A U.S.-Korea Free Trade Agreement: How Far Away?
Speech to Korea Development Institute School

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I am excited to have this opportunity today to meet so many of the young leaders of the Korea Development Institute. KDI is famous around the world for having guided Korea's growth from an agricultural backwater into an industrial giant. I expect that KDI will continue to play a hugely important role in the future, so I am flattered to have this chance to meet with you today.

Today I would like to attempt two things. First, I hope to provide some updated context for understanding economic relations between the United States and Korea. Too often I find that -- because change has been so rapid -- people are governed in their thinking by old paradigms. It is time to get up to date.

Second, I would like to address the question advertised for today's session. How close are we to being able to tackle a free trade agreement between the United States and Korea? The answer may be: "closer than you think."

U.S.-Korea Economic Relations in the 21st Century

So first, let's start out with some historical context for understanding U.S.-Korea economic relations. A good way to start would be by taking some "snapshots" of where U.S.-Korea economic relations have stood at different times in recent history.

We can start in 1960. At that time, the primary concern of my predecessors at the U.S. Embassy and their colleagues in Washington was helping to stabilize the Korean economy, and set it on a path for growth. American grant aid still comprised an important part of Korea's annual government budget, and the key discussions at institutions like KDI focused on how to get Korea's industrial economy financed, and linked to international markets.

If we jump ahead to 1980, we already see a much different picture. By this time, the key U.S. concern had become negotiating access for U.S. firms to a rapidly growing but rather closed Korean domestic market. Korea's leaders had succeeded in bringing about the world's fastest transformation from an agricultural economy to an industrial economy, but in doing so had set up barriers to protect many Korean industries from international competition.

If we fast forward again to 2000, however, we once again see a significantly changed picture. In the aftermath of the 1997-98 financial crisis and its lessons, the Korean economy had become significantly more open. In 1999 and 2000, Korea attracted more than $30 billion in inward direct investment, much of it through mergers and acquisitions, including even Korean banks and investments in such famous flagship firms as Daewoo Motors. Exports were expanding at 20 percent per year, but imports grew even faster.

In the early 21st Century, market access issues continue to be important to the United States government when we look at the Korean economy. Some industrial sectors, such as automobiles, remain significantly closed. We also remain worried about how standards are being used in the telecommunications sector, and interested in seeing further legal changes in Korea to better protect cultural content and intellectual property rights. Naturally, there are other problems as well.

But more broadly, the economic dialogue between Korea and the United States now most closely resembles our complex and subtle dialogues with other advanced industrial economies. We talk about Korea's stance in the World Trade Organization, and its plans for leveraging APEC and the ASEAN-Plus-Three process to push for more liberalization and economic growth in the region. We discuss coordination of assistance to developing countries, and manage a rapidly growing bilateral cooperative program of joint research and technology development in important scientific endeavors such as health and environmental technology. We talk about macroeconomic coordination, and the United States watches closely the critical reforms going on in Korean labor markets, capital markets, and in corporate governance in Korea. We explain to Korea our hope that additional steps will be taken to offer a predictable and stable business environment, with a transparent regulatory process and reduced government interference in the market.

Sometimes, when I explain this, Koreans surprise me by telling me that they are surprised to learn that Korea and its economic health really matter to the United States. It should be what we Americans call a "no-brainer." Korea is the 11th largest economy in the world and the United States' 7th largest trading partner. Its economic success is absolutely vital to maintaining stability and balance as the Northeast Asian region continues in its rapid development.

Too often, frankly, I find that commentators on U.S.-Korean economic relations are still caught in an old mindset. They fail to grasp the depth of our shared interests on the economic front. In fact, eager for headlines, or influenced by other political agendas, some commentators almost seem to be actively searching for "win-lose" trade issues, as if international economic relations were some kind of grand soccer tournament, rather than the complex network of mutual benefit which is today's reality. In the worst case, people have even manufactured disagreements that do not exist.

The problem with such commentary is that it reinforces the popular notion that somehow Korea is still a small developing economy and is being taken advantage of in its international economic relations. I am deeply worried by polls that show that a majority of Koreans believe that Korea's trade and investment relations with other advanced countries benefit those other countries more than Korea. This view flies in the face of the key facts that I know you all know: that Korea is a world leader in many technology fields, enjoys consistent trade surpluses and generous net inflows of investment capital, as well as inflows of important productive technology.

U.S.-Korea FTA: How Far Away?

I hope, then, that we can all agree that a strong and open Korean economy is good for the United States, just as a strong and open American economy is good for Korea. Based on this understanding, are we, together, ready to take the next step? Let me turn now to the question of a U.S.-Korea FTA.

In many ways, Korea and the United States are "natural" FTA partners. We are political and strategic allies, share important democratic values, and our economic relations continue to grow rapidly. In 2003, the Republic of Korea exported some $34 billion worth of goods and services to the United States, and imported $25 billion from the United States. As I said earlier, this makes Korea our No. 7 trading partner. For Korea, the United States is the No. 2 trading partner, just behind China. While U.S. investments to Korea slowed to $1.2 billion in 2003, a lower figure than in previous years, that investment added on to a relatively high base, and the total stock of U.S. foreign direct investment in Korea has reached over $27.5 billion. Americans have invested heavily in Korea's stock market, showing their instinctive understanding that the United States has an important stake in Korea.

The United States has ratified several free trade agreements with a range of partners. The most important agreement is the North American Free Trade Agreement, encompassing the United States, Canada and Mexico. But we also have ratified FTA's with Chile and Singapore, and recently completed talks with Australia. We expect ratification of the Australia agreement, as well as our FTA with several Central American countries, quite soon. Meanwhile, as part of our global strategy of "competitive liberalization," new discussions have started with Thailand, Morocco, Bahrain, the South African Customs Union, and a slew of countries in South America.

Conspicuously missing from the list, however, are any OECD countries besides Canada, Mexico and Australia. This is probably because negotiating FTA's between advanced economies is intrinsically more difficult than talks with developing countries, involving more sectors and a more detailed discussion of non-tariff barriers to trade.

How, then, does the United States choose its FTA partners? It is more an art than a science, but some of the key criteria include the following:

- First, geopolitics. Is the potential partner country a nation we want to support?
- Second, readiness. Is the country willing to address all relevant issues?
- Third, relevance. What is the relative importance of the trading relationship?

- Fourth, finally, benefit. What is the expected economic impact of increased trade liberalization with the partner country?

The typical contents of an FTA with the United States are complex, and include sectoral market opening agreements, as well as separate agreements covering competition policy, bilateral investment, trade in services, financial services and protection of intellectual property rights. The FTA's also include technical details covering customs and rules of origin procedures, and finally some sort of dispute settlement arrangement. U.S. FTA's also encompass environmental protection and worker rights, in order to avoid a flight of capital to locations with weaker environmental or labor protections.

Our recently concluded FTA with Australia is an illustrative example. Over the course of a couple of years, the United States and Australia sorted out a number of key issues, in addition to reaching agreement on reduced tariffs on major manufactured goods. Some of the most difficult issues were Australia's pharmaceuticals benefit scheme; certain agricultural products such as sugar, beef and dairy; trademarks and other intellectual property rights issues; and e-commerce and digital copyrights.

The key phrase in the WTO agreements governing FTA's is GATT Article 14, which says that WTO-consistent FTA's must cover "substantially all" trade between the partners involved. Despite some carve-outs by both sides, the U.S.-Australia FTA meets that test.

Looking, then, at the possibility of a U.S.-Korea FTA, I think the key threshold issue is the handling of agricultural market opening. Korea will undoubtedly want special treatment for rice, but it would be important to know how many other agricultural items Korea would want to protect under a U.S.-Korea FTA, and to what degree.

Beyond agriculture, there are a number of other tricky issues that we would seek to resolve in the course of U.S.-Korea FTA talks. To give an illustrative sense, some of the issues the United States would undoubtedly seek to resolve in FTA talks with Korea would be likely to include competition policy enforcement; pharmaceuticals pricing; the setting of technology standards; investment limits and cultural quotas; and access for services industry firms and professionals. Korea is also likely to seek concessions related to U.S. trade remedies, such as anti-dumping measures and countervailing duties. In my opinion, all these issues could be overcome in the context of comprehensive and wide-ranging FTA discussions.

Certainly a U.S.-Korea FTA would be of real benefit to both countries. For Korea, a U.S. International Trade Commission study in September 2001 concluded that a bilateral FTA would increase Korean GDP by 0.7 percent, at a minimum, without even taking into account likely increases in investment and technology flows.

So, is it possible? As I said earlier, we consider Korea to be a "natural" FTA partner for the United States. The question is whether Korea is ready or not. We have actually seen some encouraging signs of late. The resolution of the "WIPI" telecom standards issue a couple of months ago was an important signal of Korea's intention to remain a fair playing field for foreign technologies. The passage of the Korea-Chile Free Trade Agreement in the National Assembly, despite considerable opposition from farmers, was also very encouraging.

Korea’s intensified effort to negotiate bilateral FTA’s, particularly in Northeast Asia, instills general confidence that Korea will keep its economy heading in the direction of greater opening. Particularly significant is Korea's proposed FTA with Japan. The United States supports Korea and Japan in this important endeavor, and hopes and expects that it will lead to a good, comprehensive FTA. We encourage regional cooperation in Northeast Asia, and do not see it as a threat to the U.S.-Korea economic relationship. To the contrary, we believe that strong economic ties between South Korea and its neighbors, based on cooperation between free market economies, will benefit everyone active in the global economy.

I have been surprised to hear that some business leaders in Korea are uncertain about the idea of a Japan-Korea FTA. I think they are underestimating the benefits for Korea, in terms of opportunities in Japan, and a big chance to grow through the closer integration of the two economies. Sometimes it seems that Koreans underestimate themselves. I have heard people here compare Korea's role in a Japan-Korea FTA to the role of Mexico in NAFTA. I think the more accurate parallel is really Canada in NAFTA.

Finally, before concluding, I want to note that Korea will host the APEC Ministerial and Leaders meetings in 2005. APEC is the preeminent economic forum in the Asia-Pacific Region, and Korea can use its chairmanship to push vigorously for trade and investment liberalization. Korea is already contributing constructively within APEC, for example by sponsoring a creative transparency initiative. We look forward to working closely with Korea during its chairmanship.

Thank you for your attention, and I look forward to a lively discussion.