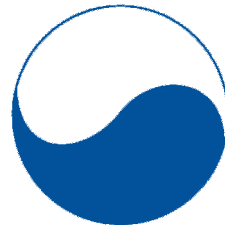


---

# **Korea's Economy 2005**



a publication  
of the  
Korea Economic Institute  
and the  
Korea Institute of  
International  
Economic Policy

Volume 21

---

## CONTENTS

### Part I: Overview and Macroeconomic Issues

<b>Economic Outlook for Korea in 2005</b> <i>Huh Chan-guk</i> .....	1
--	---

### Part II: Financial Institutions and Markets

<b>The Post-Crisis Transformation of Korea's Banking System</b> <i>Thomas Byrne</i> .....	9
--	---

<b>Prospects for Developing Korea's Financial Market</b> <i>Jeon Jong-gyu</i> .....	13
--	----

### Part III: Structural Reform

<b>Responses to Financial and Economic Distress in Korea and Japan</b> <i>Thomas Cargill and Hugh Patrick</i> .....	17
--	----

<b>New Frontiers of Financial Reform in Korea</b> <i>Kwon Jae-joong</i> .....	23
--	----

### Part IV: External Issues

<b>U.S.-Korea Economic Relations</b> <b>View from Washington</b> <i>Nan N. Fife</i> .....	29
<b>View from Seoul</b> <i>Ji Hye-yang</i> .....	38

<b>Korea's Trade and Direct Investment</b> <i>Christine Brown</i> .....	43
--	----

<b>The Yellow Sea Economic Basin</b> <i>Pietro Doran</i> .....	48
---	----

### Part V: North Korea's Economic Development and External Relations

<b>North Korea's International Economic Relations: Trends and Future Prospects</b> <i>Oh Seong-yul</i> .....	55
---	----

# U.S.-KOREA ECONOMIC RELATIONS: A VIEW FROM SEOUL

*by Ji Hye Yang*

## Overview

During 2004, Korea demonstrated less-than-expected growth caused mainly by weak private spending; however, the trade and economic relationship between Korea and the United States continued to show positive developments in 2004. To begin with, Korea ranked 10th in terms of gross domestic product (GDP) in the global economy. Having the 10th largest GDP in the world has increased the level of confidence that Korea will reach its goal of raising its per capita gross national product (GNP) level to \$20,000 by 2008. In addition, major economic indicators showed that the Korean economy performed well in 2004—recording 4.6 percent growth, 3 percent inflation, a 3.7 percent unemployment rate, and a current account surplus of \$20 billion. Also in 2004, Korea and the United States resolved bilateral trade issues such as rice and telecommunications, and Korea remains committed to resolving remaining bilateral trade issues through continued dialogue.

In terms of trade, the United States, as in the past, continues to be one of the most significant trading partners for Korea. The United States provides the second-largest export market for Korean products, while Korea is the seventh-largest buyer of U.S. goods. Korea is also the fifth-largest market for U.S. agricultural products. The United States is the largest investor in Korea—cumulative U.S. investments totaled approximately \$31 billion up to the third quarter of 2004—and, different from the past, investment is now becoming a two-way street. Korean companies are investing in the U.S. economy, as witnessed by the Hyundai Motor Company automobile assembly plant in Alabama, the Samsung Electronics dynamic random access memory (DRAM) plant in Texas, the Hynix plant in Oregon, and numerous other ventures.

Even though China surpassed the United States as Korea's number one export destination in 2004, the overall Korea-U.S. economic relationship has not diminished in shape or form. As Korea and the United

States continue to resolve pending trade and economic issues constructively, Korea-U.S. economic relations will continue to strengthen in trade and investment. The United States will remain Korea's most important economic partner.

The significance of the Korea-U.S. economic relationship is seen with a trade volume amounting to \$71 billion in 2004. With such a large trade volume, trade issues are likely to arise, but our governments have been engaging in close consultations to address these issues. For example, concrete progress has been made recently in the Korea-U.S. economic relationship. Substantial bilateral trade developments between Korea and the United States have taken place in the areas of wireless Internet platform for interoperability (WIPI) as well as agricultural products, especially rice and oranges. Although trade issues between Korea and the United States remain, the two countries are making great strides in resolving them.

Economic cooperation is not limited to the bilateral front but has expanded to the multilateral and regional fronts as well. The midterm goal of the Korean government is to create an advanced economy with a per capita income of \$20,000. To this end, Koreans have been making best efforts to continuously reform and liberalize Korea's economic system. On the trade front, Korea hopes to achieve this goal in two ways: first, through the World Trade Organization (WTO) Doha Development Agenda (DDA) negotiations; and, second, through bilateral or regional free trade agreements (FTAs). In November 2004, a significant development occurred at the Asia-Pacific Economic Cooperation (APEC) ministerial meeting: Korea's Minister of Trade Kim Hyun-chong and U.S. Trade Representative Robert Zoellick agreed to discuss the feasibility of a Korea-U.S. FTA.

The Korea-U.S. bilateral relationship has become dynamic and complex. This relationship affects both countries on the political and economic levels as well as on the bilateral, regional, and global levels. When

economic developments of the past year are reviewed, it is therefore necessary to keep in mind the multilayered environment in which both Korea and the United States operate.

## **Bilateral Trade Issues**

### ***Free Trade Agreement***

One of the most important events that would fundamentally affect the future of ROK-U.S. economic relations would be an FTA between the two countries. An important step to this end was taken on 18 November 2004 in Santiago, Chile, when Minister of Trade Kim and Ambassador Zoellick met during the APEC ministerial meeting.

The two ministers agreed that both sides should have working-level discussions on the possibility of a bilateral FTA at the government level. Accordingly, the first two working-level review discussions between the two countries were held on 3 February 2005 and 27–28 March 2005. Both sides plan to hold two additional review discussions before the trade ministers meet in Jeju for the APEC meeting of ministers responsible for trade.

However, the current review discussions will not automatically lead to an ROK-U.S. FTA. The U.S. side believes that, in order to garner domestic support, some progress on pending bilateral trade issues is essential. It is both governments' understanding that, following the review discussions to be held in May 2005, the two trade ministers will assess progress on the discussions as well as on bilateral trade issues. The ministers will then provide instructions on whether to move forward to FTA negotiations between the two countries. If concluded, an ROK-U.S. FTA will result in a tremendous economic gain to both Korea and the United States, further strengthening their already close trade and investment relations.

### ***Agriculture***

Agriculture has always been a thorny issue because of the sensitivities in Korean society as well as in the United States. The year 2004 was marked by difficult negotiations surrounding Korea's imported rice re-

gime. In December 2004, the Korean government reached an agreement with the United States which requires that Korea double the amount of rice it imports during the upcoming 10 years and guarantee access for 50,000 metric tons of U.S. rice each year; Korea also has to make imported rice available to Korean consumers.

In terms of beef, Korea in 2003 was the third-largest importer of U.S. beef after Japan and Mexico. Since the outbreak of bovine spongiform encephalopathy (BSE, mad cow disease) in the United States in December 2003, Korea has imposed an import ban on U.S. beef. Since then, the U.S. government has sent high-ranking government officials and delegations to Korea to explain various domestic measures that the U.S. government has taken against BSE.

To further discuss the issue, the two sides conducted two technical consultations—at the end of 2004 and in February 2005. The Korean government has been cautious about an immediate resumption of beef imports on the grounds that these are issues of food safety and public health, about which the Korean public is very sensitive.

During a visit to Seoul by Secretary of State Condoleezza Rice on 20 March 2005, she emphasized the importance of resolving the beef issue as quickly as possible; she explained that the role it plays in U.S. domestic policy is an important one. Foreign Minister Ban Ki-moon expressed to Secretary Rice his desire to resolve the beef issue as soon as possible, on the basis of scientific evaluation. Because the issue must be solved through scientific evaluation, Minister Ban emphasized the importance of continued close consultation between the experts. He also emphasized that Korea will not necessarily follow the model of Japan on every occasion.

Another issue that arose, in April 2004, was *Septoria citri*, a quarantine pest that was found in oranges imported from California. As a result, the Korean government imposed a tentative import suspension on California oranges. However, after intensive technical consultations between both sides, the Korean government agreed in November 2004 to resume importing California oranges.

## *Telecommunications*

In May 2002, Korea's mobile telecom operators developed WIPI with a view to addressing the lack of service interoperability among operators using different Internet platforms. At the request of the industry, the Korean government has been considering the adoption of WIPI as a mandatory standard to expand consumer choices and create a level playing field among content providers. The U.S. government has been raising concerns that adopting WIPI as the mandatory standard would drive the U.S. standard currently in use out of the Korean market. The United States has raised similar concerns about the development of standards for 2.3 GHz telecom service (WiBro).

A perception gap exists between our two governments as to the role of the government in pursuing economic policies. The U.S. government insists that the standardization effort in the telecommunications market is unnecessary and that ultimately the decision of whether to adopt a standard should be left to the market. The Korean government believes, however, that the intervention of the government is sometimes justified and necessary when important public policy interests are at stake and the market system is unable to function properly in determining such policies. Bilateral consultations during a period of two years produced constructive results in the case of WIPI. Both governments resolved the issue in April 2004 by allowing technology operability of other platforms on top of WIPI.

With respect to WiBro, the Korean government adopted an international telecommunications standard of IEEE 802.16e for the service in September 2004. The United States raised concerns that allowing only a single technology in the market dampens market forces and could impede the development of telecommunication technologies that best fit in with the service in the long run. It is therefore evident that significant progress has been made in resolving bilateral telecommunication issues; however, there is still work that needs to be done.

## *Protection of Intellectual Property Rights*

In terms of intellectual property rights (IPR) issues, the U.S. government's concern during the past sev-

eral years has focused on producers' rights for sound recordings, video piracies, and some IPR enforcement issues. Even though the U.S. government views the Korean government to be making real progress in strengthening its IPR protection regime, the U.S. government continues to insist on resolution of a few pending issues. These pending issues consist of insufficient protection of phonogram producers' rights and incomplete legislation to prevent the rating of pirated video products; these are issues that need to be resolved expeditiously, especially in light of the advanced information technology environment in Korea. As a result, the U.S. government announced that it would keep Korea on its priority watch list when it released the annual Special 301 report on the status of IPR protection in foreign countries on 3 May 2004.

In February 2004, President Roh Moo-hyun instructed the cabinet to outline a comprehensive IPR protection plan. As part of Korea's active efforts, the government-wide IPR Protection Task Force was launched on 3 May 2004, and the omnibus plan for IPR protection was made public. Given the concerted efforts of the Korean government, it is regrettable that the U.S. government did not adequately reflect the progress being made in Korea.

The U.S. government's decision to keep Korea on the priority watch list has not deterred Korea from continuing to improve and strengthen its IPR protection level. Independent of U.S. interests, Korea is actively pursuing IPR protection. The Korean government recognizes that IPR protection is essential for attracting inflows of foreign direct investment as well as supporting existing industries that rely on such protection. Nonetheless, the Korean government believes that it is important to keep in close consultation with the United States on the progress to be made in overhauling the IPR protection measures in Korea. Also, because of the rise in piracies of Korean products, especially entertainment products such as film and music in Asia, it is in the interest of Korea to pursue IPR protection. Cooperative efforts will enhance our overall bilateral economic and trade cooperation, which will, in turn, contribute toward building a better IPR protection regime in the region as well as around the world in the long run.

## ***Automobiles***

In the automobile sector, the Korean government is well aware of U.S. concerns about automobile trade imbalances, and it has taken measures to address this ongoing issue in accordance with the 1998 memorandum of understanding. In March 2004, the Korean government decided that by the end of 2004 it would lower by half the special consumption tax on passenger vehicles, and in December 2004 this reduction was further extended to 30 June 2005.

In addition, in 2004, the U.S. government expressed some concerns about elements of the Korean government's plan to introduce average fuel economy (AFE) regulations to improve motor vehicle fuel economy. After consultations with the U.S. side, the Korean government agreed that there would be an extended grace period for imported vehicles through the end of 2009. Furthermore, if non-Korean auto manufacturers have concerns that they will not be able to meet the new requirements, consultations between the respective governments will take place during the second half of 2009.

## **Cooperative Efforts**

### ***Multilateral Trade Liberalization Cooperation***

An essential aspect of any bilateral trade relationship is the WTO's DDA negotiations. Because Korea depends heavily on worldwide trade liberalization for its continued trade expansion and economic growth, it has been participating actively in the DDA.

The setback suffered during the Cancun WTO ministerial in 2003 was indeed a disappointment to Korea. It is in this context that Korea sincerely welcomed the adoption in Geneva of the July 2004 package, which enabled the members of the WTO to place the DDA negotiations back on track and facilitate the negotiation process.

Korea is concerned, however, that progress is uneven among the different areas of negotiation. In particular, compared with the pace of agriculture negotiations, progress in negotiations on nonagricultural market access services and rules is very slow. Therefore, it is critical to secure balance in the overall negotiations if members are to achieve a significant pack-

age at the Hong Kong ministerial conference to be held in December 2005.

## ***Regional Cooperation***

APEC has served and will continue to serve as a valuable venue for promoting economic relations among Asia-Pacific countries, including the United States. Korea will host the APEC economic leaders' meeting and other APEC-related meetings in 2005.

In November 2004 in Santiago, Chile, the Korean government announced the theme of APEC 2005: *Toward One Community: Meet the Challenge, Make the Change*. Under this theme are three subthemes: *Renew the Commitment to the Bogor Goals, Ensure a Transparent and Secure Business Environment, and Build Bridges over Differences*. These guiding themes were decided upon after consultations with APEC member countries.

Korea then went on to further choose priorities of APEC 2005: advance freer trade, including support for the DDA negotiations, midterm stock taking, and a future road map to the Bogor Goals while it continues to emphasize fighting corruption, sharing the prosperity of the knowledge-based economy, human security, and APEC reform. Korea will work with other member countries, particularly the United States, to make APEC 2005 a great success.

## **Conclusion: Prospects for 2005**

The economic and trade relationship between Korea and the United States will continue to grow and prosper in 2005. The two nations are currently closely engaged in exploring ways to enhance and institutionalize bilateral economic and trade relations in the form of an FTA. With this goal, Korea and the United States will make efforts through preparatory consultations for possible FTA discussions. These discussions will identify possible impediments to pursuing an FTA as well as strategies to use to overcome such obstacles. In parallel with this effort, Korea and the United States will continue to resolve trade issues, such as the beef reimportation issue and the screen quota issue, through close consultation. These two issues will be a challenge for both countries, and how these issues are ultimately resolved will affect progress in the FTA discussions.

Through its position as host of APEC 2005, Korea will continue its efforts to participate in the ongoing recovery of the global economy. The Korean government will continue to work toward improving its internal economic system. Specifically, Korea will work on strengthening domestic demand and furthering progress on the reform agenda. As a result of these positive economic changes, Korea's GDP growth is expected to continue at about 5 percent during 2005. Korea's external economic performance will also maintain its smooth expansion with an increase in its overall trade volume. In addition, bilateral trade between Korea and the United States will continue to make progress during 2004.

To make additional progress on trade issues, Korea will continue to support the DDA process. The current review discussions for the feasibility of a Korea-U.S. FTA indicate that progress is being made on both sides. A Korea-U.S. FTA would be a tremendous economic gain for both countries and will remain as a top priority in our bilateral trade relations.

The Korean government will continue to meet the challenges of 2005 by maintaining its current policies supporting economic recovery. President Roh and his administration are firmly committed to making Korea one of the world's premier places to do business. Korea's leadership will work to promote peace and prosperity in Korea through even stronger Korea-U.S. cooperation and friendship and an absolute dedication to a more transparent, more open, and more productive market economy.

*Mr. Ji is the Counselor for Economic Affairs at the Embassy of the Republic of Korea in Washington, D.C.*



Korea Economic Institute

Korea Economic Institute  
1201 F Street, N.W., Suite 910  
Washington, D.C. 20004

PRESORTED STANDARD  
U.S. POSTAGE  
PAID  
PERMIT #3777  
WASHINGTON, DC