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No. 1853
May 18, 2005



Published by The Heritage Foundation

Beyond the U.S.–South Korea Alliance: Reinvigorating Economic Relations

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Recently, increasing anxiety about the future of the U.S.–Republic of Korea alliance has raised concerns in both Washington and Seoul. Yet the two allies have more in common today than ever before in a relationship that has endured for more than 50 years. This includes shared values of open markets, free trade, respect for the rule of law, and democratic principles. With South Korea's development into one of East Asia's most vibrant market-oriented democracies, its economic relationship with the United States has steadily grown stronger, becoming one of the most important pillars supporting the alliance.

One of today's most prominent issues is the possibility of reaching a free trade agreement (FTA). Although the ongoing FTA review process will not automatically result in FTA negotiations, it will provide insights into the obstacles to bilateral trade and lay the foundation for a future trade agreement.¹

Washington and Seoul should seize this opportunity to examine thoroughly the range of trade issues that exist between the two countries and to develop solutions. Regardless of whether or not an FTA is determined to be feasible at this time, mutual acceptance and resolution of challenges in the trading relationship will lead to a more positive and productive future for the United States and Republic of Korea (ROK); therefore, the possibility of launching formal FTA negotiations should be vigorously pursued.

Talking Points

- With South Korea's development into one of East Asia's most vibrant market-oriented democracies, its economic relationship with the United States has steadily grown stronger, becoming one of the most important pillars supporting the alliance.
- Washington and Seoul should use the ongoing FTA review process to examine thoroughly the range of trade issues that exist between the two countries and to develop constructive solutions.
- Seeking an FTA will reinforce the alliance by establishing a positive venue for dialogue. The U.S. and South Korea should work together to elicit stronger and more concerted support from policymakers and the business communities in both countries.
- Regardless of whether or not an FTA is deemed feasible at this time, mutual acceptance and resolution of challenges in the trading relationship will lead to a more positive and productive future for the United States and South Korea.

This paper, in its entirety, can be found at:
www.heritage.org/research/asiaandthepacific/bg1853.cfm

Produced by the Asian Studies Center

Published by The Heritage Foundation
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Washington, DC 20002–4999
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The Current Status of U.S.–ROK Economic Relations

Since the inception of a mutual security treaty in 1953, the United States and South Korea have enjoyed a strong alliance that is considered one of the pillars of stability and security in Northeast Asia. While the alliance has provided the basis of a broad and mutually beneficial economic partnership for the past half-century, many Americans might be surprised to learn that Korea actually entered into the Treaty of Peace, Amity, Commerce and Navigation with the United States in 1882. This was Korea's first treaty with a Western power, and during this long and sometimes rocky relationship, the two allies have come together in cooperation when strategic interests have converged.²

The United States has played a critical role in the South Korean economy since the Korean War, but the bilateral economic relationship has steadily equalized in recent years, with bilateral trade expanding dramatically in the past 20 years. In 2004, total trade between the two countries exceeded \$70 billion, a 120 percent increase from 1990.³

South Korea has the world's 11th largest economy, and the United States is its second largest export market, accounting for nearly 20 percent of its total exports in 2004 (more than 6 percent of South Korea's GDP).⁴ Major exports to the United States include electrical and general machinery, cellular phones, textiles, and steel. In turn, South Korea is America's seventh largest export market,

importing such goods as semiconductors, machinery, aircraft, agricultural products, and beef. In 2003, South Korea was the United States' fifth largest market for agricultural products and third largest beef market.⁵

Bilateral trade in services has grown robustly as well. The United States is a major supplier of private services to the South Korean economy and ran a \$4 billion surplus in 2003.⁶ American companies have established a substantial presence in South Korea, with marked increases in foreign direct investment (FDI) in recent years. Over the past decade, American investments totaled nearly \$30 billion, with FDI from the U.S. reaching a new record of \$4.7 billion in 2004 alone—an astounding 280 percent increase from 2003. Today, more than 3,000 U.S. companies operate in South Korea.

Why an FTA with the ROK?

Enthusiasm for a U.S.–ROK FTA has grown steadily in recent years, particularly in South Korea, while American interest has been more cautious. In principle, the Bush Administration has been a strong proponent of bilateral trade agreements because they are an integral part of U.S. trade strategy to promote competitive liberalization, both at home and abroad.⁷

Comprehensive agreements benefit both partners by injecting new competition into their domestic economies, lowering consumer prices, and shifting factors of production to more efficient uses, leveling the playing field for exporters. While free trade is

1. The review process consists of a series of working-level meetings to evaluate the feasibility of a bilateral FTA. The review process is scheduled to conclude in June.
2. During the Korean War, the United States suffered nearly 40,000 casualties defending South Korea. During the Vietnam War, South Korea sent more than 100,000 personnel to support the American effort. Today, South Korea maintains nearly 3,600 personnel in Iraq to assist coalition forces.
3. U.S. Department of Commerce, International Trade Administration, National Trade Data, in "TradeStats Express," at tse.export.gov/NTDChart.aspx?UniqueURL=t3t4awrv25shf045y1cki0jh-2005-5-7-14-2-38 (May 16, 2005).
4. Republic of Korea, Ministry of Commerce, Industry, and Energy, "Exports by Commodity," at www.mocie.go.kr/eng/statistics/default/statistics_view.asp?num=0407&page=1 (May 16, 2005).
5. U.S. Department of Agriculture, Economic Research Service, "South Korea: Trade," updated September 23, 2004, at www.ers.usda.gov/Briefing/SouthKorea/trade.htm (May 16, 2005).
6. U.S. Department of Commerce, Bureau of Economic Analysis, "U.S. International Services: Cross-Border Trade 1986–2003, and Sales Through Affiliates, 1986–2002," updated October 29, 2004, at www.bea.gov/bea/di/1001serv/intlserv.htm (May 16, 2005).
7. The United States has FTAs with Australia, Canada, Chile, Israel, Mexico, Morocco, Jordan, and Singapore.

certainly best pursued globally to minimize barriers and distortions in trade, the slow pace of negotiations in the World Trade Organization (WTO) has led many nations to pursue free trade through bilateral and regional agreements, allowing countries to customize agreements that meet the needs and concerns of individual countries.

For the United States, an FTA with South Korea makes immense sense considering the existing areas of economic convergence and complementarities and the potential for even greater future gains. As one of America's top trading partners, with bilateral trade exceeding \$70 billion in 2004, South Korea currently enjoys relatively free access to the U.S. market while American exporters still face hurdles in South Korea.

One of the greatest benefits of an FTA for the United States would be increased opportunity to export to South Korea. A 2001 U.S. International Trade Commission (ITC) report predicted that a U.S.–ROK FTA would increase annual American exports to South Korea by nearly \$20 billion, while South Korean exports to the United States would rise by \$10 billion.⁸ The ITC study concluded that the largest gains in American exports would be in agricultural products such as dairy and meat products. South Korea, which imports over \$2 billion in U.S. farm products annually, is America's fifth largest export market for agricultural goods. An FTA would provide greater access to agricultural goods by eliminating many of the strict non-tariff barriers.

Official and private studies on the likely economic impact of an FTA conclude that it would benefit producers and consumers in both countries. For South Korea, increasing participation in trade agreements is not just beneficial, but may be necessary in order to achieve its stated goal of raising annual per capita income to \$20,000 by 2010. Partially due to its scarcity of natural resources and the economy's heavy

reliance on external trade, which accounts for nearly 70 percent of GDP, South Korea will not realize this goal unless exports grow by 12 percent annually.⁹

Significantly, the benefits of a U.S.–ROK FTA would go beyond promoting free trade, increasing economic benefits, and bolstering the broader bilateral relationship. Agreement and cooperation on economic issues provide a strong basis from which to reinforce collaboration in the political and security arenas. An FTA would undoubtedly reinvigorate and strengthen the dynamic and comprehensive U.S.–ROK alliance, which has been the cornerstone of peace and stability in Northeast Asia for more than 50 years.

In addition, a U.S.–ROK agreement would provide the United States with a strong economic presence in Northeast Asia and allow South Korea to reduce its economic dependence on China. U.S. Ambassador to the ROK Christopher Hill alluded to this strengthening of America's strategic presence in Northeast Asia when he stated that "South Korea can solidify a role as America's economic bridge in the Northeast Asian region"¹⁰ through an FTA.

Challenges and Future Tasks

Although a broad consensus on the benefits of a U.S.–ROK FTA has existed since the idea was first floated in the mid-1980s, daunting obstacles have impeded implementation. While some of these challenges are structural, lack of political will and lack of support on both sides of the Pacific have hampered any real progress toward initiating serious negotiations.

The American and South Korean business communities are enthusiastic about an FTA, but official support in Washington has been muted, due not only to specific markets such as agriculture, which is likely to be a highly contentious issue, but also to the view that South Korea needs to do more with

8. U.S. International Trade Commission, *U.S.–Korea FTA: The Economic Impact of Establishing a Free Trade Agreement (FTA) Between the United States and the Republic of Korea*, Investigation No. 332-425, September 2001.

9. Figures stated by Korea Institute for International Economic Policy (LIEP) and Korea Institute for Industrial Economics and Trade, "Korea Needs FTAs, Experts Say," *Chosun Ilbo*, August 1, 2003.

10. Ambassador Christopher R. Hill, remarks at American Chamber of Commerce General Membership Meeting, October 5, 2004, at usembassy.state.gov/seoul/www0133.html (May 16, 2005).

existing agreements and regulations. Seoul's difficulty in passing the ROK–Chile FTA, which took almost a year to ratify, does not bode well for future South Korean trade agreements.

In particular, growing popular nationalism in response to the opening of South Korean markets has caused concern in Washington. While nationalism itself is not necessarily a negative trend, in South Korea the tone is worrisomely tied to anti-foreign sentiment, including a popular backlash against foreign investments. One trade area in which popular nationalism has overtaken the debate is the South Korean movie industry, which maintains a screen quota limiting the screening of foreign movies on the basis that South Korean culture must be protected in order to thrive. Tensions over this quota remain a primary stumbling block for the conclusion of the bilateral investment treaty.¹¹

While the Bush Administration is skeptical about the near-term possibility of an FTA, support is stronger in the U.S. Congress. In May 2001, Senator Max Baucus (D–MT) introduced a bill (S. 944) authorizing FTA negotiations with the ROK, marking the second time that he sponsored such legislation.¹² Regrettably, because of the lack of broader support in Congress and in the Administration, it did not lead to the launching of formal negotiations.

Nevertheless, the United States should consider negotiating a free trade agreement with South Korea in the near future, although several areas of concern must be addressed before formal negotiations can begin. As the 2001 ITC report identified, the South Korean regulatory regime is still a significant barrier to U.S. exports, along with other non-tariff measures such as product and safety standards and pharmaceutical testing requirements. Seoul needs to address such issues before any future agreement is even considered.

To create and build positive momentum for an FTA with South Korea, the United States should consider:

- **Urging the South Korean government to demonstrate its political will by tackling issues such as U.S. beef imports and the screen quota.** Initiating action on these two issues in particular would establish that South Korea is serious about seeking an FTA with the United States. Expeditiously lifting the ban on U.S. beef imports ahead of Japan would generate many supporters for the FTA among U.S. policymakers, given that the issue is being watched carefully at the highest levels of the Bush Administration and Congress. Ending the screen quota would also send a strong signal that the political leadership in Seoul is strong enough to stand against special-interest groups seeking specialized protection.¹³
- **Working to elicit stronger and more concerted support from policymakers and the business communities in both countries.** The American and South Korean business communities have been moving gradually to organize a more effective campaign to promote an agreement and inform the general public about the potential benefits of an FTA. More important, growing numbers in Congress also understand the critical importance of the bilateral economic relationship. However, it would be equally important to have an influential advocate in the Bush Administration. Such orchestrated support to build positive momentum for a U.S.–ROK FTA would increase prospects for formal negotiations.
- **Encouraging the ongoing process of reform in South Korea.** The American pursuit of an FTA with South Korea should incorporate the broader goal of upgrading South Korea's eco-

11. A bilateral investment treaty (BIT) aims at protecting investment interests and promoting more market-oriented policies. A U.S.–ROK BIT was proposed in 1998, but South Korea's screen quota is a major impediment to concluding the treaty. Many would expect rapid conclusion of the BIT to pave the way for an FTA between the U.S. and South Korea.

12. The 106th Congress took no legislative action on his first attempt (S. 1869).

13. The screen quota, which limits the screening of foreign films, has been increasingly viewed as outdated in light of South Korea's vibrant film industry. Many South Koreans question the value of the screen quota, given that it is hindering progress toward an FTA between the two countries.

conomic system. While a bold sense of entrepreneurship has indisputably played a key role in South Korea's tremendous economic success, the economic system remains shackled by barriers that still limit entrepreneurial opportunities. The 2005 edition of the *Index of Economic Freedom*, an annual study by The Heritage Foundation and *The Wall Street Journal*, lists South Korea as the 45th freest economy out of 155 economies surveyed.¹⁴ As Asia's third largest economy, South Korea's economy has the fundamentals—such as its large supplies of capital, highly educated labor forces, modern infrastructure, and stable legal system—all in place. What is missing is strong political leadership to address more difficult issues that keep South Korea from being a truly free economy.

Conclusion

Given the challenges posed by several contentious trade issues, a U.S.–ROK FTA in the near

future may be an overly ambitious goal. Nevertheless, it is undoubtedly in the interests of both countries to work toward a trade agreement. The American National Association of Manufacturers has identified South Korea as a one of the “top five candidate countries” for a future trade agreement.¹⁵ If an agreement is to be reached, however, this positive assessment must be accompanied by concerted efforts in Washington and Seoul.

Both the United States and South Korea have much to gain from reinvigorating their economic relations. Seeking an FTA will reinforce the alliance by establishing a positive venue for dialogue and ultimately serve the national interests of both countries.

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14. Although this is an improvement of seven spots over the past two years, South Korea has fluctuated within only the “mostly free” category of economic freedom during the 11 years measured by the *Index*. See Marc A. Miles, Edwin J. Feulner, and Mary Anastasia O’Grady, *2005 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2005), at www.heritage.org/index (May 16, 2005).

15. National Association of Manufacturers, “NAM’s Recommended Candidates for Additional Free Trade Agreement Negotiations, 2005,” at www.nam.org/s_nam/bin.asp?CID=46&DID=233031&DOC=FILE.PDF (May 16, 2005).