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KORUS FTA: CHALLENGES AND POLICY RECOMMENDATIONS FROM KOREA'S PERSPECTIVES

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Abstract

With the Korea-US FTA (KORUS FTA), Korea could expect a number of benefits which include the expansion of trade, the increase of welfare, and gaining of more secure access to the other's market, specifically, for Korean products towards the U.S. The KORUS FTA with liberalization of investment regimes and service trade would unleash higher efficiency and productivities, thus generating faster growth of the Korean economy. It would also give far-reaching economic and political implications to Korea-US relations as well as the regional geo-politics in East Asia.

Notwithstanding the potential benefits, there are multi-faceted challenges in making the KORUS FTA successful. The challenges will include how to address sensitive sectors and the domestic consensus building process in Korea; how to negotiate with the U.S., and how to address the complex American policy-making process; how a KORUS FTA could be designed to support the opening of North Korea and ease tensions on the Korean peninsula, while upholding the interests of the U.S. in Northeast Asia and East Asia in general; and how to coordinate the KORUS FTA with other regional integration processes in Northeast Asia and further in East Asia.

Five recommendations are suggested: 1) The KORUS FTA should be comprehensive and of high quality, and needs to be designed and negotiated taking into account economic, political and strategic perspectives; 2) A comprehensive TAA scheme should be crafted out to address vulnerable sectors in tandem with negotiations with the U.S. while seeking longer and flexible implementation period for those sectors; 3) A public relations campaign with accurate information needs to be strengthened in working together with business circles and the public in Korea, and at the same time in the U.S.; 4) Based on the study of the implications of the KORUS FTA on cooperation with neighboring countries in Northeast Asia as well as opening of North Korea, Korea should rearrange the regional cooperation strategy which includes the strategy towards North Korea; 5) The highest level of the political will should prevail throughout the negotiation and ratification processes.

1. Introduction

Korea-US economic cooperation has made remarkable achievements in the last five decades. In the 1960s and 70s, Korea achieved rapid economic growth boosted by the increase of export, and of course, the U.S. was the most important export market for Korea. As Korea's export to the U.S. dramatically expanded in the 1980s and 1990s, Korea experienced significant pressure from the U.S. to open its market coupled with anti-dumping measures against Korean products.

Since then, Korea and the U.S. have developed a more cooperative economic relationship. Nonetheless, both countries have current bilateral trade issues such as

Korea's policy on the import of the U.S. beef, automobiles, pharmaceuticals, IPRs, Tariff Barriers (TBs) and Non-tariff Barriers (NTBs) (for the U.S.); US rules on anti-dumping, countervailing duties and safeguards, visa waiver, mode-4 movement, TBs and NTBs (for Korea).

Last year bilateral trade between Korea and the U.S. reached more than USD 72 billion. Korea is the seventh largest U.S. goods trading partner and sixth largest agricultural export market. The U.S. is Korea's second largest trading partner. The investment of the U.S. in Korea (\$35 billion) accounts for more than 30% of its total aggregated foreign investment in Korea. In turn, Korea's total investment in the U.S. is \$18 billion, accounting for more than 20% of its total investment in foreign countries.

Against this backdrop, Korea and the United States announced the official launch of negotiations for a bilateral FTA on February 2, 2006. Considering the size of two-way trade and its ever-expanding trends, the Korea-U.S. FTA will be commercially significant and even beyond that it will provide enormous political and strategic value to both countries. This paper will touch upon Korea's FTA policy, potential benefits of a KORUS FTA, potential challenges, and conclude with policy recommendations.

2. Korea's FTA Policy and KORUS FTA

A. Korea's FTA Policy

As member of GATT/WTO, Korea has advocated the primacy of the multilateral approach in advancing freer trade. By the turn of the new Millennium, Korea adopted the policy of competitive liberalization employing all three avenues of liberalization such as unilateral, bilateral and multilateral liberalization. Korea has broadly pursued three principles in selecting partners and carrying out negotiations for an FTA: multi-track basis in terms of strategy; comprehensive high-level FTAs in terms of coverage as well as contents; and broadly supported FTAs in terms of process.

Based on the FTA roadmap formulated in September 2003, Korea has been pursuing FTAs actively with more than 20 countries. Korea has concluded FTAs with Chile, Singapore, and EFTA (six countries), and negotiations are under way with Canada, Mexico (SECA), and ASEAN (13 countries). In 2005, Korea announced the start of negotiations for an FTA with the U.S. in February and with India in March.

The most important motivation to change its position towards this policy was twofold; endogenous and exogenous motivations. Endogenous motivations include the evolution and structural change of the Korean industry (agriculture sector accounted for 4%, manufacturing 29% and service 55% of its GDP in 2004); preparation for the ageing society; and addressing the polarization through the employment and resources accruing from the increase of gross domestic products. Exogenous factors include addressing the opportunity cost of being excluded from the proliferation of FTAs; to enhance competitiveness through a proactive and open door policy, as Korea's competitiveness is squeezed between that of developed and developing countries.

During the last 10 years, Korea's share in the U.S. market has decreased from 3.3% to

2.6%, whereas China's share has grown from 6.1% to 14.6%. These figures led Korea to conclude that a new strategy was needed in our trade policy to regain our competitiveness in the U.S., as well as globally.

B. KORUS FTA: Korea-US FTA

Korea selected the U.S. as an FTA partner for several reasons. However, the most important one would be the enhanced access to the U.S. market, as the U.S. is the largest economy with an import market worth US \$1.7 trillion, which is larger than China, Japan, and ASEAN combined. If the market shares of Korean products in the U.S. increased by 1%, Korea's export to the U.S. would expand by 5.9% and the GDP would increase by 1.4%.

Although the economic effects would differ depending on scenarios of agreements, the outcome of several studies turned out generally positive. A KORUS FTA will result in trade expansion and welfare increase. A study report by KIEP projects that U.S. exports to Korea would rise by \$12.2 billion dollars and Korea's export to the U.S. by \$7.1 billion (15%), and that the Korean real GDP will increase by 1.99% and the employment rate will rise by 0.63%.

Another key economic benefit resulting from an FTA is gaining more secure access to the others market, particularly for Korea's products towards the U.S. The two countries would deal with the issues of trade remedies such as anti-dumping, countervailing duties, and safeguard measures in order to avoid unnecessary disruptive trade relations. In addition, FTAs play a role to give locked-in effects for domestic reforms. A KORUS FTA with a liberalized investment regime and service trade would unleash higher efficiency and productivities, generating faster growth for Korean economies.

Lastly, KORUS FTA will give far-reaching economic and political implications to Korea-U.S. relations as well as the regional geo-politics in East Asia. A Korea-U.S. FTA will further strengthen the bilateral security relations that have been solidly maintained for the last five decades. It will give trade diversion effects to neighboring counties and overall sub-regional cooperative schemes. Experience with other FTAs indicates a KORUS FTA would probably have a larger impact than the study suggests. An FTA in effect sends the message to the business communities of both countries that our Governments regard the other country as a preferred partner. This is bound to stimulate more activities that economic models can capture.

3. Challenges for KORUS FTA – Korea's Perspective

This section will discuss multi-faceted challenges for the success of the KORUS FTA from the Korean perspective. The challenges will include how to address sensitive sectors and the domestic consensus building process in Korea; how to negotiate with the U.S., and how to address the complex American policy-making process; how a KORUS FTA could be designed to support the opening of North Korea and ease tensions on the Korean peninsula, while upholding the interests of the U.S. in Northeast Asia and East Asia in general; and how to coordinate the KORUS FTA with other regional integration

processes in Northeast Asia and further in East Asia.

A. Sensitive sectors

Agriculture and Services Sectors

Challenge is how to devise viable Trade Adjustment Arrangements (TAA) mechanism to address sensitive issues and accommodate the concerns of the disadvantaged sectors, and how to negotiate with the U.S. in agreeing to flexible and longer implementation periods.

Each economy has import sensitive sectors. It is a daunting challenge to address the disadvantaged sectors in a way that ensure the FTA would enjoy majority support. For Korea, several sectors such as agriculture, certain manufacturing sectors and service sectors have been recognized as vulnerable to the liberalization. According to KITA (2004), Korea has import sensitive products from the U.S. with around 312 product categories such as electronics, chemicals, Agri/fishery goods, precision machines, plastics, iron and steel etc. The value of these products is around USD 8.2 billion.

Agriculture accounts for about 4% of Korea's GDP in 2004. Korea's average applied agricultural tariffs are around 50% with several tariff peaks, resulting in vulnerability to liberalization. Korea allows minimum market access (MMA) for rice with TRQ of 22,500 MT. A study by KREI (Korea Rural Economy Institute) on the effects of the KORUS FTA on the agriculture sector says that total agricultural production will decrease by almost 1 billion USD, while Korea's import of agricultural products will increase by 1.9 - 3.2 billion USD, and the employment within the agricultural sector will decrease by 70,000 to 140,000.

The service sector accounts for around 55% of Korea's GDP in 2004. According to KIEP's study, Korea is far behind the U.S. in terms of labor productivity in every sector except in the electricity/gas/water service. This inferiority negatively impacts Korea's manufacturing industry, which uses services as an intermediary to production. In terms of level of liberalization by modes, the level of liberalization of the U.S. is considerably high for all modes except for mode-2 where the level is equal for both countries. Service sectors, which include financial and legal services, have some vulnerability, but many of them were already open since the financial crisis in 1997.

Public support

Challenge is how to address the sensitive sectors and the concerns of the opposing groups, so that the KORUS FTA could be successfully negotiated and passed in the National Assembly with majority support.

We found that 68% of 510 trading companies have a positive position regarding the Korea-US FTA (KITA, 2004 survey). They support the FTA because they expect the increase of export to the US, price fall of imported goods from the US, and increase of FDI from the US. Another poll result showed that an overwhelming majority of Koreans

support the Korea-US FTA, although they remain silent.

On the other hand, it was reported that approximately 260 groups in Korea formed a coalition to oppose the KORUS FTA negotiation for a number of complex reasons. One of their arguments is that a KORUS FTA would devastate Korea's agriculture and service sectors. But, their arguments are often politically motivated or ill-grounded: Their assumptions are that the FTA would open all the markets at once; and that Korea has an inferior position at the negotiating table etc.

According to IFANS, there is a potential danger that opponents of the KORUS FTA may actually provoke the antagonism of disadvantaged groups to rekindle anti-American sentiments in Korea. In politico-security terms, the KORUS FTA would be misused to lead the confrontational discussions of 'industrial protection vs. acceptance of globalization'. Another factor to pay attention to is that Korea and the U.S. have their own political schedules such as elections in mind.

B. Negotiations with the U.S.

Producing a win-win situation

Challenge is how to produce a win-win situation by maximizing the Korean interests in the negotiations, while not undermining the fundamental interests of the U.S.

In view of the TPA of the 2002 Trade Act and from testimonies by the private sector at hearings, the U.S. would seek a WTO-consistent FTA covering substantially all sectors; enhanced access to the Korean market by removing tariffs, quotas and other barriers to trade; and Korea's commitments for transparency and predictable regulatory regimes. Further, a KORUS FTA would need to include the labor standards and environmental regulations, as they are essential for garnering bi-partisan U.S. congressional support for the FTA. In terms of sectors, the U.S. would be interested in agriculture, services, IPRs and manufacturing sectors such as automobile, pharmaceutical, telecommunication etc.

The average U.S. tariff rate is as low as 2.5%, but, in terms of tariff lines, more than 2,900 products are subject to tariff rates higher than 5% in the U.S. Of the high tariff products, 681 are subject to tariff rates between 10% and 20%, and 159 are subject to tariff rates higher than 20%. For example, the U.S. applies a weighted average tariff of 13.1 % to textile and apparels, which is higher than Korea's 9.3%. 540 products out of around 1,400 textile and apparels are subject to tariff rates that are higher than 10%.

In this sense, we have to defeat a misleading argument based on over-simplified comparison of the tariff rates in the two countries. Korea's average tariff rate is three times as high as that of the U.S., but the size of the U.S. market is 17 times as large as the Korean market, and 89% of the bilateral trade consists of manufacturing goods in which we have comparative advantage. It is also known that FTAs concluded by the U.S. have exceptions such as cabotage, sugar, dairy products etc.

Influencing the U.S. policy-making process

Challenge is how to influence efficiently on the complex and cumbersome policy-making process of the U.S. in favor of Korea, which includes the administrative and legislative branches and private sector organizations.

According to U.S. law, the Hill controls the entire process of a FTA negotiation. The TPA instructs the USTR to agree to a longer implementation period for import sensitive products, and at the same time not to negotiate rules on anti-dumping, countervailing duties and safeguards nor on visa issues. The office of the USTR carries out negotiations but final decision-making authority comes from the Hill.

Moreover, Democrats have taken a generally conservative position towards prior FTA bills and have requested stringent rules on labor and environmental standards for the FTAs. Bitter polarization between Republicans and Democrats in the U.S. House has undercut the political viability of trade agreements, as illustrated by the overwhelmingly partisan and two-vote margin by which the House approved CAFTA in July 2005.

C. Geopolitical consequences

Northeast Asia and East Asia

Challenge is how Korea could best coordinate with neighboring countries, in particular, such as China and Japan for successful sub regional and regional cooperation; how a KORUS FTA could be further developed in order to get the U.S. positively engaged in Northeast Asia and East Asia in regards to peace and stability in the region.

A KORUS FTA would provide more favorable circumstances for Korea's enhanced role in the evolution of sub regional cooperation in Northeast Asia and in East Asia. In terms of economic cooperation, a KORUS FTA would help Korea develop into a regional hub for financial services or IT sector. Considering that Korea supplies intermediate goods for Chinese export to the U.S., a KORUS FTA would facilitate trade diversion from China in favor of the U.S., and thus result in slowing down the rapid growth of Chinese export to the U.S. A KORUS FTA might also place more pressure on Japan to undertake favorable consideration as to the resumption of a Japan-US FTA or a Korea-Japan FTA negotiation.

Various modalities have been suggested as ways of integration in East Asia. Since the Malaysian PM Mahathir suggested the EAEC (East Asian Economic Caucus), the idea of East Asian integration has further evolved. In addition to various bilateral FTAs connecting Northeast Asia and Southeast Asia, the ASEAN+3 format has been developed into EAS (East Asia Summit), and Japan recently proposed East Asia EPA (Economic Partnership Agreement).

However, all these proposals exclude the participation of the U.S., which is engaged in cooperation with the East Asian countries only through APEC, ARF and bilateral FTAs. Moreover, the cooperation in Northeast Asia has shown complex due to surging nationalism in each country and potential rivalries between China and Japan. Under this

situation, a KORUS FTA would play an important role for strengthening U.S. engagements in East Asia in more systemic ways as well as for Korea's initiative for the subregional cooperation in Northeast Asia.

North Korea and GIZ

Challenge is whether and how KORUS FTA could be designed to support the opening of North Korea and ease tensions on the Korean peninsula, while upholding the interests of the U.S. in the Northeast Asia and in East Asia in general.

According to IFANS report (2006), the strengthened relations between Korea and the U.S. through the FTA will contribute to the reform and opening of North Korea and further to the peaceful management of the unification process on the Korean peninsula. South Korea has emerged as North Korea's second-most important economic partner after China. Inter-Korean trade has more than doubled since 2000, to just over US\$ 1 billion in 2005. In 2004, a pilot industrial zone in Gaesung (GIZ) opened for South Korean companies to establish factories using North Korean labor.

In 2006, there are plans to expand the GIZ site beyond the 15 companies currently in operation. In a bid to help North Korea become more open, Korea will try to secure preferential tariff treatment for GIZ-made goods in the KORUS FTA. Currently, the U.S. response is that the FTA should only cover products made in South Korea.

4. Policy Recommendations

Recommendation One

The KORUS FTA needs to be designed, negotiated and implemented from holistic perspectives comprising economic, political and strategic consideration. The FTA should be comprehensive and of high quality in terms of coverage and contents.

The KORUS FTA will render enormous opportunities for Korea to optimally allocate its production factors compatible with the international standards and to lay solid groundwork to realize a more efficient and competitive country. Further, it will serve as part of the essential framework that benefits and maintains the existing Korea-US alliance for the future. The KORUS FTA will also give implications on regional geopolitics in Northeast and East Asia.

The outcome of an FTA should be comprehensive and of high quality while striking a balance of interests between the two countries and producing the win-win situation. Upon the signing of the FTA, the agreement must be approved by the legislative branches of both nations. Unless the overall package achieves a balance of interests which considers the concerns of the two countries, it will be very difficult for either country to receive the necessary domestic approval.

Recommendation Two

A comprehensive TAA scheme should be crafted out to address vulnerable sectors in tandem with negotiations with the U.S. while seeking longer and a more flexible implementation period for these vulnerable sectors.

In order to address the concerns of the disadvantaged sectors through the liberalization, Korea may seek various flexibility measures including longer implementation period, special safeguards and TRQ, where appropriate. In regards to the agriculture sector, Korea plans to spend 119 billion US Dollars in supporting structural adjustments to rural areas to enhance their competitiveness. TAA schemes could also be devised and applied mutatis mutandis to manufacturing and service sectors. Together with this spending, a rigorous monitoring mechanism needs to also be in place to enhance the efficiency of the TAA scheme.

As illustrated above, the U.S. also has vulnerable and import-sensitive sectors or issues such as anti-dumping, countervailing duties (CVD) or safeguards. The negotiation with the U.S. to secure the flexibility mechanism could be handled in conjunction with such sensitive sectors of the U.S.

Recommendation Three

In Korea, a public relations campaign with precise information needs to be strengthened in working together with business circles and the public. An early start of the systematic outreach programme towards the Hill should be made, in an attempt to garner support from the U.S. Congress.

In order to counter opposition groups to a KORUS FTA, Korean governments and business circles should work together to articulate the benefits of the KORUS FTA, and to encourage citizens to break their silences and publicly endorse and support the KORUS FTA. The Korean government should continue to provide accurate information on the benefits, the potential immediate cost, and the progress of the negotiation in a transparent manner. Further, the Korean government should not surrender to any unwarranted claim or allegations made by biased groups which continuously distracts the attention of the public to their own favor. We should be mindful of the potential danger in the manipulation of the KORUS FTA as fueling anti-American sentiments, thus more efforts in communicating the shared visionary path for the Korea-US alliance among Koreans needs to be made. In this sense, Korea's early joining to the visa waiver programme (VWP) of the U.S. could also contribute to the support of the KORUS FTA.

Cognizant of the complex and cumbersome process of the U.S.'s decision making, Korea should deal with the USTR, relevant Ministries as well as the Hill. Considering that the Hill gives enormous influence on the entire process, an early start of the systematic outreach programme with the Hill is recommended.

Recommendation Four

Based on further study of the implications of the KORUS FTA on regional cooperation in Northeast Asia and East Asia, in both economic and political terms, Korea should

rearrange the regional cooperation strategy in the region, including the strategy towards the North Korea.

In terms of economic and trade perspective, the KORUS FTA would change the division of work structure among Korea, China and Japan vis-à-vis the American market. In this sense, the KORUS FTA would give enormous implications on political and economic relations between Korea-China; Korea-Japan; the US.-China; and the U.S.-Japan. Korea should study these implications and readjust the regional cooperation strategies.

The KORUS FTA would provide bridgeheads for the U.S. in participating in the cooperation in Northeast Asia and beyond. The FTA negotiations should address the thorny question on the rules of origin for GIZ-products. This would not be an issue that can be dealt with in isolation with the overall policy towards North Korea from the U.S.

Recommendation Five

The highest level of the political commitments should be prevailed from both sides throughout the negotiation and ratification process.

Since a FTA deals with sectors across the board, it is normal to expect that the benefits as well as the costs could be unevenly distributed. Without strong leadership by the highest authorities, the negotiating process would often be distracted or hampered by the intervention of interested groups. The limited timing of the negotiations is another motivation for the negotiators to be encouraged by their highest authorities for more intensive negotiations.

5. Concluding Remarks

The two countries are currently concentrating on preparatory works before the first negotiating session, scheduled for early June in Washington, begins. Given the complexity and size of the trading relations and the range of difficult questions to be addressed in the bilateral FTA, the negotiation is not at all an easy job. We expect some ups and downs and tough phases throughout the entire negotiation period. However, I am quite optimistic for the success of the negotiations since it is a win-win undertaking and the stakes for both sides are too big to fail. [The End]

Bio Data of Mr. Seok Young CHOI

Mr. Seok Young CHOI is Minister for Economic Affairs in the Korean Embassy at Washington D.C. since February 2006. He was born in Gangleung, Korea in 1955. He was educated at the Seoul National University (BA) in Korea, the University of Heidelberg in Germany, and the Korea Development Institute School of Public Policy and Management (MBA) in Korea.

After joining the Korean Foreign Ministry in 1979, he has served various diplomatic postings in Korean Embassies in Kenya, Germany and in Permanent Missions to the United Nations in New York and Geneva. He has been involved in multilateral

diplomacy, inter-alia, in the fields of trade, environment and economic affairs.

He possessed Chairmanships in various meetings. He was Vice President of the 8th UNCSD (Commission on Sustainable Development) for 1999-2000 and Chairman of Working Group on Finance, Trade, Investment and Economic Growth of the 8th UNCSD (1999-2000). In 2001, he served as adviser in economic and social fields to the President of the UN General Assembly. During 2002-2003, in his capacity as Deputy Director General of the multilateral trade bureau of the Korean Foreign Ministry and Trade, he served as Korea's Deputy Senior Official to APEC.

Mr. Choi served as Ambassador and Deputy Executive Director of the APEC Secretariat in Singapore for the 2004 APEC Year, and Ambassador and the 13th Executive Director of APEC Secretariat for the 2005 APEC Year.

He is an author of numerous articles. His most recent publications are “Revisiting the Open Regionalism of APEC” published by KIEP (Korea Institute for International Economic Policy) in September 2004; and “The outcome of APEC 2005 Korea and Challenges ahead” published by the Institute of Southeast Studies (ISEAS) in Singapore in December 2005.

He is married to Youngin Choi with one son and one daughter.
