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# The U.S. New Trans-Pacific Initiative: Geopolitical Implications of the U.S.-Korea FTA

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Listed are his recent presentations on the related topic: "Geopolitical Implication and Domestic Politics of the U.S.-Korea FTA" (U.S. Center for Strategic and International Studies & Chosun Ilbo, Washington, DC, September 2006), "Domestic Politics of FTAs and Negotiation Strategy for Economic Integration in East Asia" (Asia-Pacific Economic Association, Seattle, WA, July 2006), and "Korea's FTA Policy Focusing its FTA with Japan and U.S." (Research Institute of Economy, Trade, and Industry (RIETI), Tokyo, Japan, July 2006).

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# **The US New Trans-Pacific Initiative: Geopolitical Implications of the US-Korea FTA**

**Se Young Ahn<sup>[1]</sup>**

## **I. Introduction**

At the 14th Asia-Pacific Economic Cooperation (APEC) Leaders' Meeting in Vietnam in November 2006, US President George W. Bush called for a bold strategy for a trans-Pacific APEC-wide Free Trade Area as a long-term goal. This is an ambitious step by the US to encourage trans-Pacific economic integration taken to respond to the rapidly changing geopolitical landscape of the region—an emerging ‘new regionalism in East Asia’ and the rising Chinese economy. The 2006-2007 US-Korea Free Trade Agreement (FTA) negotiations could act as an ice-breaker for President Bush’s Ha Noi initiative on a trans-Pacific Free Trade Agreement.

However, political tensions and conflicts between the US and Korea over FTA negotiations are increasing as negotiation rounds move forward.<sup>[2]</sup> Progress remains very limited despite the efforts of negotiators from both sides to move the talks forward. The domestic constituencies are, particularly in Korea, staging fierce political opposition and resistance to the US-Korea deal. Protest groups are insisting that there are no significant economic benefits in the US-Korea FTA for Korea, and that this deal will simply subordinate the Korean economy to the US. Making matters worse is the result of the US midterm election of November 2006. The Democrats, who traditionally hold negative perceptions of the FTA, now have majority control of the US Senate and House of Representatives. Therefore, there is increasing concern about the future direction of the ongoing US-Korea FTA deal.

There is in fact room for debate on the economic benefits and costs of the FTA deal. When we look at the new geopolitical landscape of the trans-Pacific region, it is necessary to take into account not only economic factors, but also the geopolitical implications involved.

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<sup>[1]</sup> This is revised version. The author is thankful to Dr. Choong Nam Kim and Dr. Seiji Naya for helpful comments on an earlier draft. This research was supported by the Sogang University Foundation Research Grants in 2004.

<sup>[2]</sup> The US and Korean governments have held negotiations since June 2006, and they are aiming to reach a deal by March 2007.

Geopolitical implications are far-reaching. The US-Korea FTA would be the most commercially meaningful deal since NAFTA was reached. It will enable the US to respond more effectively to an emerging “Asia-only regionalism” and rising Chinese hegemony, both of which could otherwise seriously undermine US trade interests in the region. Eventually, it will also encourage the creation a trans-Pacific Free Trade Area. Korea is concerned about weakening military solidarity with the US, the success of the deal, therefore, could become a crucial factor not only in fostering its economic prosperity but also in consolidating its national security interests <sup>[3]</sup> as well as its political clout in the East Asian region. When these geopolitical implications are included in the mix, it becomes evident that the successful completion of a US-Korea FTA is imperative for both the US and Korea.

This paper aims to analyze the geopolitical implications of the US-Korea FTA. After examining the changing geopolitical landscape of the trans-Pacific region in Chapter II, Chapter III presents the imperatives for a US-Korea FTA, focusing on US trans-Pacific cooperation. Chapter IV then provides various perspectives on the ongoing deals. Finally, this paper provides conclusions and policy recommendations for the ongoing US and Korea negotiations.

## **II. The Rapidly Changing Geopolitical Landscape in Trans-Pacific Relations**

There is a prevailing consensus that the US faces three major challenges in international trade: an expanded European Union (EU), emerging regionalism in East Asia, and the rising Chinese economy.<sup>[4]</sup> The latter two are related to the rapidly changing geopolitical landscape in East Asia.

### **1. Emerging “New Regionalism” in East Asia**

One of the most important aspects of the changing geopolitical landscape in East Asia is an emerging “new regionalism.” East Asia is one of the world’s three major economic poles, making up 20% of the world economy. Historically, East Asian economic integration has failed to proceed at a pace equivalent to that of the EU and NAFTA. Among the three major players in

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<sup>[4]</sup> Bergsten, C. Fred et al., *The United States and the World Economy; Foreign Economic Policy for the Next Decade*, IIE, Washington D.C., 2005, pp.3-12.

the region—Japan, China, and Korea—both Japan and Korea have achieved remarkable economic development through the global free trade system led by the U.S., and therefore, considered regionalism as a ‘stumbling block’ which discouraged the expansion of multilateral free trade. The third major player, China, was not an integral part of the world economy until after the end of the 1980s.<sup>[5]</sup>

However, the rapidly changing global economy is forcing the three East Asian countries to consider economic integration. In particular, the Asian financial crisis of 1997 and China’s entry into the WTO forced regional governments to acknowledge the necessity of mutual cooperation in the region. Even though Japan, China, and Korea are relative late-comers to FTAs, they are currently actively pursuing regional trade agreements. China is rapidly transforming its trade policy from a previous focus on WTO accession to one centered on FTAs.<sup>[6]</sup> Before entry into the WTO in 2003, China focused on fulfilling WTO accession conditions. However, since 2003, China has adopted an active FTA policy, beginning with the conclusion of the CEPA (Closer Economic Partnership Arrangement) with Hong Kong (June, 2003) and Macau (October, 2003) as well as ASEAN. In addition, China is currently in inter-governmental trade negotiations with a number of countries including Chile, Pakistan, and Australia, as well as joint-research with Korea.

Until the end of the 1990s, Japan held unfavorable views of FTAs because of a belief that FTA expansion had a negative impact on the world free trade system.<sup>[7]</sup> However, since 2000, Japan has also shifted its trade policy. It first concluded an EPA (Economic Partner Agreement) with Singapore in 2002 and then signed FTAs with Mexico, the Philippines, and Thailand in 2005. As of November 2006, inter-governmental negotiations with ASEAN and Malaysia were ongoing. Japan has also undertaken joint-research with China, and it plans to conclude an FTA with the ‘ASEAN 6’ by 2012 and with the ‘ASEAN 4’ by 2017.<sup>[8]</sup>

Korea also has moved steadily towards economic integration with Chile (2004), Singapore,<sup>[9]</sup> and the European Free Trade Association (EFTA).<sup>[10]</sup> Currently Korea is

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<sup>[6]</sup> Cao, S.G., “The development of FTA in East Asia and Chinese Response,” paper presented at the International Forum on North East Asia Trade Policy Cooperation & Overseas Conference, Nanjing, China, organized by the Korean Association of Trade and Industry Studies, 2002.

<sup>[7]</sup> Urata, S., “Japan’s Strategy toward FTA”, paper presented at workshop for the Asia-Pacific Bilateralism in Berkeley, CA, March 21-22, 2003.

<sup>[8]</sup> Cambodia, Laos, Myanmar, and Vietnam

<sup>[9]</sup> Signed in August 2005 and effective in March 2006.

<sup>[10]</sup> Signed in December 2005.

negotiating FTAs with Canada, Mexico, and India. Korea and ASEAN agreed on an FTA in the trade of goods in April 2006, and they are negotiating an FTA in the trade of services and investment. In addition, Korea is involved in joint research with a number of countries and economic groupings, including China, EU and MERCOSUR. When it comes to Korea's FTAs, the most remarkable and in some sense surprising breakthrough is the opening of official negotiations between Korea and the US. The East Asian nations are attempting to create trade agreements among themselves that range from simple bilateral deals and subregional arrangements, such as that between China and ASEAN, to the ultimate goal of some to create an "East Asia Free Trade Area (EAFTA)."

As for Northeast Asia, steps aimed at an East Asian economic integration have been discussed during annual China-Japan-South Korea summits since 1999. For example, the launching of joint research projects by the three parties was suggested at the 5<sup>th</sup> trilateral summit, held in Bali, Indonesia in October 2003, and exchanges and studies between experts of the three countries have been on-going on at several levels. Three stages of economic integration have been discussed:<sup>[11]</sup> First, a NEAFTA (Northeast Asian FTA) based on a China-Japan-South Korea FTA; second, the NAEA (Northeast Asian Economic Association), like EFTA and ASEAN; and finally, the creation of an NAEC (Northeast Asian Economic Community), similar to the EU.

## **2. US concerns regarding an Asia-only economic bloc**

It is reasonable for the U.S. to assume that this kind of proliferation of FTAs in East Asia could eventually evolve into an Asia-only economic bloc. In fact, the sixteen countries in the region launched the EAS (East Asia Summit) in Malaysia in December 2005. The ten ASEAN countries plus Japan, China, Korea, Australia and New Zealand were included. To the surprise of the US which did not participate, even India was included. What is of even greater concern to the US is that the development of this new regionalism is taking place not only at an "institutional" level, but also at the "market" level.

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<sup>[11]</sup>Kim, Cae-One, *Economic Integration in East Asia*, published by the KERI (Korean Economic Research Institute), Seoul, 2004.

Previously, intra-regional trade in East Asia was much less important than that in the EU and between NAFTA nations, because East Asian countries were “late-movers” in economic integration. However, as Kimura points out,<sup>[12]</sup> new developments in the realm of production sharing/fragmentation among Japan- Korea-China, particularly after the 1997 Asian financial crisis have accelerated the intra-regional trade and investment in the region. This has proven to be an extremely powerful driving force for a “market-oriented’ Asia-only economic bloc, and contributes to the increasing trade deficit between the US and the three East Asian countries.<sup>[13]</sup> The institutional and market-driven economic integration in East Asia means that if the US does not take very active steps, it will eventually become witness to an Asia-only economic bloc.

### **3. Creation of a Greater Chinese Economic Zone (GCEZ): China’s FTA policy - moving towards the South (ASEAN)**

The basic direction of China’s FTA policy is a policy of “Moving towards the South.” China concluded FTAs with Hong Kong and Macau in 2003. The Chinese Prime Minister Zhu Rongzhi proposed the idea of a China-ASEAN FTA at the Singapore China-ASEAN summit in November 2000. Two years later, in November 2002, the China-ASEAN Basic Agreement was signed at the China-ASEAN summit in Cambodia. The two parties agreed to begin tariff reductions in the trade of manufactured goods in July 2005, and to eventually reduce tariffs to 0% for most items by 2010 with the ‘ASEAN 6’ and by 2015 for ‘ASEAN 4’.

What the US should not underestimate is that Beijing’s ambition in that particular region is not merely to pursue simple economic cooperation through a China-ASEAN FTA, but that the ultimate goal is to create a GCEZ, linking all ten ASEAN countries, Hong Kong and Taiwan to Beijing. In fact, the regional economy of ASEAN is already under significant influence of overseas ethnic Chinese. Around 40 million overseas Chinese, representing about 10% of the total population of this region, hold two-thirds of this region’s economic power. To consolidate this existing Chinese economic presence, China is moving very fast towards this region. The

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<sup>[12]</sup> Kimura, Fukunari and Hayakawa , Kazunobu, “Level Uneven Terrain: Integration Strategies in East Asia,” Korea, paper presented at the APEF Conference, Choonchun, Korea, July 2006.

<sup>[13]</sup> Korea imports high-end parts and components from Japan, assembles them, and finally exports finished products to the US. Korea exports mid-end parts and components to China, where they are assembled and then exported by China to the US. It is the US which provides a huge market for the three East Asian countries’ production sharing, and as a result, is experiencing across-the-board trade deficits with all three.

three long-term stages of economic integration are: first, establishment of a China-ASEAN FTA; second, development the China-ASEAN FTA into an ACFTA (ASEAN-China Free Trade Area)<sup>[14]</sup>, and finally, creation of the GCEZ. As Table 1 indicates, once this GCEZ is created, it will account for 5.8 % of world GDP and 29.5% of the world population. There is considerable concern on the part of the US regarding this GCEZ, which could profoundly impact not only the economy but the geopolitics of the region.<sup>[15]</sup>

Table 1. Greater Chinese Economic Zone (GCEZ)

	GDP (billion US\$)	%	Population (million)	%
World	36,170	100	6,198	100
China	1,409	3.9	1,280	20.7
ASEAN 10	682	1.9	546	8.8
China + ASEAN (GCEZ)	2,091	5.8	1,826	29.5

Source: IMF, GDP (2003), Population (2002)

#### 4. Korea's choice in a new hegemony game in East Asia

The rapidly changing geopolitical landscape in East Asia has triggered competition over hegemony between Japan, the traditional economic leader, and China, the emerging challenger. The strength of the Chinese economy and the decade-long stagnation in Japan is likely to weaken the Japan's bid for hegemony while enhancing China's role in the region. On the economic front, this means that the "Flying Geese Development"<sup>[16]</sup> pattern led by Japan will eventually be replaced by the creation of a GCEZ.

However, Japan is not likely to idly stand by and allow China to emerge as the dominant hegemony in East Asia. What we are likely to witness is an escalating 'hegemony game' between these two countries, not only regarding FTA issues but in the two governments' handling of a wide range of issues, including those pertaining to history (the "history textbook" issue), territorial claims (the East China Sea dispute), and politics (visits to Yasukuni Shrine by Japanese prime ministers), etc.

<sup>[14]</sup> Park, Dong Hyun, "The prospects of ASEAN-China Free Trade Area (ACFTA)," paper presented at the APEF Conference, Choonchun, Korea, July 2006.

<sup>[15]</sup> Especially following a recent publication of the CSIS and IIE in 2006. See C. Fred Bergsten, Bates Gill, Nicholas R. Lardy, Derek K. Mitchell, *China: The Balance Sheet-What the World Needs to Know Now about the Emerging Superpower*, IIE and CSIS, Washington D.C., 2006. More information on the IIE/CSIS joint project is available at [www.chinabalancesheet.org](http://www.chinabalancesheet.org)

<sup>[16]</sup> Ahn, ChoongYoung, *Economics of Korea and East Asia*, Seoul, BakYoung Publications, 2001.

The only remaining country in East Asia which does not engage in a hegemony game is Korea. Korea is the world's eleventh largest economy with a GDP of 697.7 billion USD in 2004. All of its major trading partners are located in the Asia Pacific region: Korea's largest trading partner is China with a trade volume of 61.9 billion USD in 2005, the second is the US with 41.3 billion USD, and third is Japan with 24.0 billion USD.<sup>[17]</sup>

Considering Korea's geopolitical location, economic power, and its trade volume with the US, China and Japan, Korea's choice between China and Japan is vitally important not only to the Sino-Japanese hegemony game but also to the new US trans-Pacific policy initiative. In this sense, Korea has earned a critical casting vote.<sup>[18]</sup> If Korea were to choose to sidle up to China rather than the US and Japan, there is little doubt this would lead to the consolidation of Chinese hegemony. It will eventually allow the creation of the GCEZ, which in turn would encourage an Asia-only economic bloc. If, on the contrary, Korea chose to strengthen ties with Japan along with the US, it would help the US to strengthen its presence in the region.

The reality of the current situation is that Korea is moving closer to China both in terms of trade and overseas investment. This is leading to an increasing dependency on the Chinese economy and subsequently, less dependency on the US. Until 2003, the US was South Korea's largest trading partner, but since 2004 China has replaced the US: trade between Korea and China (61.9 billion US\$) has surpassed that between Korea and the US (41.3 billion US\$). In addition, around 40% of Korea's overseas investment now goes to China, which makes Korea the second largest foreign investor in China.

### **III. The US New Trans-Pacific Initiative and the US-Korea FTA**

#### **1. The US imperative for a new trans-Pacific initiative**

As we have seen thus far, the "new regionalism" and the creation of a GCEZ could have a tremendous impact on US prosperity and US influence in the East Asia region. Therefore, it is important to understand these changes in the region in terms of US interests. To summarize, US

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<sup>[17]</sup> [www.kita.net](http://www.kita.net)

<sup>[18]</sup> For a detailed analysis of Korea's strategic options and Sino-Korea strategic choice, see Choong Nam Kim, "Exploring South Korea's Strategic Vision in the Twenty-First Century," a manuscript (2006).

interests are challenged by an acceptance of Chinese hegemony and the cost to the US of an Asia-only economic bloc.

Throughout the post-cold war period, America's global partners in the international economy—Japan, Germany, Canada, and the UK—held fundamentally similar views: support of market-oriented economies and democratic governance. This made Japanese hegemony in East Asia more palatable to the US. The US assumed that Japan's trade interests were compatible with those of the US.<sup>[19]</sup> One-party China, however, is different indeed; it is a non-market economy and non-democratic government. China presents a new challenge to the US. China's unilateral hegemony based on a GCEZ could generate not only an Asia-only economic bloc but could also pose a security threat to the US by disturbing the balance of power in the East Asian region. One should not overlook the possibility that China may devote a sizeable share of its economic power to its military.

If the U.S. fails to grasp the situation at hand and an "Asia-only economic bloc" and GCEZ develop, the costs to the US would be great. The first would be a huge trade diversion cost. As C. Fred Bergsten points out, "*an Asian-only economic bloc excluding the U.S. could create substantial trade diversion costs, which would reduce U.S. exports alone by about \$25 billion per year immediately.*"<sup>[20]</sup> Most US businesses, particularly those in the agriculture and manufacturing sectors, would suffer from the resulting tremendous trade diversion costs.

Second would be the cost of an ever-growing U.S. trade deficit with China. The U.S. is already suffering from a huge trade deficit with China, amounting to more than 200 billion USD. The emergence of an Asia-only regionalism would eventually drive up the US trade deficit with China because such a regionalism would encourage Asia-only production sharing between China, Japan, Korea, and ASEAN member states without US participation.<sup>[21]</sup>

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<sup>[19]</sup> For a detailed analysis of the rising China, see "China: The Balance Sheet" (2006).

<sup>[20]</sup> Bergsten, C. Fred, "Embedding Pacific-Asia into the Asia-Pacific: the global impact of an East Asia Community," Speech at the Japan National Press Club, Tokyo, September 2, 2005.

<sup>[21]</sup> This, in turn, would promote the relocation of manufacturing activities to China from elsewhere in East Asia, and eventually increase China's exports to US markets.

Eventually, an Asia-only economic bloc would damage the world free trading system. It should be noted that the economic prosperity of the three East Asian countries is fundamentally based on an open US market. An Asia-only economic bloc risks breaking existing economic ties between the US and the three East Asian countries, which would seriously affect all three but the rising Chinese economy in particular. Finally it would bring about the rupture of world free trading system.

## **2. The US New Trans-Pacific initiative: President Bush's Ha Noi vision for a trans-Pacific Free Trade Agreement.**

President Bush's vision for a trans-Pacific Free Trade Area presented at the 2006 APEC Leaders' Meeting of November 2006 reflects the US' urgency to undertake a proactive trans-Pacific trade policy initiative that has two objectives. The first is to avoid drawing a line down the middle of the Pacific dividing it between the US and East Asia. The second is to build up trans-Pacific institutional ties that will enable the US to engage directly with the most dynamic economies in the world. As a matter of fact, the idea of an 'FTA of the Asia Pacific (FTAAP), which accounts for nearly half of the world trade and generates 70 percent of global economic growth, was proposed by the APEC Business Advisory Council in 2004. Business groups in the region and some US academics and trade experts have lobbied for several years for the promotion of the FTAAP, but APEC leaders have sidestepped the controversial idea, including even a feasibility study. With President Bush's Ha Noi vision, the United States is believed to be spearheading the initiative among APEC member economies to look into the viability of the plan.<sup>[22]</sup> This could face opposition from China who forging its own set of intra-regional free trade plans (creation of the GCEZ). APEC leaders embraced the US President's vision and took an important step in exploring a trans-Pacific, region-wide Free Trade Area of the Asia-Pacific as a long-term goal. APEC leaders charged their officials with exploring possible ways to achieve an APEC-wide FTA. Officials will report back to the leaders at the Sydney APEC meeting in September 2007.<sup>[23]</sup>

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<sup>[22]</sup> US Trade Representative Susan Schwab said the United States hoped the Asia-Pacific free-trade plan would eventually become a reality.

<sup>[23]</sup> [www.whitehouse.gov](http://www.whitehouse.gov)

In reality, considerable preparatory work is necessary to pave the way for such bold Trans-Pacific economic integration. Therefore, a more significant and immediate US response, particularly to the rapidly emerging GCEZ, can be seen in its choice of a ‘containment FTA’ policy. Just as the US pursues a containment strategy in the security domain, its basic policy direction is to contain or surround the Chinese economy by forming FTAs in two directions: first, from the South East, and secondly from the North East.

### **3. The US-Korea FTA imperative**

The US-Korea FTA is critical to the success of the US containment policy. As J. Schott (2006) asserts, “*The U.S.-Korea FTA, as well as the U.S. initiatives with ASEAN, are a preemptive U.S. response to the emerging new regionalism in East Asia.*”<sup>[24]</sup>, The US is pursuing a containment policy from the South East by consolidating its economic ties with Singapore, Thailand, Malaysia, and Australia through FTAs. When it comes to the containment policy from the North East, only two countries remain outside the GCEZ umbrella: Japan and Korea. The Japanese economy is too competitive and burdensome for the US to attempt a FTA. Only Korea is able to join a US containment policy from North East Asia through a bilateral FTA. In this regard, Korea’s role as a counter-balancing power against a rising China is very important for the protection of US trade interests in the region.

Secondly, a US-Korea FTA would be the most commercially meaningful FTA since the creation of NAFTA. Bilateral trade between the US and Korea amounted to nearly 72 billion USD in 2005, making Korea the 7<sup>th</sup> largest trading partner and 6<sup>th</sup> largest agricultural export market for the US. A US-Korea FTA would enable the US to recapture the Korean market—the US share in the Korean market having declined from 15 percent in 2002 to only 13 percent in 2004.

Third, a US-Korea FTA would be, from the US standpoint, the first ‘large’ trans-Pacific FTA. Up to 2006, the US had or was negotiating FTAs with Singapore, Australia, Malaysia, and Thailand. All of these could be considered ‘small’ trans-Pacific FTAs since the US trade volume

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<sup>[24]</sup> Schott, J.S.C. Bradford, and T. Moll, “Negotiating the Korea-US FTA,” IIE, Washington D.C., June 2006.

with these countries is relatively limited: none of these countries is among the US top ten largest trading partners.

Finally, in a global context, a US-Korea FTA would contribute to the sound development of a world free trade system, since it plays an important role in linking the US economy with the East Asian economies and by discouraging a so-called Asia-only economic bloc.

### **III. Perspectives on a US-Korea FTA**

#### **1. Overview of the on-going US-Korea negotiations**

The US and Korean governments opened the first round of negotiations on June 2006. Since then, they have held six negotiation rounds up to January 2007. The two governments have set a target of concluding a deal three months before the US TPA (Trade Promotion Authority) expires in June 2007. So they will have only one more round of negotiations by March 2007. The task is doable, though difficult.<sup>[25]</sup> Political tensions and reactions to the negotiations from anti-US-Korea FTA groups are increasing and several deal-breaker issues such as, agriculture, the automotive and pharmaceutical industries, the duty-free status of Kaesong-produced goods, trade remedies, etc., may lead to a stalemate in ongoing negotiations and may jeopardize a deal entirely. However both governments, at least so far, seem to have reached a solid consensus and show a willingness to conclude the US-Korea FTA. As a matter of fact US and Korea trade officials are in a better position and have a better working relationship now that could help settle politically sensitive and technically complicated issues. In addition, the result of the US midterm election, six-party talks on the North Korea nuclear issue, and suspension of the Doha Development Agenda will also affect this bilateral deal. Therefore, it is extremely difficult to forecast the future direction of ongoing US-Korea negotiations. However, this paper proposes four very tentative scenarios for a US-Korea FTA deal.

#### **2. Four scenarios**

##### ***Scenario 1: Hard bargaining, followed by an ultimately successful US-Korea FTA***

Despite efforts by US and Korean trade officials to move negotiations forward, progress remains very limited, since both governments continue to employ hard bargaining positions in order to

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<sup>[25]</sup>J. Schott et al.(2006), p.8.

maximize their individual trade interests at the expense of the other. Negotiations could be described as a ‘zero-sum game’. Both US and Korean negotiators are very sensitive to and over-conscious of political pressure and the reaction of congress and thus have not made productive concessions. However, in Scenario 1, an agreement will eventually be reached not by trade officials but through ‘political decisions’ made by the political leaders of both countries.

In this scenario, strong political leadership from the US and Korean presidents plays a crucial role and political concerns override economic ones. As a result, both sides create a ‘package deal’ or ‘give and take deal’. This means that the most politically sensitive items, for example rice, Kaesong etc., are excluded or a compromise is reached on certain points to find a solution which satisfies not only the two negotiating sides, but also domestic constituencies.<sup>[26]</sup> When would such political decisions be made by strong political leaders? It would be at the final stage of negotiations, nearing the deadline of March 2007.<sup>[27]</sup>

***Scenario 2: Technical failure—unable to reach an agreement due to time restraints***

This scenario represents a missed opportunity. In this scenario, both governments make very serious and sincere efforts, yet fail to reach a set of common agreements by the designated deadline. As a matter of practice, the deadline of March 2007 provides too short a time frame for such a complicated and controversial trade deal. Under this scenario, the pressure of reaching an agreement before the expiration of the US Trade Promotion Authority (TPA) could jeopardize the deal, but mutual trust remains between the two countries, leaving room for them to reopen dialogue in the future.

***Scenario 3: Unilateral withdrawal from the negotiation table***

Switzerland gave up its attempts to reach an FTA with the US, mainly because of the agricultural market opening issue.<sup>[28]</sup> In fact, US agricultural exports represent only 4% of Switzerland’s total agricultural imports. However the political clout of the agricultural sector is so fierce that the Swiss government withdrew from negotiations, yielding to political pressure coming from its highly organized farmers. The Korean government also unilaterally withdrew from FTA

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<sup>[26]</sup> Market opening of agriculture is one of the hottest issues in trade negotiations. Korea is demanding the exclusion of a number of specific sensitive items from the FTA, including rice, beans, beef, pork, chicken, garlic, apples, pears, grapes, and oranges. The US position on the agricultural market is a hard-line demand that the market be fully opened without exception. At the final stage, both sides will work toward a compromise on certain points to find a solution which satisfies not only the other side, but also domestic interests groups.

<sup>[27]</sup> The deal could be extended over the deadline (March 2007).

<sup>[28]</sup> Between mid-2005 and the beginning of 2006, 63 percent of Switzerland’s exports were to the European Union (EU), whereas only 10 percent were to the US. Similarly, the US held only a weak position in Swiss imports, with 83 percent coming from the EU and only 4 percent from the US.

negotiations with Japan. They held six rounds of official negotiations, but Korea abandoned the negotiation table in December 2004.

This scenario could be repeated in the US-Korea FTA negotiations. Theoretically each of the two governments is able to withdraw unilaterally. President Roh statement in the early part of 2006 deserves attention: “ --We should be aware that the negotiations could fail depending on the terms of the negotiations, For it is possible that there may be an ultimate condition that we could not yield to”<sup>[29]</sup> What that ultimate condition is remains to be seen but it could depend at least partly on how active Korean protestors are as the negotiations progress. At the very least, President Roh’s remarks serve as a reminder that it is not realistic to expect the FTA to resolve all problems US companies face in the Korean market, this would place too much of a political burden on President Roh.<sup>[30]</sup> In Scenario 3, each of the countries tries to point the finger of blame at the other for the failure to reach a deal. This would damage the US-Korea relationship somewhat, but would not destroy it.

#### ***Scenario 4: Political conspiracy***



**-Korean NGO anti-US-Korea FTA demonstration in Washington, D.C.-**

<sup>[29]</sup> Amy Jackson, “Hitting the Ground Running on the US-Korea FTA,” *Chamber of Commerce in Korea*, May/June 2006. p.35.

<sup>[30]</sup> Jackson (2006), p.35.

The picture above is of an anti-U.S.-Korea FTA demonstration in Washington, D.C. in June 2007 by Korean NGOs. The demonstrations signs read: 1) “*FTA destroys labor rights,*” 2) “*farmers, against globalization,*” and 3) “*US troops out of Korea.*” The first slogan, “FTA destroys labor rights” is typical of a ‘loser’ group’ in trade agreements—organized labor. The second slogan too is commonplace in demonstrations against trade agreements since all around the world farmers are essentially against globalization and Korean farmers are not its exception. The third slogan calling for the withdrawal of US troops from Korea is more troubling.

Why would such a slogan be found at an anti-FTA demonstration? Here it becomes necessary to understand the complexity of contemporary Korean society. There is an increasing number of “anti-US groups’ that are trying to turn Korea against the US generally. In this sense, it seems that their ultimate goal in anti-FTA efforts is to link and expand ‘anti-US-Korea FTA movement’ into a general ‘anti-US’ movement.

Based on the above, we can see that Scenario 3 (‘unilateral withdraw’) could be interpreted as or actually become a ‘political conspiracy’ (Scenario 4) if populist and left-wing politicians in Korea decide to capitalize on the anti-FTA and/or anti-US sentiments as a tool to consolidate political power in the coming presidential election. In light of a weakening US-Korea military alliance, a failed deal under this scenario would cause significant damage to the bilateral relationship and create general negative feelings about Koreans in the US, and vice-versa.

### **3. What might happen if the US-Korea FTA breaks down?**

The total breakdown of a US-Korea FTA would result in a lose-lose outcome for both countries, while its specific impact would depend on exactly how the negotiations fail. As for US interests, if talks break down in the manner spelled out under the third or fourth scenario, the US could lose an important economic ally in the region as Korea is highly likely to eventually step under the umbrella of a GCEZ. This would strengthen Chinese hegemony and weaken the US presence in the region, generating considerable risk of an Asia-only economic bloc.

As for Korea, if the deal breaks down, especially under scenario three and four, Korea could forfeit the future possibility of having an FTA with other major trading partners (ex Japan, EU, China, etc.) since its trading partners would be unable to trust the Korean government’s

ability to conduct a level two game,<sup>[31]</sup> that is, to handle and persuade its domestic constituencies.

#### **4. What might happen if a US-Korea FTA is reached?**

##### ***Competitive Liberalization***

The success of the US-Korea FTA would lead to “competitive liberalization”<sup>[32]</sup> pressures on other countries in East Asia. First, it would be China and Japan who move toward Korea to reach an FTA because the US-Korea FTA will negatively affect them through a trade diversion effect.<sup>[33]</sup> The EU will also move swiftly towards Korea. Eventually, the US-Korea FTA could even push Japan to overcome long-standing objections and pursue FTA talks with the US.<sup>[34]</sup> The US will benefit from this competitive liberalization because it fosters trans-Pacific economic integration and finally enables the US to have the FTAP (Free Trade Asia Pacific).

##### ***Korea as an FTA Hub in East Asia***

As for Korea, competitive liberalization will enable it to become an ‘FTA Hub’ country in the region if it leads to FTAs with China, Japan, the EU, Australia, etc. This sort of a Korean presence will enhance not only its economic interests but also its international role, much like the role Belgium has played in the development of the EU.<sup>[35]</sup> In addition Korea’s enhanced partnership with the US would also help it to strengthen its bargaining power in East Asia, as it is surrounded by two super economic powers.

##### ***Enhanced security in Korean Peninsula***

The US-Korea FTA will serve as a vehicle for consolidation and cooperation on security issues in Northeast Asia, as well. The role of an FTA HUB will offer Korea an advantageous position to promote peaceful resolution of the North Korean issues.

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<sup>[31]</sup> Ahn (2006 )

<sup>[32]</sup> The basic direction of US FTA policy, as Zoellick and Bergsten point out, is the concept of “competitive liberalization,” under which US negotiations with trading partners create new incentives and pressures for nonparticipating countries to join the process. C. Fred Bergsten (2006).

<sup>[33]</sup> It is expected that substantial Chinese agricultural exports to Korea will be diverted into US exports.

<sup>[34]</sup> Schott(2206), p. 13.

<sup>[35]</sup> As a result the headquarters of the EU is located in Belgium.

### *US stronghold in East Asia and countervailing power vis-à-vis a GCEZ*

From a US perspective, this FTA presents the opportunity to establish a strong foothold in East Asia, as well as a stepping stone toward the expanding huge Chinese market.<sup>[36]</sup> Furthermore, closer policy coordination among US, Japan, and Korea based on FTAs will be a very effective tool in blocking the formation of an Asia-only economic bloc.

#### **IV. Concluding Remarks**

Even though the economic effects of the US-Korea FTA continue to elicit political tension and resistance from anti-FTA groups, the geopolitical impact of this FTA would be so great and its contribution to the world free trading system so significant, that the two countries continue to view its successful conclusion as the ultimate goal. Considering the rapidly changing geopolitical landscape in the Asia Pacific region, the failure of the US-Korea FTA is no longer considered an option. Rather both sides consider it imperative to succeed because its breakdown costs are so high and its impact on the geopolitical landscape as well as the domestic economies is potentially so productive.

Therefore, the most important question is how to address 'the deal-breakers' such as agriculture, Kaesong and automotive issues. As mentioned previously, trade officials at the negotiation table have been unable to address these hot issues successfully. As a matter of fact, the U.S. and Korean trade officials are faced with a dilemma. While they both recognize the imperative of successfully concluding the deal, they are faced with the reality of considerable domestic resistance. They must return home only with negotiation outcomes that are acceptable to their respective legislatures and domestic interest groups. If talks are derailed by such a dilemma, then the only possible solution is a political decision made by the Presidents of both countries.

In the US the expression 'Presidential Liberalism - Congressional Protectionism' is used. It means that generally in democratic states such as the US and Korea, the administrative body holds more liberal attitudes towards trade policy than the legislative body which is more closely associated with advocating the economic interests of its electorate. Therefore, it is only the President who can adopt a comprehensive approach towards the US-Korea FTA by analyzing its purely economic effects and its geopolitical implication together. In this regard, the success of

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<sup>[36]</sup> Myron Brilliant, "US-Korea FTA Business Coalition," Chamber of Commerce in Korea, May/June 2006.

the US-Korea FTA will require above all strong political leadership which takes a firmer stance in promoting the agreement and overcoming political resistance to it.

If the US-Korea FTA deal is concluded through this kind of political leadership, it will eventually become a ‘comprehensive but mid-level’ FTA. Currently, the US-Korea deal includes a broad range of issues, from trade and investment to intellectual property rights, service, trade remedies, competition, and more. In this sense, the US-Korea FTA will be certainly comprehensive one. However, when it comes to politically sensitive issues that have the potential to be deal-breakers, a mid-level FTA would allow the US and Korea to exclude or reserve certain items that prove to be overly politically sensitive.<sup>[37]</sup> This is possible, of course, only as long as these ‘significant exceptions’ are not against the GATT/WTO regulations, particularly the GATT XXIV-8.<sup>[38]</sup>

For all the reasons discussed so far, a successful mid-level FTA would be a much more desirable outcome for both the US and Korea than the complete failure of talks would be. US and Korean negotiators must find some room for productive concessions in upcoming talks. The market-opening of Korean agriculture is a case in point. Korean farmers are demanding the exclusion of most agricultural products from the deal, where as the US is in a firm position of complete market opening.

Considering the unacceptable results from the claims of Korean farmers in the case of the Korea-Chile FTA,<sup>[39]</sup> the legitimacy of their claims must be called into question. On the other hand, the approach of the US Congress and business interests that are demanding and expect the resolution of all long-standing trade issues and a complete market opening of the Korean agricultural sector is unproductive. If at least some significant new export opportunities are provided by the FTA to US farmers, the Mid-level FTA should be ratified by the US Congress and should receive the support of interest groups.

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<sup>[37]</sup> During negotiations of an FTA between the US and Australia, sugar proved to be a deal breaker, and subsequently, was completely excluded from the US-Australia FTA.

<sup>[38]</sup> GATT XXIV-8: “In regard to interim agreements, the working party may in its report make appropriate recommendations on the proposed time-frame and on measures required to complete the formation of the customs union or free-trade area. It may if necessary provide for further review of the agreement.” The full text of the GATT agreement can be found at [http://www.wto.org/english/docs\\_e/legal\\_e/10-24\\_e.htm](http://www.wto.org/english/docs_e/legal_e/10-24_e.htm)

<sup>[39]</sup> The Korean government agreed to give huge compensation to the farmers who claimed to be ‘seriously injured’ by imported Chilean agricultural products. But subsequently there was not so significant increase in competition from Chilean agricultural products.

The extent to which the US-Korea FTA will affect the two countries is not predetermined but will depend greatly on the negotiation game in upcoming rounds. While must reserve judgment until a final deal becomes public. “Short term cost for long term gain” should be the motto adopted by both parties since a successful FTA could far outweigh the costs of mutual concessions on limited economic issues.

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