

2 South Korea's Regional Economic Cooperation Policy: The Evolution of an Adaptive Strategy

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2.1 Introduction¹

South Korea has emerged as the world's eleventh largest economy less than four decades after the devastation of Japanese colonial rule, the Korean War, and protracted poverty and underdevelopment. Several factors account for its stellar economic performance, including the availability of qualified human capital, a timely transition to an export-led growth strategy, and the guidance of a developmental state. But few have appreciated the merits of South Korea's external ties. A strong bilateral alliance with the United States allowed South Korea to enjoy the enormous benefits of free riding in both security and economic areas. While American troop presence and massive military assistance eased its security concerns and budgetary burdens, South Korea's timely access to American markets within the framework of the Generalized System of Preferences (GSP) served as the engine of its manufactured exports. The alliance with the United States and the status of a developing country within the GATT system powerfully aided South Korea's economic ascension.

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However, such benefits could not last forever. As South Korea began to enjoy increasing wealth (and balance of payment surpluses) after the mid-1980s, it became subject to various external constraints. Bilateral pressures from the United States and the European Union (EU) for market opening, regional integration in Europe and North America (the North American Free Trade Area, or NAFTA), and challenges of globalization forced South Korea to realign its regional economic strategy.² After the mid-1990s, stalled trade cooperation at the WTO level and divisions among members of the Asia-Pacific Economic Cooperation (APEC) forum on trade liberalization further demanded policy realignment in Seoul. Meanwhile, the 1997 Asian financial crisis highlighted the importance of regional economic cooperation and integration: South Korea under the presidency of Kim Dae-jung initiated the ASEAN Plus Three (APT) process, which has the potential to become an “East Asia-wide” free trade area or East Asian community.³ President Roh Moo-hyun, who succeeded Kim in 2003, went further by proposing the Northeast Asian Cooperation Initiative, which aims to institutionalize a specifically Northeast Asian community.

This chapter explores the evolutionary dynamics of South Korea’s regional economic cooperation policy within this historical context. More specifically, our chapter will address the following issues: How have external factors, such as the collapse of the Cold War structure in East Asia, the region’s gradual process of institutionalization, and the Asian financial crisis of 1997, affected South Korea’s regional strategy? What domestic factors have been responsible for shaping South Korea’s regional economic policy shift? And how has the interplay of external and domestic factors influenced the formation and evolution of Seoul’s regional policy?

Section 2.2 of the chapter provides a brief overview of the global and regional strategies that South Korea pursued in the postwar period. Section 2.3 examines how and why South Korea shifted its policy focus away from multilateralism to regionalism in the post-Cold War period. Section 2.4 highlights South Korea’s policy changes in the

² Moon and Park 2000, 6; and Aggarwal and Koo 2005.

³ Initially launched in 1998, ASEAN Plus Three has gradually turned into a formal venue for more institutionalized regional cooperation. See Stubbs 2002.

wake of the 1997 Asian financial crisis. Section 2.5 looks into the case of the Roh Moo-hyun government's Northeast Asian Cooperation Initiative. The final section discusses some theoretical and comparative implications of South Korea's regional community building strategy.

2.2 Gains from Bilateral Security Alliance and Multilateral Trade Policy: Re-Examining Cold War Legacies

After World War II, the United States emerged as the hegemonic leader in shaping the regional order governing Northeast Asian security and trade relations.⁴ With access to the US security umbrella and domestic market, South Korea was a primary beneficiary of these institutional arrangements and regarded them as the mainstay of its foreign policy during the Cold War period. Regionalism – regional cooperation and integration – was not yet on the table. The Cold War system polarized the Northeast Asian region into two competing ideological camps, and collective memory of Japanese colonialism prevented countries in the region from accepting or participating in a regional cooperation and community-building scheme, particularly under Japan's leadership.⁵ South Korea was not an exception to this general trend.

Lacking a regional option, South Korean trade policy during the Cold War period centered on multilateralism, particularly following its admission to the GATT in 1967. It was a natural outgrowth of South Korea's export-oriented industrialization (EOI) strategy. Throughout the postwar period, South Korea utilized EOI as a policy tool to catch up with advanced industrial countries in the West.⁶ The GATT was a double blessing for South Korea's export promotion strategy: while facilitating South Korea's manufactured exports through preferential treatment (i.e., GSP), the GATT allowed it to protect its domestic import markets as a developing country. In this way, the GATT assisted South Korea's further integration into the world economy.

⁴ Hemmer and Katzenstein 2002; and Calder 2004.

⁵ Katzenstein 1997.

⁶ Amsden 1989; and Shin and Chang 2003.

By contrast, South Korea was lukewarm toward building regional institutions to ease security tensions and facilitate economic integration in the region. South Korea's response to Malaysian Prime Minister Mahathir bin Mohamad's proposal for forming an East Asian Economic Group (EAEG), the first initiative for building a formal East Asian regional economic institution, underscored its tepid interest in East Asian regionalism.⁷ The EAEG's rationale reflected the changing political and economic dynamics in East Asia, such as the expansion of Japanese production networks into Southeast Asia after the Plaza Accord of 1985, growing trade conflicts across the Pacific, and newly emerging anti-American sentiment in the region. However, South Korea was reluctant to embrace the idea not only because Mahathir's scheme excluded the United States, but also because it could have paved the way to the formation of a yen bloc under Japan's leadership.

2.3 The Emergence of South Korea's Regional Policy in the Early Post-Cold War Period: Achievements and Limitations

The impact of the Cold War's end did not materialize immediately in Northeast Asia, with its legacies undermining South Korea's pursuit of regionalism. Despite the Roh Tae-woo government's ambitious Northern policy, designed to normalize diplomatic relations with China and former communist regimes and to reduce security tensions on the Korean peninsula, the overall security milieu in Northeast Asia was not conducive to promoting South Korea's regional cooperation strategy. While the first nuclear crisis in 1993–94 derailed Seoul's engagement policy with North Korea, the bilateral security alliance between Seoul and Washington remained intact.⁸ Meanwhile, a more positive legacy of the Cold War – the GATT – also limited the scope of Seoul's regional policy. The successful conclusion of the Uruguay Round and the establishment of the WTO maintained South Korea's support for multilateral trade institutions. Together with Japan and

⁷ The EAEG was quickly renamed the East Asian Economic Caucus (EAEC).

⁸ Suh 2004, 136.

China, South Korea remained one of the very few WTO member countries that did not enter into any preferential trading agreements.⁹

While the bilateral security alliance and multilateralism continued to guide South Korea's foreign economic policy, a variety of developments prompted South Korea to seek more diversified strategies. First, the combined strategy of GATT-centered multilateralism and EOI resulted in an excessive reliance on the US market, which in turn deepened its structural vulnerability. Even a modest slowdown of the US (and world) economy led to a substantial decline of South Korean exports, destabilizing its economic performance. Second, Washington's trade policy increasingly demanded strict reciprocity, further strengthening South Korea's incentives to find alternative export markets. In order to overcome chronic bilateral trade deficits with South Korea, the United States aggressively pressured Seoul to open its import markets to American firms, while imposing import restrictions, mostly non-tariff barriers, on South Korean manufactured goods.¹⁰ Equally important were the advent of the European Union and the formation of NAFTA. With trade conducted within the framework of such regional preferential agreements growing from 22.5% in 1955 to 66.3% in 1997, South Korea faced increasing fears of exclusion, particularly with respect to these two huge markets.

In this rapidly changing environment, East Asian countries realized that they needed to foster intraregional economic cooperation in order not to fall behind the new trend of regionalism elsewhere. Seen from this perspective, time ripened for establishing an inclusive regional framework – namely APEC – rather than a more exclusive regional grouping such as Mahathir's JEAEG. Along with Australia, Japan was active in creating APEC. Though traditionally maintaining a low-key posture in foreign policy rather than taking leadership,¹¹ Japan played a crucial leading role in creating APEC by not only resuscitating the APEC agenda but also by bridging differences between the United States and East Asian countries.

⁹ Koo 2005, 142-143.

¹⁰ For a concise summary of deteriorating trade relationship between South Korea and the United States, see Moon 1987; Wade 1993; and Bayard and Elliott 1994. During the same period, Japan also faced U.S. pressure for market opening. See Lincoln 2001; Schoppa 1997; and Pekkanen 2005.

¹¹ Doner 1997; and Krauss 2000.

South Korea also welcomed the creation of APEC and participated actively, hosting one of its annual meetings in Seoul in November 1991. Seoul's rationale was clear. On the one hand, APEC retained a multilateral character with the participation of a large number of countries, attenuating its exclusivity.¹² The creation of an Asia-Pacific free trade area would provide South Korea with new access to export markets and resource-rich countries such as ASEAN countries, Australia, and New Zealand. On the other hand, APEC was an institutional choice that could accommodate South Korea's interests in regionalism as well. APEC possessed a regional character, aiming to serve as a preliminary consultative mechanism for creating a free trade agreement in the Asia-Pacific region. South Korea's participation in APEC meant that it could gradually free itself from the legacies of Cold War and begin to explore the possibilities of regionalism.

However, APEC would not prove an equilibrium regional solution. In the mid-1990s, South Korea was forced to reassess its policy in the face of APEC's internal troubles. The roadmap adopted by the 1994 Bogor Declaration, which set trade liberalization for developed countries by 2010 and for developing countries by 2020, aroused dissension among the membership. At the 1997 APEC summit in Vancouver, two opposing camps, led by North American and East Asian corps respectively, came into conflict over Early Voluntary Sectoral Liberalization (EVSL). While the United States and Canada introduced an EVSL initiative to put selected sectors on a faster track toward liberalization, South Korea, Japan, and ASEAN countries strongly opposed this plan. This conflict was symbolic in demonstrating that East Asian countries' advocacy of an informal and consensual approach clashed with the formal and institutionalized approach favored by the United States, Australia, and New Zealand. Unable to effectively coordinate conflicts among member countries, APEC lost its appeal as a transregional cooperative body.

Amidst APEC's internal divisions, Mahathir's vision of)EAEC was resurrected in the form of the ASEAN Plus Three (APT) dialogue. The idea of APT was first floated by Singapore's Prime Minister

¹² John Ravenhill argues that it would be more precise to define APEC as a "trans-regional" body rather than a regional organization equivalent to the EU. Ravenhill 2000, 329.

Goh Chock Tong in October 1994 when he proposed to hold the inaugural meeting of the Asia–Europe Meeting (ASEM).¹³ ASEAN countries immediately approved the proposal, demanding that South Korea, China and Japan join ASEM as well. In response to ASEAN's request, all three Northeast Asian countries participated in a series of preliminary meetings for ASEM during the second half of 1995, setting the tone for the creation of the APT.¹⁴

2.4 The Asian Financial Crisis and Changes in South Korea's Regional Policy

The outbreak of the Asian financial crisis in 1997 forced South Korea to reevaluate the efficacy of the regional economic policies it had pursued in the post-Cold War period. The way the United States and the IMF handled the crisis generated deep uneasiness throughout East Asia. Initially, American disinterest renewed concerns about the lack of US policy engagement with the region; later, the United States and East Asian countries differed on how to manage the spreading crisis.¹⁵ The IMF eventually intervened by imposing its stringent conditionalities on beneficiaries of standby loans – and in the process precipitated immense dissatisfaction with the solutions emanating from Washington.

The crisis had a profound impact on East Asian regionalism. It is said that the region's resentment over American and IMF management of the Asian financial crisis made East Asian countries aware of the need to set up regional cooperative mechanisms.¹⁶ Moreover,

¹³ Hoa 2003, 10. The Asia-Europe Meeting was an initiative of ASEAN to institutionalize cross-regional economic cooperation with the European Union. The first ASEM meeting was held in Bangkok in December 1997. On ASEM, see Gilson 2004.

¹⁴ Stubbs 2002, 442.

¹⁵ Higgott 1998.

¹⁶ For example, Japan floated the idea of an Asian Monetary Fund (AMF) in 1997 by expressing its willingness to contribute more than half of the resources for a US\$100 billion fund. Hong Kong, Taiwan and Singapore also indicated their intent to participate in the AMF, and South Korea and most other East Asian countries agreed to the idea. Even China, which was against the idea at first, changed its attitude.

as mentioned above, APEC's incapacity to advance cross-Pacific trade liberalization encouraged some of its member states, including South Korea, to search for alternatives.¹⁷ It is in this context that the Kim Dae-jung government began to shift its foreign trade policy from multi-lateralism and transregionalism, such as APEC, to regional and bilateral trade policies. The most pronounced policy initiatives were APT and free trade agreements.

2.4.1 ASEAN+3

Since its inception, thirteen nations in East Asia – the ten members of ASEAN and China, Japan, and South Korea – have striven to expand the scope of APT, rather than utilizing it merely as a preparation session for ASEM.¹⁸ The meeting was quickly elevated to the summit level in Kuala Lumpur during the annual ASEAN leaders' meeting in December 1997. After a second ASEAN leaders' meeting in 1998, the group turned the meeting into an annual affair.

Given that the Kim Dae-jung government was beginning to contemplate a regional strategy, APT seemed to be a proper venue for South Korea to project its ambitious visions. During the 1999 APT summit, the Kim government played a pivotal role in establishing and operating the East Asia Vision Group (EAVG) and the East Asia Study Group (EASG). Seoul's initiative derived from a number of factors. First, East Asian countries, still suffering in the wake of the 1997 Asian financial crisis, shared a common interest in consolidating regional economic cooperation. Second, East Asia lacked a regional bloc comparable to those in Europe and North America. Third, Kim sought an institutionalized venue for China–Japan–South Korean summits. And finally, Kim had a strong conviction that regional economic integration and cooperation would lead to common prosperity and peace in the region.¹⁹

Nonetheless, the AMF did not make any tangible progress, due to strong opposition from the United States. See Harvie and Lee 2003, 43.

¹⁷ Bergsten 2000, 20–22.

¹⁸ As a consequence, separate ministerial meetings were held under the rubric of ASEAN+3. See Stubbs 2002, 442.

¹⁹ For a concise summary of Kim Dae-jung's policy toward APT, see Kim 2006, 11.

Seoul's initiative produced some meaningful changes. The EAVG and EASG set out to examine how to utilize APT as a mechanism to forge regional cooperation and ultimately transform it into a more permanent regional institution. In particular, the EAVG is credited with providing key concepts for regional integration and cooperation. For example, after conducting studies about a joint surveillance of short-term capital movements and an early warning system in East Asia, the group proposed the establishment of an East Asian Monetary Fund and a regional exchange rate coordination mechanism, which would be geared to the creation of a common currency area in the long run.

The EAVG's principal accomplishment came at the finance ministers' meeting at Chiang Mai, Thailand, in 2000. The Chiang Mai Initiative worked out a series of agreements among Asian central banks to lend foreign exchange reserves to one another via "swap" agreements to help them protect their currencies on foreign exchange markets.²⁰ Since then, there has been much discussion about creating an Asian Monetary Fund (AMF) and common currency baskets.²¹ In November 2000, heads of member countries gathered in Singapore and agreed to explore the possibility of formalizing their ties and forming an East Asian Free Trade Area (EAFTA). This agreement quickly paved the way for others. During the 2004 summit in Vientiane, the ASEAN+3 nations signed thirty-five bilateral or multilateral agreements, including the landmark free trade agreement between China and ASEAN. These agreements are seen as the building blocks toward an eventual region-wide free trade area. Finally, the leaders of the thirteen East Asian nations agreed at a meeting in Laos in December 2004 to hold the first East Asian Summit in Kuala Lumpur in 2005. The launch of the East Asian Summit signifies the beginning of a historic process with the objective of transforming the APT arrangement into an East Asian community.

²⁰ For further details on the Chiang Mai Initiative, see Chap 4 by Katada and Solis in this volume.

²¹ See for example, Lamberte et al. 2001.

2.4.2 Reactive Approach to FTAs

Apart from APT, free trade agreements provided another alternative for South Korean policymakers.²² South Korea's heightened interest in FTAs was prompted by a new understanding of their positive effects. The South Korean government previously held the view that FTAs created trade diversion and were not desirable for a trade dependent country such as South Korea. Because of concern over the negative effects of FTAs, South Korea took a passive approach to them in the 1990s. In the aftermath of the financial crisis, however, the Kim Dae-jung government began to claim that FTAs could serve as 'building blocks' toward multilateral trade liberalization.

Because South Korea was a trading state and many of its largest trading partners had already jumped on the bandwagon, FTAs might have been an unavoidable choice. Indeed, the Kim Dae-jung government's trade policy remained reactive, aiming to counter others' FTAs.²³ These proliferating FTAs generated a shared concern among the government and private firms that South Korea should not be left behind in the new fad. However, the majority of policymakers still considered multilateralism the best strategy for South Korea, and regarded FTAs as essentially an insurance policy in the case of failure of the multilateral trading regime.

It is against this background that the Kim Dae-jung government began to deliberate on FTAs. Immediately after taking office in 1998, its first measure was organizational reform related to foreign economic policy. The Kim government created the Office of the Minister for Trade (OMT) under the Ministry of Foreign Affairs and Trade (MOFAT).²⁴ Mandated to streamline bureaucratic coordination among multiple government agencies and thereby facilitate negotiations with foreign countries, the OMT had authority over a broad scope of foreign economic policies. Particularly noticeable was the establishment of an FTA bureau within the OMT to facilitate FTA negotiations.

²² Aggarwal and Urata 2006 and Dent 2006 explore FTAs in Asia.

²³ Kim and Lee 2003.

²⁴ Koo 2006, 141.

Along with the organizational reform, the Kim Dae-jung government took concrete actions for bilateral FTAs. In November 1998, the Inter-Ministerial Trade Policy Coordination Committee formally announced that South Korea would start FTA negotiations with Chile, while conducting feasibility studies with other prospective FTA partners such as the United States, Japan, New Zealand, and Thailand. Shortly after the announcement, the Kim government created a special task force on a South Korea–Chile FTA, under which five working groups were established to deal with a variety of issues such as market access, trade rules, services, intellectual property and legal procedures.²⁵

The Kim Dae-jung government's negotiation strategy vis-à-vis FTAs was motivated by its efforts to minimize the negative effects of FTAs on the domestically oriented, import-competing sectors, rather than to maximize positive effects. FTAs are generally expected to generate substantial economic gains over the long run if increased competition leads to improved productivity. However, South Korea has faced two serious challenges in the process of initiating, negotiating, and concluding FTAs with its major trading partners. The first challenge was political, involving a trade-off between short-term political loss and long-term economic gains. Managing the political drama of winners versus losers posed the most critical challenge. The key point was how to deal with the visible costs to certain domestic actors that would appear in the short- to medium-term, before the long-term benefits of FTAs ultimately materialized. Second, heightened competition from imports could bring negative repercussions to inefficient sectors as well as even relatively competitive export-oriented sectors.

The thrust of the Kim Dae-jung government's FTA strategy was reflected in the profile of South Korea's FTA partners. The Kim government aimed to form FTAs primarily with faraway countries with which South Korea had modest trade volumes. Chile ranked thirtieth among South Korea's trading partners, accounting for a mere 0.63% of its overall trade. Seoul also negotiated or conducted joint studies with lightweight partners such as India (its sixteenth largest trading partner, with a 1.23% share) and Canada (its twenty-first largest

²⁵ Sohn 2001, 7.

trading partner, with a 1.11% share).²⁶ Singapore, South Korea's eleventh largest trading partner (2.33% share), was regarded as an ideal partner because it does not have competitive agricultural sector.²⁷ Chile has a highly competitive and export-oriented agricultural sector, but it was assumed that seasonal difference between the two countries would mitigate negative effects on the Korean agricultural sector.²⁸

2.5 The Roh Moo-hyun Government's New Regional Policy

The Roh Moo-hyun government initially approached the region through its Northeast Asian Cooperation Initiative for Peace and Prosperity but later shifted to a more proactive FTA strategy as a more effective mechanism for realizing its strategic goals.

2.5.1 Northeast Asian Cooperation Initiative for Peace and Prosperity

Upon its inauguration in February 2003, the Roh Moo-hyun government proposed an ambitious regional plan, the Northeast Asian Cooperation Initiative (NEACI). The initiative was intended to build a regional community of mutual trust, reciprocity, and symbiosis. Given developments in other regions of the world, the Roh government saw Northeast Asian regional integration as a justifiable solution to cope with the challenges of globalization and as a way to accomplish the globalization process more efficiently. With Northeast Asia trailing in the regional institution 'game,' the initiative aimed to facilitate an expedited process of community-building in economic and security domains.

NEACI was a break from previous South Korean policy. The Roh Tae-woo and Kim Young-sam governments undertook "internationalization" and "globalization" campaigns, and the Kim Dae-jung

²⁶ KITA homepage. Available from <<http://www.kita.net>>. Accessed on 15 February 2006.

²⁷ Ibid.

²⁸ Yoo 2002.

government championed the idea of a broad East Asian community within the APT formula. In contrast, the Roh Moo-hyun government's initiative was much narrower in scope, focusing solely on Northeast Asia. The Roh government thought it inconceivable to assure an East Asian, Pacific, and global reach without settling immediate political, economic, and socio-cultural challenges arising from its proximate region, Northeast Asia. However, the initiative did not ignore the world beyond Northeast Asia; it foresaw a Northeast Asian focus that would be naturally tied to South Korea's active involvement East Asia through APT, in the Pacific through APEC, and internationally through multilateral cooperative structures.

What motivated the Roh government to propose the NEACI? The most critical impetus was the continuing security dilemma in the region. The dismantling of the Cold War structure led to an end to bipolar military confrontation and improved diplomatic relations among countries in the region. Yet, unlike Europe, the end of the Cold War has not brought about tangible peace dividends in Northeast Asia. The North Korean nuclear quagmire, tensions over the Taiwan Strait, major realignments of US strategic posture in the region, the ascension of China as a global power, and Japan's move to resuscitate its military power have profoundly complicated the security landscape in Northeast Asia.

The economic situation is also complex. Beneath a growing intraregional economic interdependence and division of labor lies a new pattern of intensified competition. Most East Asian countries, regardless of their developmental level, have been moving into more value-added, capital- and technology-intensive industries. Japan, the newly industrialized economies (NIEs), and ASEAN countries have all promoted cutting-edge industries such as semiconductors and computers. As a result, in contrast to the traditional , "flying geese" model, which was predicated on a harmonious intra-industrial division of labor among countries in the region, a "swarming sparrow" pattern of development has become more prevalent, further deepening economic competition among regional rivals.²⁹ In particular, China, Japan, and South Korea compete head-to-head in terms of export items and destinations, causing a major coordination dilemma. Despite increasing

²⁹ Bernard and Ravenhill 1995; and Rhyu and Lee 2006.

concerns over fierce competition, duplicated investments, and surplus capacity, the region still lacks both the institutional mechanisms to address such problems and a leading nation to furnish public goods for regional economic cooperation and integration.

There also remain socio-cultural challenges. The cultivation of a common regional identity continues to be hampered by lingering parochial nationalism and deepening mutual distrust.³⁰ Bitter historical memories of domination and subjugation still haunt the region, particularly among the people of China and South Korea. As ongoing disputes over historical distortion among Korea, China and Japan demonstrate, nationalism and subsequent cognitive dissonance pose a critical obstacle to region-building in Northeast Asia.³¹ These cognitive barriers, emanating from a history of bitter enmity, generate real ambivalence regarding intraregional cooperation.

NEACI is intended to minimize the negative effects of old and new challenges while maximizing benefits of new opportunities. The Roh government proposed several policy measures in order to implement the initiative. It made diplomatic efforts to transform the Six-Party Talks for the North Korean nuclear crisis into a viable and lasting multilateral security regime. It not only proposed the institutionalization of the China–Japan–ROK summit apart from the ASEAN+3 process, but also initiated a Northeast Asian defense ministers' meeting. To facilitate this process, it has been strengthening bilateral and multilateral military cooperation and expanding confidence-building measures, such as joint naval exercises, exchange of military personnel, and coordination of training programs among the Northeast Asian countries.

The Roh government has also proposed several cooperative projects potentially conducive to Northeast Asian community building. They include cooperation on energy and transportation, the environment, and regional economic development, as well as social and cultural cooperation. However, these ambitious projects have not yet proceeded past the planning phase. Most importantly, failure to resolve the North Korean nuclear problem through the Six-Party Talks process

³⁰ On the role of ideas and norms in the formation of regionalism in East Asia, see Acharya 2004.

³¹ Kim and Moon 1997; and Funabashi 2003.

has not only critically undermined inter-Korean relations, but also derailed efforts to institutionalize multilateral security cooperation in the region. Moreover, precarious inter-Korean relations have blocked the implementation of such cooperative regional projects as energy and transportation networks.

Unpredictable external events have also prevented the Roh government's Northeast Asian Cooperation Initiative from making meaningful progress. For example, in December 2005, deteriorating Sino-Japanese relations culminated in a clash at the ninth APT summit at Kuala Lumpur, which was followed by the first East Asian Summit (EAS). Seoul's relations with Tokyo have also deteriorated in recent years. Aside from the thorny issues such as Japanese history textbooks and Japanese Prime Minister Koizumi's visits to the Yasukuni shrine, the perennial territorial dispute over the Dokdo/Takeshima islands has plagued bilateral relations.³²

2.5.2 Proactive FTA Strategy

With its ambitious regional vision in trouble, the Roh government realized that FTAs might be a more effective mechanism for achieving its strategic goals. Although the policy shift toward FTAs under President Kim Dae-jung had marked a dramatic departure from South Korea's traditional trade policy, it was not until President Roh entered office in 2003 that the roadmap for FTAs and detailed action plans for its FTA strategy were prepared.³³ The Roh Moo-hyun administration consolidated Kim's FTA agenda by outlining a comprehensive roadmap for South Korea's multitrack FTAs. Under the roadmap, South Korea's FTA partners are classified into three broad groups: (1) immediate FTA partners such as Chile, Singapore, the European Free Trade Association (EFTA), and Japan; (2) medium-term FTA partners such as Mexico, Canada, ASEAN, and China; and (3) long-term FTA partners such as the United States, the EU, and India. The roadmap emphasized that FTAs were an important part of South Korea's goal to become an "open trading state."³⁴ In

³² Rozman 2006.

³³ Lee 2006, 5; and the Ministry of Foreign Affairs and Trade of Korea 2006.

³⁴ The Ministry of Foreign Affairs and Trade of Korea 2006.

contrast to its rather peripheral status in President Kim's economic and strategic agenda, FTA policy became a core element of President Roh's foreign economic policy vision.

As shown in Table 2.1 below, South Korea's FTA track record has been remarkable. After ratification of the South Korea–Chile FTA in 2004, South Korea signed and ratified FTAs with Singapore, the EFTA, and ASEAN in 2004–2005. These four FTAs would likely cover about 14% of South Korea's total trade, if fully implemented.³⁵ South Korea also signed an FTA with the United States in 2007, which currently awaits ratification, and has been negotiating FTAs with Japan, Canada, and Mexico. In addition, a number of feasibility studies are currently underway with China, India, the EU, South Africa, and MERCOSUR. If these prospective FTAs were concluded successfully, they would likely cover up to 65% of South Korea's total trade.³⁶

Table 2.1 Current status of South Korea's FTAs³⁷

Under joint study	Under negotiation	Awaiting ratification	Concluded
Korea–China	Korea–Canada	Korea–US	Korea–Chile
Korea–China–Japan	Korea–EU		Korea–EFTA
Korea–GCC	Korea–Japan		Korea–Singapore
Korea–MERCOSUR	Korea–India		Korea–ASEAN
Korea–SACU	Korea–Mexico		

A careful examination of the Roh Moo-hyun government's FTAs reveals two interesting anomalies. One is the lack of policy efforts to expedite a FTA among China, Japan, and South Korea, and the other is an unexpectedly early push for the ROK–US FTA.

One might expect rapidly rising intraregional trade and FDI in Northeast Asia to spur South Korea to prioritize institutionalized economic cooperation with China and Japan. South Korea is expected to realize significant tangible and intangible benefits from bilateral and/or trilateral FTAs among the three countries. Nonetheless, it has

³⁵ KITA homepage. Available from <<http://www.kita.net>>.

³⁶ Ibid.

³⁷ MOFTA FTA Homepage. Available from <<http://www.fta.go.kr>>.

made very little progress on these fronts, which is puzzling given these countries' geographic proximity and economic interdependence.

Three factors have combined to hinder the formation of FTAs in Northeast Asia. The first and most important factor is historical animosity and its legacies lingering in the minds of the people in the three countries.³⁸ One might think that this antipathy would not have a direct impact on the creation of a China–Japan–Korea FTA. In reality, however, the success of a trilateral FTA depends on domestic consensus and the absence of veto players. Collective memory of the past and clashes of national identities can easily disrupt efforts to institutionalize the trilateral FTA by mobilizing political opposition. It took about five years for South Korea and Japan to launch formal government-level negotiations in 2003. Bilateral talks stopped after the sixth round of negotiations in November 2004.³⁹

Second, rivalry between China and Japan is another obstacle. China and Japan have not yet entered a head-to-head collision, but a delicate pattern of rivalry between the two countries has hampered the formation of a trilateral FTA. Whereas Beijing has favored the FTA approach, Tokyo has been reluctant due to fear that China would be the major beneficiary. Likewise, intensified rivalry between the two countries can severely hurt the momentum for institutionalizing broader economic integration in East Asia, as illustrated by their competitive efforts to attract ASEAN as an FTA partner. This rivalry is highly likely to mitigate against the formation of a Northeast Asian FTA for the foreseeable future.

Third, countries are concerned about the distribution of benefits from bilateral FTAs in the region (see Table 2.2). A China–Japan FTA would make South Korea a loser, and a Korea–Japan FTA would hurt China. But a China–Japan–South Korea trilateral FTA is expected to produce positive-sum outcomes for all, even though there is a problem of relative gains. Judged from the matrix of mutual gains emerging from the Northeast Asian FTA, it seems irrational for the three countries not to expedite the formal institutionalization of regional cooperation through an FTA. In South Korea, it is generally believed that an FTA in Northeast Asia would balance its trade profile, while reducing

³⁸ Ikenberry and Mastanduno 2003; and Pempel 2005.

³⁹ MOFTA FTA Homepage. Available from <<http://www.fta.go.kr>>.

its trade deficits with Japan and at least maintaining the status quo with China.

Table 2.2 Balance sheet of FTAs between and among Korea, Japan, and China (% , millions of US dollars)⁴⁰

	Korea—China— Japan FTA		Korea—China FTA		Korea—Japan FTA		China—Japan FTA	
	GDP*	Economic gains	GDP*	Economic gains	GDP*	Economic gains	GDP*	Eco- nomic gains
Korea	3.2	12644.5	2.4	10687.8	1.1	3682.8	-0.2	-1189.6
China	1.3	8191.2	0.2	917.0	0.0	-358.0	1.1	7335.3
Japan	0.2	12265.1	0.0	119.9	0.0	2184.7	0.2	10289.8

* Effect on GDP growth rates in percentage

But some pessimists in South Korea claim that a Northeast Asian FTA would sandwich South Korea between horizontal competition with China and vertical pressures from Japan. This concern is particularly palpable in the agricultural sector, in which liberalization seems inevitable in the formation of the Northeast Asian FTA.

Given that political opposition from the agricultural sector still remains quite formidable, it is a daunting task for the South Korean government to push for the Northeast Asian FTA.

Competitive economic structures create another hurdle to intraregional cooperation. China, Japan, and South Korea have maintained rather complementary economic structures in the past. In 1996, for example, there was no overlap among the top ten export items among the three countries. Only five items overlapped in the top 50 export items, and eight in the top 100. But by 2002, two items overlapped in the top ten, ten items in the top 50, and 15 items in the top 100. Japan and South Korea have shown a relatively steady trend in overlapped export items (e.g., from four to five in the top ten export items, and from 34 to 39 in the top 100 export items). But China is changing the overall landscape of East Asian competition. China's ascension is literally threatening Japan and South Korea. There were no overlapping items between the two pairs of countries in their top ten export items in 1996, but this rose to four items in 2002. In short, the number of competing items in the top 100 also increased from 15

⁴⁰ Japanese Cabinet Secretariat. Quoted in *Dong-A Ilbo*, 11 January 2002.

in 1996 to 29 in 2002.⁴¹ The increasingly competitive nature of these countries' economic structures has made the subregional idea less attractive to them.

Table 2.3 Overlapping export items between and among Korea, Japan, and China

Countries	Overlapping export items	top	10Overlapping export items	top	100
	1996	2002	1996	2002	
China–Japan–ROK	0	2	8	15	
Japan–ROK	4	5	34	39	
China–Japan + China–ROK	0	4	15	29	

Under these conditions, China, Japan, and South Korea have adopted an “ASEAN first, and Northeast Asia later” posture. Because China and Japan were each more interested in an FTA with ASEAN, South Korea had to follow the path they set. This “detour regionalism” is likely to delay the process of Northeast Asian economic community building.

With Northeast Asian regionalism stagnating, in February 2006 the Roh government surprised the Korean public by announcing that it would embark on FTA negotiations with the United States, becoming the first Northeast Asian country to do so. South Korea's entrance into the “KORUS” FTA negotiations signaled that the focus of its FTA policy had profoundly changed from a reactive and gradualist strategy to minimize the negative effects of FTAs, to a proactive and aggressive strategy aimed to maximize their benefits. Overall, the two countries' complementary industrial structures suggest that South Korea is not likely to suffer serious negative repercussions. Benefits would be concentrated in South Korea's major industries such as auto and other manufacturing products, realized at the expense of South Korea's less competitive agricultural and service sectors.⁴² Yet despite the political sensitivity of issues such as screen quotas in the film industry, government subsidies to farmers, and restructuring of the financial sector, the Roh Moo-hyun government pressed forward with the negotiations.

⁴¹ KITA press release, 12 September 2002.

⁴² Schott and Choi 2001.

What accounts for the policy shift? First, the Roh government believed that the KORUS FTA has the potential to improve not only economic ties but also overall diplomatic and security relations between Seoul and the Washington. In light of the changing security outlook in Northeast Asia – China’s growth, Japan’s normalization, and most importantly North Korea’s nuclear adventurism – the Roh government might have seen few options but to strengthen its ties with the United States.

Second, an ideological shift within the South Korean government also played a role. Traditionally, South Korean bureaucrats have had a mercantilist mindset. Although bureaucrats in the Kim Young-sam and Kim Dae-jung governments championed globalization and neo-liberal reforms, their mercantile ethos remained rather intact. But under the Roh Moo-hyun government, economic policymakers have become sufficiently liberal to proactively initiate FTA negotiations with a government that would clearly demand greater market access. Kim Dae-jung’s neoliberal reforms focused on the domestic arena, clearly articulating the linkage between these domestic reforms and foreign economic policy; Roh’s government used the FTA negotiations to expedite this restructuring of the Korean economy by introducing new competition in inefficient sectors. This view – that FTAs can be tied explicitly to the purpose of locking in economic reform – has become prevalent within the Roh Moo-hyun government.⁴³ For this purpose, the Roh government highlighted the previously under-sold potential benefits of FTAs: decreasing prices of imported goods, increasing productivity, growing employment, attracting foreign capital, and so on.

Third, reflecting this ideological shift, the OMT emerged as the chief government agency in charge of FTA policymaking within the government. Its institutional legitimacy was not firmly established under the Kim Dae-jung government. But with its enhanced status under the Roh Moo-hyun government, OMT gradually took a leadership role in foreign trade affairs that in turn led to changes in the bureaucratic balance of power. Furthermore, as a champion of neoliberal economic ideas, the OMT was well positioned to fend off domestic

⁴³ Indeed countries often use FTAs to expedite the economic adjustment process. See Pempel and Urata 2006; Solis and Katada 2005; and Ravenhill 2006.

opposition as well. As an agency in charge of foreign economic policy-making, the OMT is relatively free from pressure from special interest groups.⁴⁴ In addition, when NGOs and interest groups from sensitive sectors, such as the film industry, agriculture, and service sectors, raised their voices opposing the KORUS FTA,⁴⁵ the Roh government responded by establishing a presidential committee to effectively shield the OMT from mounting domestic opposition in August 2006.⁴⁶

To summarize, South Korea's FTA strategy under the Roh Moo-hyun government has turned more proactive, as evidenced by its efforts to conclude FTAs with a number of countries, including the United States. In contrast to the reactive approach taken by the Kim Dae-jung government, the Roh government consciously attempted to link a KORUS FTA to domestic economic reforms, while placing it within a broader context of bolstering strategic partnerships between the two countries.

2.6 Conclusion

We have examined how South Korea's regional policy has evolved in the face of external factors such as the collapse of the Cold War structure in East Asia, the region's slowed progress of institutionalization, and the Asian financial crisis of 1997. As a primary beneficiary of the Cold War structure, epitomized by the bilateral security alliance with the United States and GATT-centered multilateralism, South

⁴⁴ Of course, this does not mean that the OMT operates in a political vacuum. Aside from its critics and public opinion, the OMT closely consults various private business councils as well as the National Economic Advisory Council under the President's Office. Yet in contrast to its counterpart ministries in the government, such as the Ministry of Finance and Economy (MOFE), the Ministry of Commerce, Industry, and Energy (MOCIE), and the Ministry of Agriculture and Forestry (MOAF), the OMT rarely consults small firms and individual farmers directly, while putting much more emphasis on the feedback from big business and industry associations, such as the Federation of Korean Industries, the Korea International Trade Association, and the Korea Federation of Small and Medium Business. See Lee 2006, 7.

⁴⁵ *Joongang Daily*, 3 February 2006.

⁴⁶ *Chosun Daily*, 24 July 2006.

Korea took a passive approach to building regional institutions to ease security tensions and to facilitate economic integration in Northeast Asia.

After the end of the Cold War, the lethargic progress of multilateral trade liberalization spurred South Korea to explore complementary strategies. At the time, APEC was an optimal choice: a regional body with a multilateral character. But the Asian financial crisis prompted South Korea to make another policy turn. The region's resentment over American and IMF management of the crisis prompted East Asian countries to pursue cooperative mechanisms at the regional level. In accordance with this changing milieu, the Kim Dae-jung government became keenly interested in a new version of East Asian regionalism. Specifically, the Kim government took initiative in institutionalizing the ASEAN+3 process, expecting that it had a potential to lead to an East Asia-wide free trade area or East Asian community. With the international trading environment in flux, the Kim government also embraced bilateral FTAs.

Inspired by its predecessor's vision and strategy, the current Roh Moo-hyun government has actively explored ways to build and enhance a regional community in Northeast Asia, while redefining FTA strategies in a more proactive way. The Roh government has aimed to solve perennial regional problems, such as palpable security tensions, economic competition, and socio-cultural conflicts, by unveiling an ambitious plan for a peaceful and prosperous Northeast Asia. However, this ambitious regionalist vision withered in the face of stalemate in the Six-Party Talks, Sino-Japanese rivalry, and deteriorating bilateral relations between South Korea and Japan. In the face of policy gridlock, the Roh government decided to take advantage of FTAs as a policy tool for realizing its strategic goals. With this policy objective in mind, the Roh government took a proactive approach to FTAs, in stark contrast to its predecessor.

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