?

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¹⁰ On October 15, 2009, Korea and the EU initialed the Korea-EU FTA.

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