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East Asian Economic Integration: Implications for a U.S.-Korea

FTA

Inkyo CHEONG¹

Department of Economics, Inha University

I. Introduction

Korea concluded its first FTA with Chile October 2002 and the first FTA began to be implemented April 2004. The successful conclusion of the first FTA will be especially important to Korea, and other potential FTAs will heavily depend on the first model. The experience will help the government to minimize risks and possible losses, as well as to be better prepared for the operation and negotiation of FTAs.

The United States has long been Korea's most important trading partner. Although the recent economic boom in China causes Korea-China trade to grow rapidly, the U.S. has remained in first place. In turn, Korea is one of important trading partners of the United States. The volume of trade between Korea and the U.S increased steadily until 2000, when it saw a slight downturn due to the depression of the economy. In 2002, exports from Korea reached \$32.8 trillion while imports from the U.S. reached \$23 trillion. The proportion of exports to the U.S out of Korea's total exports peaked at 39.98 percent in 1986, declining to 15.58 percent in 1997 before recovering to 20.2 percent in 2002. In 2002, the proportion of exports to Korea out of the total U.S. exports was 3.3 percent, indicating that Korea is the sixth-largest exporter to the U.S. and the seventh-largest importer.

In spite of the close trade and investment relations between Korea and the U.S., discussions regarding an FTA between the two countries have been inactive. This paper will look into the emergence of regionalism in East Asia and try to draw implications

¹ Tel: (82) 32 860-7785, Fax: (82) 32 863-8717, E-mail: inkyoy@inha.ac.kr

This draft is an extension of Cheong (2004), with more focus on the recent progress of East Asian regionalism, while original paper presented a discussion on a strategic importance of a U.S.-Korea FTA.

for a U.S.-Korea FTA. So far, the two countries have limited their outlook on a bilateral FTA. In addition, this paper emphasizes the political and strategic significance of an FTA as well as its economic effects. That is, instead of upholding agricultural sector opening and screen quota disputes as preconditions of an FTA, this paper argues that the two countries should evaluate an U.S.-Korea FTA with economic aspects as well as non-economic interests. This paper points out that the U.S. should take advantage of the U.S.-Korea FTA to secure its interests in East Asia and to avoid exclusion from East Asian regional economic integration. In conclusion, the U.S. and Korea should start official talks on a bilateral FTA between two countries.

II. Emerging Regionalism in East Asia

1. Internal and External Environment

Since the end of the World War II, the world economy has witnessed two parallel trends of integration, namely, multilateralization of global economic and trading relations under GATT/WTO and regionalization of different economies or groups of nations. The EC, the predecessor of the EU, was successful in regional economic integration through its establishment of regional free trade agreements, later developing into a customs union, and then economic and political one. Initial efforts for regional integration in Europe were launched right after the conclusion of the World War II, with the birth of OEEC (now called OECD) in 1948 and the Council of Europe (CE) in 1949. The key turning-point was marked by the signing of the 1952 Paris Treaty, laying the foundation for the formation of the European Community of Steel and Coal in the same year. Important treaties and agreements in the second half of the 21st century led to the establishment of European Economic Community (EEC), European Community (EC) and then European Union (EU).² Outside the EU framework, there were also economic integration efforts among some European countries such as the group of Northern European countries or among neutral nations.

The U.S. has shifted its focus to regional and bilateral integration since the mid of 1980s and early 1990s: signing FTAs with Israel, Canada, and then forming NAFTA,

² Roma Treaty (RT) in 1957 laid foundation for the establishment of European Common Market and Tariff Alliance; The Single European Act (SEA) in 1985 eliminated non-tariff barriers on the transaction of labor, goods, service and then capital (1992). The Maastricht Treaty (MT) in 1992 marked the establishment of economic and monetary union, political union as well as other fundamental institutional pillars needed for the coming European Union; Amsterdam treaty (AT, 1997) and Nice treaty (NT, 2000) deepened institutional integration in European Union aiming at a comprehensive political union.

with Jordan etc. and more than 300 agreements of economic cooperation, trade and bilateral investment throughout the two terms of presidency of B. Clinton (1993-2000). Tremendous efforts to accelerate bilateral agreements have been made under G. Bush's administration (2001-04) with "competitive liberalization" strategy – creating competition in liberalization initiatives through a number of bilateral deals – the term put forward by the US Trade Representative Robert Zoellick of G. Bush's administration.

The WTO, created in 1995, allows some exceptions which permit the creation of regional trading agreements (see GATT/Article XXIV; GATS/Article V etc.), most of which are in the form of regional/free trade agreement (FTA) or custom union (CU). The fundamental principle of WTO is non-discrimination, which means that each Member shall accord immediately and unconditionally the Most-Favour-National Treatment and Nation Treatment to any other Member. The WTO framework, however, does not ban two or some countries from reaching agreements on deeper and wider liberalization than those committed in GATT/WTO. As a result, more than half of regional trading agreements have emerged since the establishment of the WTO.

The round of multilateral economic integration (called the Doha Development Agenda [DDA]) reached a deadlock due to the fact that issues of negotiation have been extended to non-tariff matters and beyond the scope of pure trade (for example, "Singapore issues") in the Cancun WTO Ministerial Meeting. The developed and developing countries could not reach an agreement on such matters as agricultural subsidies, labor standard, and environment. Developed countries found themselves in disagreement on the agenda of the DDA,³ especially on "Singapore issues" – transparency in government procurement, trade facilitation, and investment and competition policies.

The East Asia economic crisis in 1997-1998 forced this region to seek a new motivation for reform and growth, shifting their foreign economic policies to regional and bilateral integration. Most East Asian countries, typically Korea, Singapore, Hong Kong and China, made use of international trade for economic growth. Therefore, foreign markets, especially those of Northern America and Western Europe constituted a prerequisite for maintaining the growth momentum of these East Asia countries.

Since 1999, East Asia has witnessed a strong proliferation of bilateral FTAs in the world, and then Japan and Korea followed suit and implicitly announced that the WTO was no longer the only choice by concluding bilateral FTAs. In fact, the GATT/WTO

³ The agenda of the DDA consisted of 6 major issues: Agriculture, Approach of non-agriculture and service market; Singapore issues; Trade Rules (on dispute settlement and trade compensation); Intellectual Property Rights (TRIPS); and Trade and Development issues.

framework is incapable of dealing effectively with new issues of international relations such as trade in services, e-commerce, government procurement, movement of labor, and others. China and Thailand swiftly put forward their bilateral FTA initiatives and ASEAN, as a single block, also speeding up the making of bilateral commitments with Australia and New Zealand (CER).

2. The Evolvement of FTAs in East Asia

The East Asia is the least developed region in terms of regionalism. The main regional trade agreement in East Asia is the ASEAN Free Trade Area (AFTA). Currently, AFTA has 10 members and is pursuing trade liberalization. Recently, these countries have been discussing bilateral FTAs with China, Japan, India and CER (the FTA between Australia and New Zealand). The evolvement of FTAs in East Asia is summarized at the Appendix.

The East Asia, until the year 2002 when the bilateral FTA between Japan and Singapore (JSEPA) was signed, AFTA (1992) was the first and only FTA experiment aiming at strengthening ASEAN intra-bloc trade. Until recently, the Northeast Asian countries - China, Japan, and Korea - have not participated in any regional trade agreements. After the financial crisis, however, these countries began to show a great interest in establishing FTAs.

In 1998, Korea announced its plan to proceed with an FTA with Chile and also began a joint study with Japan. The Korea-Chile FTA negotiations were launched in December 1999 and concluded it in October 2002. Japan and Korea developed bilateral FTA strategies with a view to accelerating domestic reform, maintaining their competitive positions in the international and regional markets, as well as response to the rise of China. Japan and Korea both had the feeling of being belated in the regional and bilateral races while suffering from the pressure of the United State and China in the regional and global markets. The two East Asian countries originally faithful to the multilateral framework have realized that multilateral commitments are now of almost of little help for domestic reforms, and therefore, the establishment of bilateral FTA becomes a major card in their trade policy adjustments.

Japan and Korea faced strong resistance from agricultural sectors with regards to its commitments on market openness and liberalization. As a result, the two countries were rather cautious in selecting Mexico (in Japan – Mexico FTA) and Chile (in Korea – Chile FTA) as their partners in bilateral FTA negotiations. Especially, in the case of

Japan – Singapore FTA, the agricultural sector was removed from the negotiation table.

Currently, Japan and Korea are, however, very active in seeking bilateral FTA partners in the region. The two countries themselves are under negotiation for a bilateral FTA, targeting the conclusion of the negotiation by the end of 2005. Japan has signed a framework agreement with ASEAN (AJCEP), and are doing joint studies on bilateral FTAs with each ASEAN member including Thailand, Malaysia, Indonesia and Vietnam. At the same time, Japan is exploring the opportunity of having bilateral FTAs with non East Asian countries. After signing bilateral FTA with Chile, Korea is conducting joint studies on and negotiating bilateral FTA with Japan, Singapore, Thailand, ASEAN, Mexico, the EFTA, India etc.

China shifted its policy to bilateral FTAs with visible geo-political and geo-economic motivations, taking advantage of exceptions obtained from being a WTO member. Although being a new member of WTO, China has been very active in taking advantage of the exceptions in GATT/WTO framework to form the Framework Agreement on Trade and Investment with Hong Kong (CEPA), and then signed a bilateral FTA with ASEAN as a whole and later with each of its member, firstly with Thailand⁴. China is in the process of negotiating bilateral FTAs with Malaysia and the Philippines while studying bilateral FTAs with Macao, CER, and a trial FTA with Japan and Korea.

Bilateral FTA policy of China has also reflected its geo-political and geo-economic considerations, not only pure trade motivations. China and ASEAN are planning to conclude negotiations by 2004 and to effectuate the free trade between the two regions by 2010. The deals with ASEAN as well as with each of its members created a closer linkage, forming an economic sphere favorable to China, instead of seeing ASEAN “being whirled into” the orbit of Japan and the U.S. Through bilateral FTAs, China could, to some degree, show its regional role in the expansion process of economic ties in East Asia.

ASEAN bloc promotes external economic ties in order to strengthen its internal integration and maintain its competitiveness against the pressure of Chinese attraction; yet, there seems to be individual effort rather than a collective action. It can be esteemed that since the 1997-1998 crisis, the ASEAN has gradually lost its attractiveness compared to China in the eyes of international investors. The crisis revealed defects in the structure of the economy of each member and the inefficiency of ASEAN cooperation mechanisms. It has become urgent to enhance each member’s internal

⁴ China and Thailand have reached a bilateral FTA agreement on agriculture with 160 farming products committed.

reform and strengthen the economic ties among the members. Besides, Singapore and Thailand have actively found their own “way out” through bilateral FTA channels. This has put the ASEAN into a dilemma of regional integration intensification: agreement by word, not by heart.

The ASEAN can only be attractive when it maintains a unified market of considerable scale as AFTA⁵ though the implementation of AFTA has not born many fruits so far. Accordingly, ASEAN needs to take advantage of FTAs with the U.S., Japan, China, Korea, and India etc. to become the "hub" of East Asian bilateral and multilateral FTA commitments. This idea has, step by step, been put into practice⁶ but will only be successful if ASEAN members do not form its own bilateral FTA with those partners. Yet, what is happening in reality is opposite to this assumption.

At present, ASEAN cooperation and integration efforts are made at various levels such as individual bilateral FTAs (Singapore, Thailand, Malaysia, the Philippines); ASEAN+1 formula (with China, Japan, Korea, and India); ASEAN+3 formula (with Northeast Asian region); and the idea to set up the ASEAN Economic Community (AEC) put forward in 2003. It can be viewed that ASEAN members' effort to form individual bilateral FTAs is an outstanding trend, though the ASEAN+1 formula is getting some initial results.

Among ASEAN countries, Thailand is actively shifting towards bilateral FTAs due to internal political motivations and in harmony with the wave of the establishment of regional and global bilateral FTAs. Malaysia and the Philippines starts to consider their own bilateral FTAs seriously so as not to be reduced to an unfavourable position in international trade.

3. Future Prospects for East Asian Regionalism

Since 1998, political leaders of the ASEAN+3 (China, Japan and Korea) have established an annual summit, discussing economic cooperation measures in the region. The ASEAN+3 process, which started in 1997, can be an igniting source for East Asian economic integration. The region discusses the transformation of the ASEAN+3 summit meeting into an East Asian summit for a more enhanced institutional approach in East

⁵ AFTA creates a market of 550 million people with the total GDP of USD 570 billion, half of the population and the GDP of China.

⁶ See the journal by Canada's Asia Pacific Business Network, “*Asian powers queue up for free trade deals with Southeast Asia*”, Asia Pacific Bulletin, November 15th, 2002.

Asian cooperation. Then, within this framework, the idea of an East Asian FTA (EAFTA), covering the whole countries in the region, is likely to gain more momentum among member countries.

There are many obstacles, however: differences in their political systems and level of economic development as well as historical remnants and so on. But in spite of these impediments, East Asia will overcome these and pursue economic integration in order to respond to the global trend of regionalism. The EU was enlarged, encompassing ten Central and Eastern European countries and a Free Trade Area of the Americas (FTAA), which covers both North and South America, will be realized. Given the prospects of the advent of the two major blocs, East Asia recognizes the need for deeper economic integration, including an EAFTA. Then, the question is how to reach East Asian economic integration. All potential member countries in East Asia have different ideas and directions to pursue a regional free trade agreement. Another question is whether there is any way to narrow the gap between the countries in respect to their perception of East Asian economic integration? How can we maximize the synergy gains in integrating East Asia economically?

According to Ahn, Baldwin and Cheong (2004), many of East Asian countries think that East Asia will be integrated in future, and Northeast Asian countries - China, Japan and Korea – are supportive of the establishment of an EAFTA. Although they deliver different views on how to achieve it, they all agree that China, Japan and Korea, which represent 90% of the East Asian GDP, must play a leading role in forming an EAFTA. China seems to advocate the merits of an ASEAN-China FTA and then ASEAN + 3 approach, implying bilateral FTAs of China, Japan and Korea with ASEAN. However, Japan might prefer an approach to East Asian regionalism by forming a Japan-Korea FTA first, and then concluding bilateral FTAs with ASEAN and China, taking into account the static and dynamic benefits.

Although East Asian regionalism could be developed in several directions depending on approaches by two major players in Northeast Asia, a Japan-Korea FTA seems to be a contributing factor for East Asian regionalism. Baldwin (2004) argues that East Asia regionalism will shift from talk to action – resulting in a rapid spread of preferential arrangements – provided that at least one major FTA gets signed. He predicts that the Korea-Japan FTA currently under negotiation may well be the trigger. The arguments supporting this assertion are based both on historical analogy and political economic reasoning. In the Americas and Europe, the 1990s witnessed waves of regionalism triggered by single idiosyncratic events of preferential liberalization - the US-Mexico FTA in North America and the European Union's Single Market programme. The paper

argues that the 'domino theory' is the political economic logic behind the waves of regionalism. To put another way, trade and investment diversion created by a preferential trade arrangement among a nation's trade partner tends to stimulate extra political pressure within the nation to redress the discrimination. Since signing a new FTA is the easiest way to redress the discrimination, one FTA tends to encourage others. Moreover, the paper argues that the 'force for inclusion' and the cost of exclusion gets stronger as more FTAs are signed, so the spread of FTAs can be quite rapid.

III. The U.S. Response to the Evolvement of East Asian Regionalism

The U.S. is the most important trading partner for most of the East Asian countries. In addition, considering the international status of the U.S., the sole superpower, and the high linkage of its military and political relations with East Asia, East Asian countries will need strong relations with the U.S., but if the U.S. is excluded from economic integration in the region, economic relations with the U.S. will be weaker. During past years, East Asian countries observe slightly declining trade shares with the U.S., and East Asian regionalism will enforce closer economic relations among East Asian countries. This is not good for East Asian countries, since East Asian countries as well as the U.S. Especially, East Asian countries will experience losses from trade diversion, as well as trade conflicts with the U.S. in the integration process.

The U.S. will be more concerned with the development of a Japan-Korea FTA or a China-Japan-Korea (CJK) FTA among FTAs in East Asia, since the three countries in Northeast Asia occupy 90 percent of East Asia in terms of market and economic power. A substantial internal consensus has formed in Korea, regarding the idea that a Korea-Japan FTA can be a core force for integrating East Asian economies is prevalent (Baldwin 2004). Although there are many concerns about its potentially negative effects on the Korean economy, including increasing Korea's economic dependency on Japan and increasing Korea's trade deficit with Japan, both parties are negotiating a bilateral FTA.

Choi and Schott (2003) negatively evaluate the progress of a CJK FTA based on several aspects, including rivalry between China and Japan. However, their evaluation misses the position and role of China in a CJK FTA. The review of a CJK FTA proposed by former Chinese Prime Minister Zhu Rongji in 2002 can be interpreted as a sign of China's uneasiness towards Korea-Japan FTA progress. The Trilateral Joint Research Project is being performed by the Development Research Center of the State

Council (DRC) in China, the National Institute for Research Advancement in Japan (NIRA) and the Korea Institute for International Economic Policy (KIEP).

So far, Korean manufacturers have supported a CJK FTA, as shown by the support given to an FTA among the three countries at the CJK business forum in 2002. According to the Trilateral Joint Research Team's questionnaire survey of business enterprises, a large proportion of the respondents supported the idea of establishing a FTA among China, Japan and Korea (85 percent in China, 79 percent in Japan and 71 percent in Korea). In addition, Chinese Premier Wen Jiabao suggested that government officials in the three countries introduce CJK FTA discussions at the China-Japan-Korea summit in Bali, 2003, but Japan did not agree to the suggestion. China plans to hold a large-scale international seminar in the first half of next year, inviting Japanese and Korean representatives from the public and private sectors.

China seems to have proposed a CJK FTA as a stepping-stone for mid/long-term Northeast Asian regional economic integration. Rather than participating in a Korea-Japan FTA as a third member, it seems that China prefers to take the initiative for a CJK FTA and the leading role in place of Japan in its formation. There are both pros and cons for China in launching a FTA. Although China has internal problems in pursuing FTAs, it also has merits. As for merits, China has strong leadership from its government, a consistent administrative system and an absence of NGO anti-FTA campaigning. Thus, China has favorable FTA conditions and could produce distinct results within a short period when the government comes to a policy decision.

A Korea-Japan FTA will be evolved and the discussions on a CJK FTA as proposed by China will continue – even after a Japan-Korea FTA negotiations began. The difficulties in the formation of a CJK FTA may be differences in economic development stages, political factors (historical problems and border conflicts) and political rivalry between China and Japan. If there are problems in launching a CJK FTA due to the uneasy China-Japan relationship, a China-Korea FTA might take its place. Chinese scholars showed high concern over an FTA with Korea in an international conference on a China-Korea FTA organized by KIEP-Academy of Macroeconomic Research, one of Chinese national think-tanks, October 2004.

In the past, the U.S. has explicitly expressed opposition to an East Asian Economic Group (EAEG, and later EAEC) proposed by Malaysian Prime Minister Mahathir and has, furthermore, encouraged East Asian countries to pursue open regionalism within the APEC (Bae 2000). Now, the U.S. seems to promote economic cooperation with East Asian countries not only by supporting the movement of regionalism in East Asia, but also by seeking to conclude bilateral FTAs with individual ASEAN member countries.

During a visit to Thailand in April 2002, USTR Robert B. Zoellick showed support for East Asia regionalism, including bilateral FTAs with China/Japan and bilateral ASEAN agreements because of the contributions he anticipated these agreements would have for world trade liberalization.⁷ U.S. President George Bush, on the other hand, suggested ‘the Enterprise for ASEAN Initiative (EAI)’ at the APEC Summit held in Los Cabos, Mexico in October 2002, which would promote economic cooperation with Southeast Asian countries.

Compared to the past, there are much fewer reasons for the U.S. to oppose East Asian regionalism in economic terms (Choi, 2003). First, the U.S. is pursuing regionalism and the majority of economists now consider regionalism as contributing to the development of a multilateral trading system (Building Blocs). There has also been criticism over the roles of the U.S. and IMF in dealing with the financial crisis in East Asia.

As for national security, there are still many issues to be clarified regarding whether U.S. considers China to be a potential threat or not. There are three U.S. viewpoints toward China (Lee 2003). 1) Positive viewpoint: There is an expectation that the Chinese economy will not pose a threat because it will become increasingly dependent on neighboring economies. Stronger economic relations with neighboring countries will lead China promote a more market-oriented economy irreversibly away from the old central planning and socialistic political system. 2) Negative viewpoint: A situation of rivalry wherein there cannot be a constructive relationship established with China unless China’s political system changes. 3) Compromise: The U.S. should counterbalance China’s rising power using military superiority while maintaining a positive outlook.

If the U.S. position on China is close to the negative or compromise options, the U.S. will be more concerned with the evolution of regionalism in East Asia if China, now the rising power in political, economic and military areas, takes a hegemony position in East Asia, noting that China is competing a leadership in East Asia with Japan through FTAs (Cheong 2002). This will lead the U.S. to pursue closer linkages with other East Asian countries. As mentioned before, one of the alternative policies the U.S. can take is to strengthen its relationship with Korea and Japan if it is unable to control the expansion of FTAs in East Asia (Choi, 2003).

The U.S. will be concerned about the economic and non-economic losses it might suffer when the U.S. is excluded from East Asian regionalism such as a Japan-Korea FTA and a CJK FTA. What could U.S. trade policies be possible at this moment? The U.S. concern over FTAs in East Asia is reflected in its approach towards ASEAN in 2002 through the introduction of the EAI, the conclusion of the U.S.-Singapore FTA

⁷ For detailed information, refer to [<http://usembassy-australia.state.gov/hyper/2002/0408/epf110.htm>].

and discussions on a U.S.-Taiwan FTA. The U.S. cannot put a brake on the emergence of East Asian regionalism since the U.S. itself is also pursuing FTAs. The U.S. will have no other choice than to examine concluding more bilateral FTAs with East Asian countries.⁸

The U.S. needs to launch a bilateral FTA with one of three Northeast Asian countries in order to respond to the evolvement of East Asian regionalism, since it is unlikely that the U.S. will join the Korea-Japan or CJK FTAs currently under active discussion. Considering the rapid progress being made in FTA negotiations in East Asia, it is essential for the U.S. to get involved in securing its economic and non-economic interests. It remains to be seen which country the U.S. can maximize its national interest when carrying out FTA negotiations.

IV. Evaluation of a U.S.-Korea FTA

1. General Discussion

While U.S. researchers have conducted discussions concerning the Korea-U.S. FTA, Korea has taken a passive position to research. Although informal discussions on Korea-U.S. FTA started in the mid-1980s, formal discussions have yet to be held between the two. Former USTR William Brock visited Korea and informally sounded out Korea's position regarding the Korea-U.S. FTA on April 1984. In addition, Peter Murphy, former U.S. representative to GATT, brought up the potential FTA between the two countries in May 1985. Moreover, former USTR Peter Allgeier talked on the potential FTA in January 1988.

The discussions about the Korea-U.S. FTA were embodied in a report by the USITC examining Asian-Pacific FTAs in 1989. This report suggested that Singapore, Korea and Taiwan would be the most suitable FTA partner in East Asia for the United States. Moreover, Korea was considered the most appropriate country among these three in economic terms. However, due to the anti-American sentiment in Korea in the late 1980s, the USITC judged an agreement too difficult to push.

From then, Korean research institutes started to conduct studies on a potential FTA with the United States. Representative research from Korea includes "The Economic Effect of a Korea-U.S. FTA" Kim Wootack (1986), a study that uses the Armington

⁸ It can be suggested that APEC can be an alternative for East Asian regionalism. However, it seems that APEC lost its momentum for regional trading bloc without the progress on the Bogor Goal.

model, and “The Analyses of a Korea-U.S. FTA on Korean Industries,” a study co-studies by the Korea Industry and Trade Association and the Korea Institute for Industry and Technology. However, discussions on the FTA did not last long, as they were perceived as part of a push from the U.S. to open the Korean market. In the 1990s, FTA discussions were suspended due to disputes over tariff concessions in the agricultural sector under the Uruguay Round.

However, the U.S. showed renewed interest in a Korea-U.S. FTA following the start of Korea-Chile FTA negotiations. The U.S. chamber of commerce and industry sent a letter to former President Clinton in July 1999 regarding the possibility of a Korea-U.S. FTA. The U.S. Senate of Finance Committee then asked the USITC to submit a research paper on the economic effects of a Korea-U.S. FTA in December 2000. In addition, the 14th Korea-U.S. Business Meeting held in Hawaii in January 2001 pushed for an early settlement of a bilateral investment treaty and an FTA between the two countries. In 2004, the U.S. government officials made favorable comments on a U.S.-Korea FTA, and the Korean government became to regard the U.S. as one of Korea’s FTA partner countries. According to the FTA roadmap prepared by the government of Korea September 2003, a U.S.-Korea FTA could be pursued in the long-run, giving no meaningful implications.

2. Numerical Assessment

Examples of analyzing the numeric economic effects of a U.S.-Korea FTA were Wang and Cheong (1998), Choi and Schott (2001), USITC (2001), and Cheong (2002). The other three papers analyzed the tariff-abolition effect of a U.S.-Korea FTA using the CGE model. Wang and Cheong (1998) looked at three different scenarios where tariffs were removed under a U.S.-Korea FTA – absolute tariff-abolition in every sector, tariff-abolition in every sector except agriculture and 50-percent tariff-removal in the agricultural sector with 100-percent tariff removal in all other sectors. Through this research, Wang and Cheong suggested that Korea could expect economic benefits from a U.S.-Korea FTA, but excluding the agricultural sector, which is expected to be a major point of contention in negotiations, would result in large losses for Korea. Choi and Schott concluded that both countries could enjoy economic welfare gains if all sectors (agriculture included) were liberalized under the FTA. They also predicted that the FTA would produce trade diversion effects for Japan and China.

Table 1. Estimated Economic Effect of a U.S.-Korea FTA

Researcher	Model	Major Results
Kim Wootaeak (1986)	Armington Model (Partial balance)	<ul style="list-style-type: none"> - Korean exports to the U.S. increase 18.25% and imports from the U.S. rise 12.93% - Korea's trade balance with the U.S. would increase by \$1 billion
Korea Trade Committee – Research Institute of Industry (1989)	Applying trade and industry indices (trade specialization index, etc)	<ul style="list-style-type: none"> - Korean goods that benefit: clothing, steel, metal, textiles, traveling goods - U.S. goods that benefit: agriculture, chemical, electronic machinery, general machinery - Ambiguous goods: communication, automobiles, computers, general industrial machinery.
Wang and Cheong (1998)	Multi-region, multi-sector CGE model	<ul style="list-style-type: none"> - Korea's GDP improves by 0.36% and its welfare increases by \$21.5 billion. - Excluding the agricultural sector would decrease Korea's total welfare.
Choi-Schott (2001)	Multi-region, multi-sector CGE model	<ul style="list-style-type: none"> - In the long run, Korea and the U.S. can both expect welfare to improve by \$10.9 billion and \$8.9 billion, respectively. - Korean exports and imports to the U.S. can increase by 30.3% and 49.4%, respectively.
USITC (2001)	Multi-region, multi-sector CGE model	<ul style="list-style-type: none"> - The Korean and U.S. GDPs would improve by 0.69% and 0.23%, respectively. - Korean exports and imports with the U.S. would increase 21% (\$100 billion) and 54% (\$190 billion), respectively, causing Korean trade balance accounts with the U.S. to fall by \$90 billion
Cheong (2002)	Multi-region, multi-sector CGE model with increasing return to scale	<ul style="list-style-type: none"> - Under the assumption of perfect competition, Korea's GDP will increase up to 0.25%, reaching 2.03% with economies of scale. - Korea's trade conditions would improve internationally.

Choi and Schott (2001) and USITC (2001) estimated the economic effects of a Korea-U.S. FTA using the GTAP model and GTAP database (version 4). Although the model and database were similar, they produced somewhat different estimations due to the applications of different aggregations in industries and regions, as well as different model closure.

The major conclusion of the papers can be summarized as follows. A U.S.-Korea FTA would mean economic benefits for both countries with substantial gains for Korea but modest gains for the U.S. (Cheong and Wang 1999, USITC 2001, Schott and Choi 2001, Cheong 2002). Under a bilateral FTA, the GDP and welfare of both countries are expected to improve, favoring U.S. agricultural exports and Korean clothing and textile exports. Accordingly, USITC (2001) identifies these areas as most likely to be sensitive issues during negotiations, as Korean clothing and textiles exports would increase by \$70 billion while U.S. agricultural exports (including processed goods) would increase by \$140 billion.

According to Kang (2003), the U.S. seems to set two pre-conditions for an FTA with

Korea; opening agricultural markets under the proposed bilateral FTA and concluding the U.S.-Korea BIT before starting official discussions on a U.S.-Korea FTA. In general, Korean sentiment toward a Korea-U.S. FTA seems to be improving. First of all, business groups from both sides, including the Korea-U.S. Business Meeting and the American Chamber of Commerce in Korea (AMCHAM Korea), are in support of the U.S.-Korea FTA. Second, political barriers, including anti-American sentiment in Korea, have shown great progress compared to the early 1990s, although we saw a temporary rise of Anti-American sentiment after the death of two schoolgirls during US military exercises in Korea, and Korea's deployment of troops with the request from the U.S.

From an economic point of view, broad consensus was formed on the needs of a bilateral FTA between U.S. and Korea (according to research results). However, there is a great discrepancy in the views of both countries on a U.S.-Korea FTA. Korea is concerned about minimizing opening the agricultural sector for a U.S.-Korea FTA. Korea has not concluded the BIT with the U.S. because the screen quota issue is as yet unresolved. Thus, Korea is not likely to be active in discussing an FTA with U.S. Ratification of the Korea-Chile FTA has been postponed and Korea's lack of will to carry out FTAs is likely to be taken into account by other countries. There are more selling points to a U.S.-Korea FTA than the U.S.-Korea BIT, as the significance of the U.S.-Korea BIT is confined to improving the investment environment and increasing inflow of investment, whereas a U.S.-Korea FTA not only implies increased economic benefits through a unified market, but also consolidating economic alliances with the United States. A U.S.-Korea FTA is expected to be contributing to the security of Korean peninsula if it becomes necessary to strengthen national security and military alliances. The U.S. can expect the improvement of political and diplomatic relations with Korea under the bilateral FTA, in addition to economic gains. Cheong (2004) emphasizes the strategic importance of a U.S.-Korea FTA.

2. Issues related to a U.S.-Korea FTA

Agricultural market access

American agricultural products, even in case of the unilateral opening of agricultural markets, are not expected to take up substantial shares in Korea's domestic markets (rice from Southeast Asia and China is more competitive than that of the U.S. and Australian meat is more price competitive than the U.S.). The U.S. should adopt a flexible approach to the opening of agricultural markets by guaranteeing Tariff Rate

Quota minimum market access using a U.S.-Korea FTA rather than by adhering to the principle of a multilateral opening of agricultural markets in Korea. Korea should also take a U.S.-Korea FTA as an opportunity to accelerate its restructuring drive in the agricultural sector.

Korea's trade liberalization

Korea is expected to undergo a trade liberalization process in two ways in the near future, and as a result, the environment for carrying out a U.S.-Korea FTA is likely to improve. It is inevitable that industrial markets will open due to a Korea-Japan FTA. This would lead to the restructuring of industries in Korea, and the Korean manufacturing sector will be more positive towards an FTA with the United States. Multilateral negotiations on agricultural liberalization are proceeding very slowly due to the failure to reach a consensus on the Doha Development Agenda principles at the WTO Ministerial Conference at Cancun, Mexico. However, a great extent of agricultural market opening in Korea is expected to come from the multilateral system, which would substantially reduce economic barriers to FTAs.

As Korea effectuates the FTA with Chile and concludes FTAs with Japan and Singapore, it will be sure to implement the agreements. U.S. companies raised some questions related with Korea's intentions toward implementing the contents of FTAs at a conference on a U.S.-Korea FTA organized by the USITC May 2001. Korea accomplished its outstanding economic growth by using an export-oriented trade policy but is now in a situation where it has to accelerate trade liberalization through the multilateral and bilateral trading system.

Consolidating the relationship between the U.S. and Korea

A U.S.-Korea FTA should be recognized for its usefulness in maintaining the traditional alliance between the two countries. A U.S.-Korea FTA could be a way to enhance the understandings of both countries by expanding bilateral trade volume and investment and the exchange of human capital through a U.S.-Korea FTA.

Korea should overcome its disadvantageous position as an economic minor power through a U.S.-Korea FTA rather than becoming too dependent on Japan and China. In the short term, the U.S. should take a U.S.-Korea FTA as momentum to participate in Northeast Asia economic integration rather than being indifferent to the move, as it will be more difficult for the U.S. to establish FTAs with China and Japan. Afterwards, the

U.S. should examine ways in which to take part in China-Japan-Korea FTA discussions.

The U.S. has not objectively evaluated a U.S.-Korea FTA. The U.S. overlooks the strategic importance of a U.S.-Korea FTA. There is a tendency for the economic effects of a U.S.-Korea FTA to be regarded in relation with the market access of to agricultural sector. This is related with the voting districts of some politicians who are concerned over a U.S.-Korea FTA, and the issue was presented in a document form the U.S. Senate Committee on Finance requesting “special attention to agricultural goods” when asking the USITC for an analysis report on the expected economic effects of a U.S.-Korea FTA in December 2000.

Some U.S. industrial sectors are overly defensive. They should acknowledge that more substantial economic benefits under an FTA can be obtained through mutual cooperation in the form of expanding intra-industry trade and strategic alliances among companies. The U.S. should consider a U.S.-Korea FTA as a channel to participate in Northeast Asia and East Asia’s economic integration. The U.S. should also utilize FTAs for the sake of its military interests and national security in the Northeast Asia region. In conclusion, Korea, with its limited experience in FTAs and a passive position toward market opening, is focusing on the negative aspects of a U.S.-Korea FTA rather than its potentially positive effects. At the same time, the U.S. is limiting its focus on a U.S.-Korea FTA to economic aspects rather than political and strategic considerations.

V. Conclusion

As FTAs became more widespread and entrenched in the 1990s, they increasingly became a threat to non-member countries. Despite GATT/WTO Article 24 mandating that the overall trade barriers of any new regional or bilateral trade agreement be no higher than preexisting ones, the trade diversion effects of regionalism are having increasingly negative effects on the trade of non-member countries. A realistic Korean policy response to the spread of FTAs would be the establishment of FTAs with major trading partners such as the United States. Existing studies on FTAs show the potential effects for both the U.S. and Korea, as this would be the most significant trade agreement into which Korea might enter.

Not only would a Korea-U.S. FTA allow both countries to benefit from preferentially favorable measures, it would likely reduce the amount of trade disputes involving Korea. The U.S. is Korea’s most important trade partner, but also its greatest source of trade friction. Even though a Korea-US FTA would not eliminate all trade friction between

the two countries, such liberalization would likely reduce the occurrence and severity of trade disputes. This paper concludes that the U.S. and Korea would gain benefits from a bilateral FTA, especially substantial political and strategic meaning for both countries. It is undeniable that non-economic factors have been more important than economic factors in U.S.' forming the FTAs with Singapore, Jordan, Morocco and Israel.

If we take into consideration both economic and non-economic importance, the U.S. and Korea should begin their discussions on a bilateral FTA soon, as it will still take years to conclude an agreement if the U.S. and Korea were to start discussion now. The timing of the conclusion of FTA would be a more critical issue than content in view of the rapidly changing global trade environment.

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Appendix

Progress of major FTAs in East Asia (2004)

FTA	Stages of Evolution				
	Discussion	Joint study	Negotiation	Signed	Implementation
ASEAN					
ASEAN FTA					X
ASEAN-China (CEC)					X
ASEAN-Japan (CEP)				X	
ASEAN-India				X	
ASEAN-U.S (EAI)			X		
ASEAN + 3		X			
ASEAN-South Korea		X			
ASEAN-CER		X			
ASEAN-EU	X				
Japan					
Japan-Singapore					X
Japan-ASEAN			X		
Japan-Mexico				X	
Japan-Malaysia			X		
Japan-South Korea			X		
Japan-Philippines			X		
Japan-Thailand			X		
Japan-Chile		X			
Japan-Canada	X				

Japan-Taiwan	X				
Korea					
Korea – Chile					X
Korea – Japan			X		
Korea – ASEAN			X		
Korea – Mexico			X		
Korea - China	X				
Korea - Singapore				X	
Korea – Canada	X				
Korea - US	X				
Korea – EFTA		X			
Korea – India		X			
China					
China-ASEAN			X		
China-Hongkong					X
China-Malaysia			X		
China-Philippines			X		
China-Macao	X				
China-New Zealand	X				
China-Australia	X				
Singapore					
Singapore-CER					X
Singapore-U.S	Signed TIFA with the U.S				X
Singapore-EFTA					X
Singapore-Japan					X
Singapore-Canada			X		
Singapore-Mexico			X		

Singapore-India			X		
Singapore-S.K		X			
Singapore-Taiwan	X				
Thailand					
Thailand- Bahrain					X
Thailand-Peru					X
Thailand-India					X
Thailand-China					X
Thailand-BIMSTEC					X
Thailand-Australia				X	
Thailand-U.S	Signed TIFA with the U.S		X		
Thailand-Japan			X		
Thailand –Korea		X			
Thailand-N. Zealand		X			
Thailand-S. Africa		X			
Other FTAs					
Taiwan-Panama			X		
Taiwan-US	X				
Taiwan-Japan	X				
Taiwan-Singapore	X				
Taiwan-Costa Rica	X				
Hongkong-China					X
Hongkong-Macao				X	
Hongkong-N.Zealand			X		
Philippines-China			X		
Philippines-Japan			X		
Philippines-US	X	Signed TIFA with the U.S			

Malaysia-China			X		
Malaysia-Japan			X		
Malaysia-U.S	X				
China-Japan-S.K	X				
Pan-East Asia FTA	X				

Source: Cheong (2003) and updates