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## Korea-US Free Trade Revisited

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Two years ago, we published an analysis of the costs and benefits of negotiating a bilateral free trade agreement (FTA) between South Korea and the United States (Choi and Schott 2001). Neither government had proposed such an initiative, but it was under active discussion by business leaders and academics in both countries. The study concluded that

- economic welfare gains for both countries would be significant, if all sectors—including agriculture—were covered by the obligations;
- deep-rooted political opposition to specific reforms existed in both countries;
- the FTA would generate substantial trade diversion, particularly affecting suppliers in Japan and China; and
- an FTA could induce a series of counterbalancing initiatives among other East Asian countries in response to the expected discrimination in the US and Korean markets.

For the United States, the main benefits of the FTA would derive from modest welfare gains (resulting primarily from improved terms of trade); from the likely catalytic effect of the Korea-US accord on trade liberalization in the region as Taiwan, the Association of Southeast Asian Nations

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(ASEAN), and possibly Japan sought comparable pacts; and from the support the trade initiative could give to promoting growth and stability on the Korean peninsula. For Korea, the FTA would induce much larger welfare gains as the country implemented domestic economic reforms pursuant to its FTA obligations (such reforms are needed in any event but would be hard to enact in the face of strident political opposition in Korea absent a payoff of US concessions that improve access for Korean exporters to the US market); would counter trade diversion suffered by Korean exporters as a result of other US preferential trade pacts (especially the North American Free Trade Agreement, or NAFTA); and would provide additional incentives for foreign investors in the Korean economy. These findings led us to recommend that “if the United States and Korea want to maximize both welfare gains and political comity in the Asia-Pacific region, the preferred trade strategy should be to concurrently pursue trade reforms bilaterally, in APEC [the Asia Pacific Economic Cooperation forum] and in WTO negotiations” (Choi and Schott 2001, 79–82).

Over the past two years, the trade environment has changed significantly, creating new opportunities but also posing irksome new challenges to prospective Korea-US negotiations. First, the launch of the Doha Round negotiations in the World Trade Organization (WTO) in November 2001 revived prospects for global trade reforms that had been dormant since the failed Seattle WTO ministerial in 1999. The passage of US trade promotion authority (TPA) in August 2002 provided US officials with the congressional mandate and negotiating flexibility needed to pursue comprehensive trade agreements in bilateral, regional, and multilateral forums (provided the agreements cover broad-ranging rights and obligations and produce balanced results in certain import-sensitive sectors). That authority already has been applied to ratify and implement FTAs negotiated with Singapore and Chile, and could be used to facilitate a Korea-US FTA. Indeed, the US International Trade Commission has already been asked by Congress to study the economic implications of a comparable agreement with Korea; it issued conclusions (USITC 2001) in September 2001 similar to those reported by Choi and Schott (2001).

Second, the international trade environment has become more unsettled, especially from a Korean point of view. The Doha Round is traversing rough shoals, with talks threatening to stall on the contentious issue of agricultural reform. While Korea studies its FTA options, its competitors in East Asia have begun to negotiate. Most prominent among the new initiatives is the China-ASEAN free trade talks. The prospect of a broad “10 plus 1” pact has in turn provoked Japan to pursue a comparable initiative; in addition, Japan launched FTA negotiations with Mexico in late 2002. Discussions among the even broader grouping of ASEAN and Northeast Asian countries, the “10 plus 3,” seem far removed from concrete trade negotiations—though the prospect of such a regional trading powerhouse excites the imagination of many Korean policymakers. Whether China

wants any part of that game is another story. More ominously, the flare-up of North-South tensions on the Korean peninsula raises the political risk premium of investment in Korea; conversely, however, that threat also reinforces interest in deepening trade ties as part of a broader strategy to strengthen economic and political stability in the region.

Third, developments in the bilateral economic relationship also have generated mixed signals about the desire to move into FTA negotiations. On the one hand, there have been important US investments in the Korean economy, including the purchase of Daewoo by General Motors. On the other hand, some trade disputes, notably over steel, have become more contentious. Perhaps more telling is the rapid growth in Korea-China trade, which stands in stark contrast to the basically flat growth rates of Korea-US trade over the past two years. In sum, the decision to launch FTA negotiations between the United States and Korea now involves a much more complicated calculus than it did just two years ago.

This chapter offers a reappraisal of the economic and political benefits and costs of pursuing a bilateral Korea-US FTA. It examines the current status of bilateral trade and investment, as well as the range of trade frictions that could be resolved by an FTA—but that at the same time pose practical obstacles to such a negotiation. We then analyze the potential benefits of an FTA, drawing on both computable general equilibrium and gravity models to suggest parameters of the potential trade and welfare gains for each country. The next section addresses the potential costs of an agreement, in terms both of trade diversion from other suppliers in East Asia and of possible distractions from ongoing WTO negotiations. We conclude with near-term prospects for trade negotiations and policy recommendations.

## **Bilateral Trade and Investment**

Among all the countries with which the United States is either negotiating or seriously considering an FTA, Korea is the one with which it has the most extensive trade relationship. Two-way merchandise trade totaled \$56 billion in 2002, with the United States running a bilateral trade deficit of \$14 billion. In addition, bilateral trade in services reached almost \$11 billion in 2001. Agricultural products in 2002 accounted for less than 5 percent of total trade but represented 11.6 percent of US exports to Korea (see tables 7.1 and 7.2). Overall, Korea ranked as the United States' seventh-largest trading partner in 2002.

The United States remains Korea's most important trading partner, accounting for 20.2 percent of Korean exports and 15.1 percent of Korean imports in 2002. To be sure, trade with China (including Hong Kong) is growing rapidly; in fact, China edged out the United States as Korea's largest export market in 2002. Imports from the United States still exceed those from China, but Chinese suppliers are catching up quickly at the ex-

**Table 7.1 US trade with Korea, 1995–2002** (millions of dollars)

Product	1995	1996	1997	1998	1999	2000	2001	2002
<b>US exports to Korea</b>								
Agriculture	2,946	3,231	2,305	1,761	2,261	2,252	2,264	2,449
Share of total (percent)	12.0	12.7	9.5	11.0	10.3	8.6	10.8	11.6
Total merchandise	24,480	25,430	24,290	15,980	22,040	26,300	20,900	21,150
<b>US imports from Korea</b>								
Agriculture	176	176	183	155	180	203	224	248
Share of total (percent)	0.7	0.8	0.8	0.7	0.6	0.5	0.6	0.7
Total merchandise	24,030	22,530	22,940	23,700	31,150	39,830	34,920	35,280
<b>US trade volume with Korea</b> (exports plus imports)								
Agriculture	3,122	3,407	2,488	1,916	2,441	2,455	2,488	2,697
Share of total (percent)	6.4	7.1	5.3	4.8	4.6	3.7	4.5	4.8
Total merchandise	48,510	47,960	47,230	39,680	53,190	66,130	55,820	56,430
<b>US trade balance with Korea</b> (exports minus imports)								
Agriculture	2,770	3,055	2,122	1,606	2,081	2,049	2,040	2,201
Total merchandise	450	2,900	1,350	-7,720	-9,110	-13,530	-14,020	-14,130

Note: "Agriculture" is defined as chapters 1–24 in the Harmonized Schedule.

Source: US International Trade Commission Trade Database, <http://dataweb.usitc.gov>.

pense of both US and Japanese companies (see table 7.3). Japan remains the leading source of imports, but the Japanese share of the Korean market has steadily eroded from a peak of 41 percent in 1971 to less than 20 percent for the past few years. These dramatic shifts in market share explain in part Korea's growing interest in a regional trade pact with China at the same time that it continues to study potential FTAs with Japan and the United States.

Over the past decade, manufactured goods have accounted for about 60 percent of US exports of goods and services to Korea (mainly electrical machinery and equipment, aircraft, scientific equipment, and organic chemicals), and 80 percent of Korean exports to the United States (primarily autos, telecommunications equipment, semiconductors, computers and parts, and apparel). Interestingly, 30 percent of total Korea-US trade in 2002 was in Harmonized Tariff Schedule chapter 85: electrical machinery and equipment (mainly semiconductors and computers and parts). In the case of computer chips trade, the two countries show a clear pattern of intraindustry trade: the United States exports high-tech processors and chips, and Korea mainly exports memory chips.

Indeed, Korea's intraindustry trade has steadily increased over the years, with the extent of such trade with the United States somewhat less than that with its other global trading partners. This trend has important implications, since a given expansion of intraindustry trade is generally

**Table 7.2 US-Korea trade by major product, 2001–02**  
(millions of dollars, percent of total)

Industry	2001		2002	
	Value	Share	Value	Share
<b>US imports from Korea</b>				
Agricultural and food products	223.4	0.6	247.4	0.7
Minerals and chemicals	1,077.4	3.1	832.3	2.4
Textiles and apparel	1,383.5	4.0	2,032.2	5.8
Goods related to transportation	7,095.5	20.3	7,528.7	21.3
Other manufactured goods	24,395.4	69.9	23,879.2	67.7
Special categories	742.0	2.1	764.0	2.2
<i>Goods subtotal</i>	34,917.2	100.0	35,283.8	100.0
Services	3,765.0	n.a.	n.a.	n.a.
Total	38,862.2	n.a.	n.a.	n.a.
<b>US exports to Korea</b>				
Agricultural and food products	2,264.4	10.9	2,449.4	11.6
Minerals and chemicals	2,412.1	11.6	2,572.6	12.2
Textiles and apparel	304.8	1.5	271.9	1.3
Goods related to transportation	3,050.6	14.6	2,756.8	13.1
Other manufactured goods	12,423.8	59.7	12,624.2	59.9
Special categories	371.8	1.8	406.6	1.9
<i>Goods subtotal</i>	20,827.5	100.0	21,081.5	100.0
Services	7,121.0	n.a.	n.a.	n.a.
Total	27,948.5	n.a.	n.a.	n.a.

n.a. = not available

Sources: US International Trade Commission Trade Database, <http://dataweb.usitc.gov>; the Office of Textile and Apparel, <http://otexa.ita.doc.gov>; and the US Department of Commerce Bureau of Economic Analysis, [www.bea.doc.gov](http://www.bea.doc.gov).

thought to pose fewer adjustment problems and subsequently fewer trade conflicts than intraindustry trade.

In addition to its role in trade, the United States has been the largest source of foreign direct investment in Korea (see table 7.4). The stock of US FDI in Korea reached \$10 billion by year-end 2001 and should be valued even higher when flows related to the recent purchase of Daewoo by General Motors are included in the statistics.<sup>1</sup> That investment exemplifies an important shift in US corporate involvement in the Korean economy. In the past, US investors usually took minority stakes in joint ventures because of restrictions on fully owned subsidiaries or majority-owned companies. Liberalization of investment laws and regulations since the 1997 economic crisis has helped to encourage more substantial

1. General Motors Group (including GM, Suzuki, and Shanghai Automotive Industry Corp.) holds a 67 percent share in GM Daewoo Auto & Technology Company. The remainder is held by Daewoo Motors Creditors Committee. General Motors (US) paid \$251 million for its 42.1 percent share of the new company in October 2002 (correspondence from GM Corporation, May 2003).

**Table 7.3 Korea's major trading partners, 1995–2002**  
(share of trade in percent)

Country	1995	1996	1997	1998	1999	2000	2001	2002
<b>Exports to</b>								
United States	19.3	16.7	15.9	17.3	20.6	21.9	20.8	20.2
Japan	13.6	12.1	10.9	9.3	11.1	11.9	11.0	9.3
China	7.3	8.8	10.0	9.0	9.6	10.7	12.1	14.7
China + Hong Kong	15.9	17.3	18.6	16.1	15.9	17.0	18.4	20.9
<b>Imports from</b>								
United States	22.5	22.2	20.8	21.9	20.8	18.3	15.9	15.1
Japan	24.2	21.0	19.2	18.0	20.1	19.9	18.9	19.6
China	5.5	5.7	7.0	6.9	7.4	8.0	9.4	11.4
China + Hong Kong	6.1	6.5	7.6	7.5	8.1	8.8	10.3	12.6

Source: Korean Customs Department, [www.customs.go.kr/hp/homepage/eng/index05.htm](http://www.customs.go.kr/hp/homepage/eng/index05.htm).

US investments; the GM deal and the purchase by Newbridge Capital of Korea First Bank are the most ambitious of these.<sup>2</sup> Locking in those reforms and complementing them with the types of investor protections included in the Singapore and Chile FTAs with the United States would be high priorities for US negotiators of an FTA with Korea.

### Bilateral Trade Frictions

Any trade relationship as sizable as that between the United States and Korea will naturally provoke a number of bilateral frictions. Such disputes highlight both the problem areas in the trade relationship and some of the most significant opportunities to expand trade, if an FTA can remove existing legal and regulatory obstacles. Both countries publish annual laundry lists of complaints by their domestic industries covering trade barriers, discriminatory standards, and tax and procurement policies, among other areas.<sup>3</sup> In addition, the American Chamber of Commerce in Korea releases an annual report on bilateral trade relations.

The United States has an extensive litany of complaints about Korean trade and regulatory practices that impede trade and investment by US firms. The list compiled by the Office of the US Trade Representative extends 24 pages in its 2003 report on foreign trade barriers—longer than that for any other country in the FTA queue and exceeded only by the lists for Japan, China, and the European Union! The good news is that a num-

2. Completion of the long-standing negotiation of a bilateral investment treaty, which continues to be stalled over disputes regarding Korean screen quotas, could boost FDI even more.

3. The US Congress requires the US Trade Representative to issue an annual *National Trade Estimate Report on Foreign Trade Barriers*. In the spirit of reciprocity, the Korean Foreign Ministry publishes an annual *Foreign Trade Environment* report that reviews foreign trade policies and practices that are considered detrimental to Korean export interests.

**Table 7.4 FDI stock in Korea, 1995–2002** (millions of dollars)

Indicator	1995	1996	1997	1998	1999	2000	2001	2002
Stock of US FDI in Korea	5,557	6,508	6,467	7,365	7,474	8,968	10,524	12,192
Stock of world FDI in Korea	9,451	12,422	12,526	19,043	32,143	37,106	40,767	43,689
US share (percent)	58.8	52.4	51.6	38.7	23.3	24.2	25.8	27.9
Stock of US FDI in world	699,015	795,195	871,316	1,000,703	1,215,960	1,316,247	1,383,225	1,520,965
Share in Korea (percent)	0.8	0.8	0.7	0.7	0.6	0.7	0.8	0.8

Sources: The US Department of Commerce Bureau of Economic Analysis, [www.bea.doc.gov](http://www.bea.doc.gov); and UNCTAD, *World Investment Report*, Geneva, various issues.

ber of problems have either been mitigated by the implementation of Uruguay Round tariff reforms or resolved through bilateral agreements (including the long-running dispute over Korean beef imports). The bad news is that many more problems remain, affecting billions of dollars of bilateral trade.<sup>4</sup>

The most enduring and prominent problems involve the auto sector, semiconductors, and agriculture. Restrictions on the import and sale of autos in Korea remain a source of major concern for US firms. Tariffs on autos (8 percent) are about the same as the average levies on manufactured goods, but the sale of American cars is further constrained by sales taxes (based on engine displacement) that burden large vehicles (primarily imports) much more than small, domestically produced cars. As a result, auto imports account for less than 1 percent of domestic consumption in Korea. Past disputes over semiconductors also seem to be heating up, as subsidies provided by the Korean government to help restructure its industry provoke new countervailing duty (CVD) complaints in the United States. In April 2003, the US Commerce Department issued a preliminary determination that imports from Hynix Semiconductor are liable to CVDs of more than 50 percent (*Financial Times*, April 2, 2003, 15). Other US concerns involve such areas as screen-time quotas, burdensome regulations in financial service sectors, and pharmaceutical pricing practices (see USTR 2003, 239–63).

In agriculture, Korea still maintains very restrictive access to its rice market. Other farm imports face an average tariff of 62 percent, though tariffs on forestry and fishery products are not bound in the WTO and thus can be increased at any time without violating Korean trade obligations. Some products of export interest to the United States (e.g., oranges)

4. Choi and Schott (2001, table 3.4) estimated that bilateral disputes covered \$1.85 billion in US imports from Korea, and \$2.5 billion in US exports to Korea in 1999. These figures include the now-resolved beef dispute but do not take into account the recent US steel import restraints.

are subject to tariff-rate quotas with overquota tariffs of 60 percent. In addition, customs clearance red tape and sanitary and phytosanitary certification requirements continue to plague importers of US farm products.

Koreans' main concerns are that the United States uses antidumping (AD) actions and countervailing duties overzealously and in contravention of WTO obligations, and that it maintains high tariffs on some products of major export interest to Korea. The tariff peaks protect a number of textiles, apparel, footwear, and luggage products. Despite those high levies, Korean exports totaled about \$400 million in 1999, or 10 percent of total US imports of these products (see Choi and Schott 2001, table 3.1). Exporters of these products would be a major beneficiary of a bilateral FTA, though the value of the FTA preferences would depend on whether US tariff reforms are extended on a most favored nation basis, as proposed in the Doha Round.

The problem with antidumping actions is harder to reconcile, either in a bilateral FTA or in WTO negotiations. As of April 2003, there were 23 US antidumping and CVD measures in effect against Korean exporters. US antidumping and countervail orders against Korean firms represent only 6.7 percent of all current US orders (compared to Korea's 3 percent share of total US imports). Interestingly, all but five of these orders involve iron and steel products, and almost all US orders implemented during the past decade are against iron and steel products (see table 7.5). It is only a slight exaggeration to say that Korea really does not have an antidumping problem with the United States; rather, it has a big steel trade problem.

The steel trade problem involves both AD and CVD cases and US safeguard measures. Korean producers, which were affected by US safeguard actions against line pipe imports in February 2000, were a major target of the broader US steel safeguards in March 2002.<sup>5</sup> As a result, the volume of Korean steel exports to the United States in 2002 fell 16 percent from 2001 levels (and about 40 percent from their peak in 1998), with most of the losses coming from flat and long steel products that were subject to immediate 30 percent tariffs. However, the US protection was attenuated in part by product exclusions from the safeguard measures.<sup>6</sup> Korea brought and won complaints in the WTO against both safeguard actions (though the latest decision is under appeal).

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5. The 2000 safeguard measure imposed a tariff-rate quota that allowed each non-NAFTA supplier to export 9,000 short tons of line pipe to the United States; overquota imports were subject to a 19 percent tariff. As a result, Korea's exports in 2000 fell by two-thirds from their 1999 levels. Korea filed a WTO complaint, but by the time the case was fully adjudicated and Korea and the United States had reached a mutually acceptable settlement, the line pipe safeguard was only six months away from its scheduled expiration.

6. POSCO—the principal Korean steel producer—was the largest beneficiary of the product exclusions to the global steel safeguard, in part so it could supply unfinished steel to a mill owned by US Steel in California.

**Table 7.5 US antidumping and countervailing duty cases against Korea (in effect as of April 2003)**

Product	Industry	Date ordered	
<b>US antidumping orders</b>			
Malleable cast-iron pipe fittings	Iron/steel	May 1986	
Top-of-the-stove stainless steel cooking ware	Miscellaneous	January 1987	
Industrial nitrocellulose	Chemicals	July 1990	
Polyethylene terephthalate (PET) film	Chemicals	June 1991	
Circular welded nonalloy steel pipe	Iron/steel	November 1992	
Welded ASTM A-312 stainless steel pipe	Iron/steel	December 1992	
Stainless steel butt-weld pipe fittings	Iron/steel	February 1993	
Corrosion-resistant carbon steel flat products	Iron/steel	August 1993	
Oil country tubular goods	Iron/steel	August 1995	
Stainless steel wire rod	Iron/steel	September 1998	
Stainless steel plate in coils	Iron/steel	May 1999	
Stainless steel sheet and strip	Iron/steel	July 1999	
Carbon steel plate	Iron/steel	February 2000	
Polyester staple fiber	Miscellaneous	May 2000	
Structural steel beams	Iron/steel	August 2000	
Steel concrete reinforcing bar	Iron/steel	September 2001	
Stainless steel angle	Iron/steel	May 2001	
Stainless steel bar	Iron/steel	March 2002	
<b>US countervailing duties</b>			
Top-of-the-stove stainless steel cooking ware	Miscellaneous	January 1987	
Corrosion-resistant carbon steel flat products	Iron/steel	August 1993	
Stainless steel sheet and strip	Iron/steel	August 1999	
Carbon steel plate	Iron/steel	February 2000	
Structural steel beams	Iron/steel	August 2000	
<b>Summary:</b>			
<b>Total orders</b>		<b>Steel orders</b>	
Total US orders in effect	341	Total US orders on steel in effect	193
US orders against Korea	23	US orders against Korea on steel	18
Korean share of orders (percent)	6.7	Korean share of orders on steel (percent)	9.3
Korean share of US goods imports, 2002 (percent)	3.1	Korean share of US steel imports, 2002 (percent)	5.3

*Sources:* US International Trade Commission, [www.usitc.gov](http://www.usitc.gov); USITC Trade Database, <http://dataweb.usitc.gov>; and US Census Bureau, FTD Steel Imports Trade Data, [www.census.gov/foreign-trade/Press-Release/steel\\_index.html](http://www.census.gov/foreign-trade/Press-Release/steel_index.html).

## Bilateral Disputes in the WTO

Since the WTO entered into force in January 1995 with its new dispute settlement procedures, the United States and Korea have filed 12 cases—6 by each country—involving bilateral trade problems. Not surprisingly, the US cases have involved problems with nontariff agricultural protectionism, which generally have been settled in favor of the US side (either by mutual agreement or by WTO panel ruling). One other case dealt with procurement problems associated with the construction of the new

Inchon airport, and the WTO panel ruled that the matter fell beyond Korea's obligations in the WTO government procurement agreement. The Korean cases dealt with problems with the conduct of US antidumping and safeguard investigations, and the WTO panels generally supported Korea's complaints (see table 7.6).

These cases provide further evidence that antidumping actions and agriculture continue to pose the most enduring obstacles to bilateral trade and the negotiation of an FTA. Neither issue can likely be fully resolved in the context of a bilateral agreement. But precedents from NAFTA and other FTA negotiations suggest that some special treatment under US laws could be provided to FTA partners (as is now done for safeguards cases in NAFTA), and targeted agricultural reforms could be implemented (if accompanied by compensatory domestic income transfers).

## **Potential Benefits of a Korea-US FTA**

Korea and the United States could derive many potential economic and noneconomic benefits from a bilateral FTA. Economic benefits include expansion of trade and associated welfare gains, more secure access to the other market, and other long-run dynamic effects stemming from increased investment and incentives to implement additional economic reforms. Noneconomic benefits include better management of bilateral economic relations between the two governments and the strengthening of their political and security relationship.

## **Expansion of Trade Between Korea and the United States**

To the extent that border and regulatory barriers distort trade and investment flows and thus impede growth, one should expect an FTA to increase trade between the partner countries. How much? To set parameters on the possible aggregate trade effects, we deployed both gravity and computable general equilibrium (CGE) models.

Results from the gravity model analysis show that although the two countries already are very much integrated in trade, bilateral trade expansion is still possible. The analysis also shows that for the last several years of the 1990s, trade integration between Korea and the United States weakened. Perhaps some exports lost their competitiveness and therefore lost market share in the other market. Or perhaps some exports fell because trade barriers rose, or some exporters decided to sell their products elsewhere because of continuing barriers to bilateral trade. Whatever the explanation, the underperformance of the two countries' bilateral trade implies that the United States and Korea have some room for improvement through an FTA.

**Table 7.6 Korea-US trade disputes brought to the WTO (as of April 2003)**

Consultation requested	Case number	Filed by	Subject of dispute	Status of case
April 1995	WT/DS3	United States	Korean measures concerning testing and inspection of agricultural products	Consultations pending. Although the case is dormant, US farm groups still complain about Korean practices.
May 1996	WT/DS41	United States	Korean requirements on shelf-life products	In July 1995, the parties reached a mutual settlement.
May 1997	WT/DS84/1	United States	Korean internal taxes imposed on certain alcoholic beverages	Korea lost the panel decision (September 1998) and the appeal (February 1999), so it amended its tax law (January 2000).
July 1997	WT/DS89/1	Korea	US AD duties on Korean color TV receivers	Korea withdrew the complaint (September 1999) after the US revoked the AD duties.
August 1997	WT/DS99/1	Korea	US AD duties on Korean dynamic random access memory semiconductors (DRAMs)	The US lost the panel decision (January 1999) and claimed to have implemented the panel recommendations (January 2000). The DSB agreed, at Korea's request, to reconvene the panel (April 2000), but Korea asked the panel to suspend its work (September 2000). The case may heat up again, as the US imposed a preliminary CVD against Korean DRAMs in April 2003.
February 1999	WT/DS161/1	United States	Korean measures restricting imports of beef	Korea lost the panel decision (July 2000) and the appeal (December 2000). In response, Korea eliminated its quotas on imported beef in 2001 and will reduce its tariffs on imported beef by 40 percent by 2004.

(table continues next page)

**Table 7.6 Korea-US trade disputes brought to the WTO (as of April 2003) (continued)**

Consultation requested	Case number	Filed by	Subject of dispute	Status of case
February 1999	WT/DS163	United States	Procurement practices at a Korean airport	The panel found in May 2000 that the issue fell outside the Agreement on Government Procurement. The US did not appeal, and the DSB adopted the panel report in June 2000.
July 1999	WT/DS179	Korea	US AD duties on Korean stainless steel	The panel report (adopted February 2001) found that certain US practices in AD cases were inconsistent with the WTO. The US has revised its methodology.
June 2000	WT/DS202/1	Korea	US safeguards on imports of line pipe	The US lost the panel decision (October 2001) and the appeal (February 2002), though the Appellate Body weakened some of the panel's findings. The US settled the dispute by permitting Korea to export more line pipe from September 2002 through February 2003, when the safeguard expired.
June 2001	WT/DS234	Korea	US Byrd Amendment	The US lost the panel decision (September 2002) and the appeal (January 2003). The Bush administration proposed that the Byrd Amendment be repealed, but that proposal currently has insufficient support in the US Senate.
March 2002	WT/DS251	Korea	US steel safeguard	In May 2003, the panel ruled the US measures violated WTO obligations; the Appellate Body upheld the bulk of that ruling in November 2003.

DSB = Dispute Settlement Body

Sources: WTO Dispute Settlement Gateway, [www.wto.org/english/tratop\\_e/dispu\\_e/dispu\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/dispu_e.htm); World Trade Online, [www.insidetrade.com](http://www.insidetrade.com); and WorldTradeLaw.net, [www.worldtradelaw.net](http://www.worldtradelaw.net).

To understand the potential economic impact of a preferential trading arrangement between the United States and Korea, we performed an analysis using the GTAP (Global Trade Analysis Project) model. In our analysis, we simulated the formation of a free trade agreement under the assumption that all tariffs (or only nonagricultural tariffs) are removed between the United States and Korea. One of the findings from this analysis is that Korea and the United States could expect a significant increase in their bilateral trade volume as a result of forming an FTA. In the case of full liberalization including agriculture, US exports to Korea would increase by 46 percent in the medium run and 49 percent in the long run, while US imports from Korea would increase by 26 percent and 30 percent, respectively. John Gilbert (2003) also confirms the same result of trade expansion, showing that US exports to Korea would increase by 48 percent and US imports from Korea would increase by 23 percent as a result of a Korea-US FTA.

## **Welfare Improvement**

Increased bilateral trade does not necessarily mean that there are net welfare gains in both economies; if welfare losses due to trade diversion exceed the gains from bilateral trade expansion, then the countries could be worse off. In fact, our analysis shows that the formation of an FTA would lead to a significant trade diversion for Korea and the United States. Overall, however, the trade pact would be welfare enhancing for both countries (even in the case of partial liberalization excluding agriculture). The absolute welfare gains are evenly allocated across both economies, in the range of \$1.5 billion to \$8.9 billion for the United States and \$1.7 billion to \$10.8 billion for Korea.<sup>7</sup> As the much smaller economy, Korea obviously has proportionally more to gain. Thus, net welfare gains would range from 0.02 percent to 0.13 percent of GDP for the United States and from 0.38 percent to 2.41 percent of GDP for Korea. It is important to note that these results are probably lower-bound estimates of the impact of an FTA: the model does not capture service protection data, which may be a major potential source of welfare gains.

The welfare gains from a Korea-US FTA derive from different effects in the two economies. In the US case, most of the gains are from improvements in the terms of trade. These improvements reflect the benefits of export expansion into the Korean market. Allocative efficiency gains or losses are small, reflecting the relatively low distortion levels in the US economy. In contrast, terms-of-trade effects are less significant for Korea and in some cases are negative. Negative terms-of-trade effects indicate a

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7. These figures are expressed in 1995 dollars as generated by the model. For details of the analysis, see Choi and Schott (2001).

cost from trade diversion being imposed on the Korean economy. For Korea, the largest gains come from improvements in allocative efficiency—essentially the Vinerian trade creation effect: the benefit associated with replacing inefficient domestic production with imports. This result suggests that Korea has less to gain from an FTA with the United States than from unilateral liberalization. In fact, Gilbert (2003) shows that allocative efficiency gains for Korea are three times greater from unilateral free trade than from an FTA with the United States, and that the total welfare gain is 67 percent higher.

Another important finding is that the potential gains of a Korea-US FTA are reduced by more than half for both economies if agriculture is excluded from the agreement. This result reflects both the importance of agricultural market access for the United States and the potential efficiency gains from agricultural trade reform in Korea.

### **More Secure Market Access**

Another key economic benefit from an FTA is gaining more secure access to the other market. This objective is particularly important for Korea, since shipments to the United States account for about 20 percent of total Korean exports (equivalent to about 7 percent of Korean GDP).

To secure better access to the US market, Korean trade officials place priority on the development of FTA disciplines on contingent protection measures, just as the Canadians did in their FTA negotiations in the 1980s. Canadian manufacturers were particularly concerned that the imposition of antidumping and countervailing duties made access to the US market uncertain and created disincentives for investment in Canada.<sup>8</sup> Korea finds itself in a comparable situation; indeed, many Korean exports already have their access to the US market inhibited by antidumping and countervailing duties and by safeguard measures. One difference, however, is that Canada and Mexico now get preferential treatment from the United States in safeguard cases (though not in AD or CVD cases) under special rules that apply to NAFTA signatories.<sup>9</sup> As a result, Canada and Mexico were exempted from recent US steel safeguards. Korea obviously would like similar protection for its exporters.

### **Long-Run Dynamic Effects**

To this point, we have dealt primarily with tariff liberalization, but an FTA would cover a broader array of trade reforms. In addition to eliminating

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8. See Schott and Smith (1988) for more discussion of the Canada-US FTA.

9. However, these preferences are now being challenged in the WTO dispute settlement system.

tariffs, an FTA would also cover a wide range of nontariff barriers and other economic issues, including investment, standards, rules of origin, government procurement, intellectual property rights, and competition policy. A liberalized investment regime and service trade would unleash higher efficiency and productivity, generating faster growth for both economies. Therefore, an FTA would have a positive, long-run dynamic effect. For example, increased direct investment from the United States and new industrial alliances would enable many Korean firms to benefit from technology transfer. Many US firms could also benefit from strategic alliances with Korean firms, permitting them to use Korea as a base for further expansion of their activities in China and other Asian markets.

For Korea, there is an additional important benefit. An FTA with the United States would likely accelerate Korea's ongoing domestic reform program and stimulate economic growth. Japan also seems to have this benefit of an FTA in mind in its bilateral FTAs with Mexico and Korea.

## **Better Management of Economic Relations**

Forming an FTA would result in a better economic relationship between the two countries by reducing bilateral trade frictions and reinforcing trade and investment linkages. Since an FTA would not only eliminate tariffs but also lower nontariff barriers, it would lessen many trade frictions between the two governments. This outcome is especially important in the bilateral trade in autos, a source of long-standing discord between the United States and Korea (as noted earlier). In addition, an FTA would increase investment, which in turn would generate increased trade through US affiliate companies, as a substantial share of US trade takes place between parent and subsidiary. Expanding intraindustry trade and investment would subsequently create vested interests in both countries for good relations.

## **Strengthening Security Ties**

Aside from the economic benefits of an FTA, the United States and Korea have another common interest that an FTA could reinforce: a strong security relationship. The two countries have been close military allies for the past 50 years. Forming an FTA not only would bring them much closer in their economic relations but also could improve the climate for cooperation on political and security issues.

Indeed, political objectives often have driven US participation in FTA negotiations. The US-Israel FTA was the first and clearest example of this motive. Congressional support for NAFTA arguably hinged on broad concerns about immigration and US security interests and democracy in Central America. Similarly, US support for trade preferences under the

Caribbean Basin Initiative (CBI) was tied to the goal of resolving the migration and drug trafficking problems in that region. More recently, the US-Jordan FTA, signed in October 2000, seeks inter alia to strengthen the economic foundation for Jordan's participation in the peace process in the Middle East.

Strengthening the political and security relationship could turn out over time to be a much more important benefit of a Korea-US FTA than the consequent economic gains. The trade pact could be particularly valuable as a show of US support for peaceful relations in Northeast Asia and as a means of ensuring that South Korea has the means to advance that process. Recently, Korea-US relations have been under strain caused by the rising anti-American sentiments in Korea and differences between the two countries on the policy responses to the North Korean nuclear threat. Such tensions elevate the political risk of doing business in Korea and thus tend to damp investment (at least in the short run). Moving forward on an FTA could help to offset these negative factors. Indeed, many APEC countries, including Korea, seek to deepen trade ties with the United States as part of a strategy to ensure continued US military engagement in the region.

## **Effects on Regional Integration**

Should a Korea-US FTA be implemented, it is generally expected that the increase of US exports to Korea would exceed the increase of Korean exports to the United States, since US trade barriers are much lower than those of Korea. As a result, the US trade deficit with Korea should be reduced. At the same time, some of the increase in US exports to Korea would come at the expense of Japanese products currently imported into Korea. Thus, while Korea's trade balance with the United States would worsen, its trade balance with Japan would improve.

Our GTAP model simulations confirm these effects of a Korea-US FTA on bilateral trade balances. Although the improvement in a bilateral trade balance does not significantly affect the overall economy, it is important politically and can influence Korean trade policy for better or worse. Korean officials believe that a reduction in their trade deficit with Japan and in the trade surplus with the United States would help them, respectively, to manage protectionist pressures at home against dominant Japanese firms and to mitigate US protectionism directed against competitive Korean exports. Korea has often been under trade pressure because of its chronic trade surplus with the United States. At the same time, a chronic and severe trade deficit with Japan has at times led Korea to try to artificially divert Japanese imports under the "import source diversification system." An FTA with the United States could enable Korea to "naturally" divert the source of imports from Japan to the United States, thereby re-

aligning its trade imbalances with both countries. From the point of view of Korean trade officials, it would kill two birds with one stone.<sup>10</sup>

But that is only part of the story. If a Korea-US FTA were realized, many economies besides Japan (including Taiwan, China, Mexico, Australia, New Zealand, and Canada) would be affected by trade diversion in some sectors (see below). Therefore, a Korea-US FTA would have significant implications for the Asia-Pacific region; indeed, it could promote a bandwagon effect that would prompt other countries to pursue bilateral FTAs in the region, especially with the United States. That is what Singapore is trying to do with its web of bilateral FTAs. Basically, it is attempting to cobble together a core group of FTAs to revive progress toward a regional FTA as envisaged by APEC leaders a decade ago. A Korea-US FTA thus could accelerate the APEC process toward free and open trade and investment in the region by the Bogor target dates of 2010 and 2020.

## Potential Costs of a Korea-US FTA

An FTA between the United States and Korea would have some associated political costs for both countries as well as economic costs for US and Korean trading partners due to trade diversion, especially for neighbors in the Asia-Pacific region. It could also have negative implications for the WTO and the Doha Round.

### Political Costs of Domestic Adjustments

While an FTA between the United States and Korea would yield economic benefits for both partners, each country would have individual winners and losers from closer trade integration and each would have to change long-standing policies that protect politically powerful industries from foreign competition. Simply put, the benefits from trade would be distributed unevenly among various sectors of the economy, and those facing stiffer competition would likely object vocally.

For Korea, the biggest loser would be the agricultural sector. Thus, as in the Uruguay Round of multilateral trade negotiations, the most vociferous opposition to an FTA with the United States (and to the Doha Round as well) would likely come from agricultural interests. Korea's farm sector is heavily subsidized and not competitive, but it still wields substantial clout in national politics. Korean farmers have disproportionate representation in the National Assembly, even though agriculture, forestry,

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10. However, Korea and Japan agreed in October 2003 to negotiate an FTA to be concluded by 2005. Such a pact would mitigate the discriminatory effect of a Korea-US FTA on Japanese exports to Korea.

and fishing now account for only 5 percent of GDP and involve only 11 percent of the Korean population (down from 48 percent in 1970). However, because of the rapid urbanization and industrialization of the past 30 years, many in the urban population still have family members residing in agricultural areas and thus support farm protection and subsidies. Over time, however, as the agricultural population continues to decline, these ties—and the political power they lend to the farm sector—are likely to weaken. Only 6 percent of young workers (aged 20–24) are in farming today, and almost 70 percent of the agricultural workforce is more than 50 years old.

Over the near term, agriculture will continue to pose the largest obstacle to free trade talks. Yet without some liberalization of agricultural protection, Korea may become isolated in international trade talks, and Korean industries and exporters may lose the chance to lower foreign barriers affecting their products. Changing demographics suggest that Korea could mitigate at least some of the domestic opposition to farm reforms by switching from trade protection to income support for Korean farmers. Indeed, this is the direction taken by European policy aimed at internal reform of the region's common agricultural policy. If the European Commission is successful in its reform agenda, then Korea (and Japan) would be isolated in opposition in the WTO to farm trade reform.

There is some indication that Korean officials are slowly moving in the same direction as the Europeans. Faced with unexpectedly strong opposition by farmers to the Korea-Chile FTA, the Korean government is proposing a trade adjustment assistance (TAA)-type program for Korean farmers to be included in its FTA implementation bill. However, if such subsidies are large enough to mollify the opposition of Korean farmers, they could very well pressure a government budget already under considerable strain.

For the United States, the main losers from an FTA with Korea would be some manufacturing industries, notably textiles and apparel, steel, and electronics. Just like their counterparts in Korea, these US industries would ask for more subsidies and import relief via antidumping and safeguard measures. From Korea's point of view, support for an FTA with the United States depends significantly on whether a prospective trade pact can deal with problems arising from the use of antidumping actions, countervailing duties, and safeguard measures. Reforms in these areas are particularly important for the steel and electronics industries, which as noted earlier have been frequently targeted by the United States.

US political resistance to an FTA with Korea could surface in two ways: opposition to revisions in US antidumping law and to tariff cuts on textiles and apparel, and indifference about a deal with a relatively small economic payoff. The former could generate strong resistance to a bilateral trade pact; the latter would likely present only a modest barrier to the start of prospective negotiations. Antidumping cases are considered by

many US industries as the first and best line of defense against foreign unfair trade practices. Thus, many members of the US Congress, including strong protrade advocates, might not continue to support US trade reforms if antidumping actions are not in the trade policy toolbox. In addition, US industry would probably strongly contest the granting of tariff preferences to Korean textile and apparel exporters in a bilateral FTA. To be sure, such benefits were granted, albeit grudgingly, to Mexico in NAFTA, and more recently to Caribbean and African producers in the US Trade and Development Act of 2000. But a Korea-US FTA would attract more opposition from US industry for two reasons: the Korean textile and apparel industry is not integrated with US firms, and many of the Korean firms are highly competitive.

The wild card in this area is what happens in the Doha Round. The United States has proposed the elimination of all industrial tariffs by 2015 and a sharp interim reduction in peak tariffs (including those on textiles and apparel) by 2010. If US objectives are even partially satisfied in the WTO talks, US industry will likely respond to the new trade liberalization by demanding greater use of contingent protection measures. Such actions in turn could exacerbate the already strident disputes over antidumping and countervailing duties.

## **Trade Diversion**

The United States and Korea are, respectively, the largest and the seventh-largest trading economies in the world (with Japan, the European Union, Canada, China, and Hong Kong in between). An FTA between the United States and Korea would have a sizable impact on and numerous implications for other countries, especially those in the Asia Pacific, that trade heavily with the United States, Korea, or both. With the formation of an FTA, partner countries' exports to each other's markets would increase, in part at the expense of reduced imports from third countries that do not enjoy the duty-free benefits of FTA partners. This trade diversion effect would be a major concern and cost for countries that are competing with the United States and Korea and that would lose market share in the US and Korean economies.

Which countries might be vulnerable to trade diversion caused by a Korea-US FTA? A look at the import market shares of each country provides a first-order approximation of countries at risk. In the Korean market, Japan and China are the second- and third-largest exporters, after the United States. In the US market, Canada, Japan, Mexico, the European Union, and China are the major exporters, followed by Korea.

How vulnerable is trade from these countries? The analysis of export similarity indices (ESIs)—the similarity in the structure of export commodities in comparison to that of the other FTA partner countries—

indicates that if a Korea-US FTA is formed, Japan and Germany would be the most likely to suffer from trade diversion in the Korean market, and Taiwan, Japan, and Mexico would be most likely to suffer from trade diversion in the US market. Overall, Japan and Taiwan would be most affected—particularly Japan, because it exports so much to both the United States and Korea (see Choi and Schott 2001, chapter 5).

The results of sectoral analysis using the revealed comparative advantages (RCAs) of major competing countries indicate that Japan would probably experience a fall in exports, mostly in the chemical and machinery sectors, with the exception of power-generating and office machines; Germany, in chemicals and general industrial machines; and Canada, China, Australia, and New Zealand, in agricultural, food, and raw materials exports. In the US market, Taiwan would probably suffer from trade diversion mostly in textile fibers and in office and electrical machinery; Japan, in rubber products and office and telecommunications machines; Mexico, in textile fibers, telecommunications, and electrical machinery; the European Union, in steel products; and Australia and New Zealand, in textiles, fibers, and steel products. Thus, different countries would feel different trade diversion effects in different sectors.

The preceding discussion of trade diversion, of course, focuses on the short-run direct impact of a Korea-US FTA. In the long run, trade diversion would depend on investment, income, and other effects. Nonetheless, the simulation results of the GTAP model generally confirm the expected trade diversion, even in the long run. For example, the simulation results show that Korea increases imports from the United States but imports less from all other regions. However, the pattern is not so clear in the case of US imports. Expansion of US income tends to result in increases in imports from Japan and in some cases from ASEAN countries, Australia, and New Zealand.

## **Possible Negative Impact on WTO Negotiations**

The pursuit of an FTA between Korea and the United States need not divert attention away from the WTO negotiations. However, a prospective FTA could have adverse effects on current WTO talks.

First, pursuing an FTA with the United States would highlight the need to reform Korean agricultural policies and would thus provoke domestic lobbies in Korea to even stronger resistance against trade liberalization. The farm lobby does not discriminate between FTAs and multilateral negotiations; it dislikes them all. Inciting additional domestic opposition to any trade liberalization accord could make it even harder for Korea to engage in the Doha Round.

Second, if the process of multilateral liberalization stalls, then FTAs might be given prominence as defensive or fallback strategies. While a

Korea-US FTA could catalyze other trade pacts through a process of competitive liberalization, as noted above, it could also incite countries to offset the discrimination against their trade by imposing new contingent protection measures, creating new discriminatory trading blocs, or both. Either way, the WTO process would suffer.

## Prospects and Recommendations

Balancing the costs and benefits of a Korea-US FTA involves a complex calculus of economic and political factors. Econometric models suggest that both countries will gain from a bilateral agreement at the expense of other important trading partners, especially the European Union, China, and Japan. For the United States, the potential gain is very small in relation to its \$10 trillion economy. Gilbert (2003) calculates the US welfare gain at 0.03 percent of GDP, generated primarily from terms-of-trade effects associated with preferential treatment in the Korean market. For Korea, the potential income gain is more significant. Gilbert (2003) forecasts welfare gains of almost 0.4 percent of GDP, resulting primarily from increased efficiency of Korean industries induced by domestic reforms. However, these welfare gains would be substantially reduced if the FTA excludes important sectors like agriculture.

Both the United States and Korea have important economic stakes in the Asia-Pacific region that would be affected by a prospective FTA. The same holds true if Korea proceeds with FTA talks with Japan or China or both. Given the complementary pattern of trade among East Asian countries, FTAs in the region will likely generate significant trade diversion and thus encourage the negotiation of parallel agreements to counter the discrimination from other pacts. In short, “competitive liberalization” is likely to thrive in the APEC region (Bergsten 1996).

In fact, Korea, China, and Japan are already involved in this process of competitive liberalization. While China and Japan separately pursue an FTA with ASEAN, Korea may be forced to follow suit to protect its market share and trading interests in the region. Preliminary talks already have begun with Singapore and Thailand on a bilateral basis.

Studies have shown that Korea would gain more from having an FTA with China and Japan together than from a bilateral FTA with either China or Japan. In fact, one of the major policy goals of the current Korean administration under President Roh Moo-hyun is to build Korea as the economic hub of Northeast Asia—especially as a business center (distribution and financial). Thus, Korea has a strong interest in pursuing a Northeast Asian (Korea-China-Japan) FTA.

Given the current economic status of Korea, China, and Japan, however, we are not likely to see a Northeast Asian FTA between these big trading nations in the near future. First of all, China is not ready for an FTA with

a more advanced economy such as Japan or Korea. It already is having some problems in implementing the extensive reforms to which it committed in its protocols of accession to the WTO, and thus is not likely to be ready in the near future for the even deeper liberalization and deregulation required by an FTA. Second, Japan and Korea are not ready to open their markets to increased agricultural imports from China. Witness the strong resistance by their agricultural lobbies to FTAs with Singapore and Chile—neither of which is really known as an agricultural powerhouse.

The most likely development in this region over the next several years would be a bilateral FTA between Korea and Japan. The two countries have been toying with this idea for the past five years, and they plan to launch negotiations soon. Japan seems to be more eager to start this undertaking while Korea prefers to form a three-way Northeast Asian FTA.

Despite the economic and noneconomic benefits cited above, the short-term prospect for an FTA between Korea and the United States is not very good. The biggest problem remains the agricultural sector in Korea. Attempts by the Korean government to mute the opposition of farm groups by establishing a program to compensate farmers harmed by FTA reforms have met strong political resistance, and it is not clear whether the implementation bill will pass the National Assembly. The Roh administration doesn't seem to want to take on this domestic political fight. Indeed, when asked about the possibility of a Korea-US FTA during his visit to Washington in May 2003, President Roh admitted that the resistance of the agricultural sector would make it difficult for Korea to pursue *any* FTA.

The recent rise in nationalism in Korea could also work against a potential FTA between the United States and Korea. Recall that this was a central argument against the launching of Korea-US FTA negotiations in the late 1980s (see USITC 1989). Fifteen years later, the problem persists. Any attempt to negotiate an FTA between Korea and the United States would unavoidably involve the politically sensitive issue of agricultural-sector reform in Korea, which in turn would likely exacerbate anti-American sentiments in Korea among farmers, students, and even some businessmen.

Nevertheless, the two countries must not lose sight of either the substantial economic benefits that could accrue from an FTA or the positive spillovers on political and security relations. Thus, Korea and the United States should pursue an FTA as an important long-term goal. Several steps should be taken now to better prepare for launching FTA talks in the future.

First, the two countries should increase their efforts to wrap up their negotiations for a bilateral investment treaty (BIT), which has been deadlocked for the last few years because of the dispute over Korea's movie screen quota. Both sides should consider stepping back from their original demands. The United States should accept an increase in the quota for foreign content providers rather than insist on its complete elimination. Korea should drop its protectionist position and agree to such liberalization. Given the rapid improvement in the competitiveness of the Korean movie

industry in recent years, the practical impact on Korean industry of increased foreign competition should be relatively minor. For the last couple of years, the market share of Korean movies has been higher than the current screen quota ratio (40 percent). If the Korean movie industry insists on further protection, the government could offer some type of nonprice subsidy or safeguard protection. In any event, it is strongly recommended that the two countries try to sign a BIT as soon as possible. The Korea-US BIT would be the first step toward an FTA between the two countries.

Second, the general public in Korea is not very well informed about what an FTA would mean for Korea. Their perceptions are shaped by what they read in the newspapers about an FTA's negative impact on the Korean agricultural sector and what they see in TV news programs about farmers' street demonstrations against any such agreement. It therefore is important for the general public to be more educated and informed about a possible FTA, particularly about its benefits to other sectors in the economy and to consumers. In this respect, some actions taken by the US-Korea Business Council are encouraging. In early 2003, the council established a joint task force to draw up active strategies to promote the successful negotiation of both a BIT and an FTA between the two countries. But more attention needs to be paid to focusing the public debate in Korea itself on the benefits of as well as the adjustments required in pursuing freer trade policies, including through FTA and WTO accords.

Third, both governments should work to contain the rise in anti-American sentiments in Korea. To some degree, these feelings, which are not deeply rooted in the society, have been manipulated for political ends by certain groups using the unfortunate accidental death of two schoolgirls killed by a US armored vehicle in 2002 to fan public ire. The two governments should take additional steps to prevent tragedies of this type from adding fuel to anti-American sentiment in Korea. For example, they could establish a joint investigative team to review all such incidents in the future. Such reviews would be more credible in the eyes of the Korean public than the findings of US military tribunals.

In sum, there is a strong economic rationale for moving forward with negotiations on a comprehensive free trade agreement between Korea and the United States—but only if agricultural reforms are an integral part of the deal. Whether the two countries can muster the political support for dismantling barriers in sensitive sectors is unclear, however. The decision may turn on how much farm reform is conceded in the WTO's Doha Round and on what other Asia-Pacific trading partners do to deepen regional trade ties. The outcome of the WTO ministerial in Cancún in September 2003 is not encouraging in the first regard, as it demonstrated Korea's reluctance to negotiate agricultural reforms. If WTO negotiations get back on track, then Korean officials will have to decide whether they can support that deal—and, if so, whether they can go further by offering more open access to FTA partners. If China and Japan, as well as the

ASEAN countries, expand their network of bilateral and regional FTAs, can Korea stand aside? And if those East Asian pacts discriminate against US exporters, can US trade officials stand aside—or do they insist on bilateral deals of their own? Over time, and perhaps sooner rather than later, we believe that the two countries will move toward free trade for both economic and political reasons.

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