

Korea's strategy: High risk, low return

Despite expressions of disappointment following the third round of negotiations in Seattle, the Korean and U.S. governments are still optimistic about the prospects for reaching a free trade agreement. Since the beginning of the talks, both sides have launched PR campaigns to shift public opinion in their favor. In his KBS interview on Aug. 31, President Roh was full of confidence regarding the impact of an agreement. He cited studies which suggest that countries with multiple FTAs have higher growth rates; he referred to an analysis by the Korea Institute for International Economic Policy, which indicated significant net positive benefits for Korea's economy; and he warned critics not to underestimate Korean government officials' capability to negotiate a deal.

Low return — without fundamental change

Yet its implications would be far more complex than suggested in the PR campaigns. Without a doubt, there will be benefits. KIEP's figures of 0.4 percent increase in GDP in the short run and 2 percent in the long run have been criticized, but they do indicate the potential benefit from an overall economic perspective. My main issue with these predictions is that they suggest sustainable, additional growth — which is by no means guaranteed. For example, the benefits could be lowered significantly if other

An Outsider's Insight

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countries also strike FTAs with the United States. The biggest such impact would come from a U.S.-Japan agreement, as Japan's trade and export patterns to the United States most closely resemble Korea's. President Roh himself noted that being faster than the neighbors in striking a deal has been a keen consideration for him. That, inadvertently, may have been the best concession that the long-term return from the FTA is limited: the FTA is not a panacea for Korea's economic challenges. Instead, Korea needs to adopt a more balanced, fair and efficient economic model by addressing a number of fundamental issues.

Four reform areas are particularly important. Government reform, including a radical reduction in regulations; corporate reform to loosen the grip of the chaebol on the economy; and reform of the country's highly inefficient and unfair labor market. None of these challenges is resolved by the FTA. The fourth priority area is to open up the country. But isn't that exactly what the FTA will do? Yes and no. Yes in that many sectors will see products and services flow

more freely. No in the sense that the focus of the FTA is on trade, i.e. exports and imports, rather than investment (although there are some areas where the United States is pushing for an opening to foreign investment, such as telecommunications, only to be rebuffed by the Korean side). Yet what Korea needs more than anything else is foreign direct investment. Korea's stock of FDI as a percentage of GDP is the lowest among OECD countries except Japan. The empirical evidence linking foreign direct investment and economic growth is fairly robust — much stronger than the link between FTAs and economic growth. Beyond the investment per se, participation of foreign companies also adds synergies which domestic firms cannot offer, and transfers valuable learning and a new way of thinking (that is why so many young Korean graduates are keen to join a leading multinational rather than a chaebol). Numerous studies have confirmed and quantified the impact of FDI on Korea. If Korea wants to position itself as a Northeast Asia hub and benefit from the enormous opportu-

nities in the region, it needs to put the highest priority on attracting FDI.

Public sentiment and the high risk factor

Korea needs fundamental change which goes far beyond the FTA. Why, then, is such change so difficult? First, because interest groups are powerful barriers to change. In my earlier columns, I have already described how government bureaucracy, chaebol and labor unions have been blocking change in Korea.

The second obstacle to change is public sentiment. Numerous surveys have been conducted regarding public opinion toward the FTA. Both proponents and opponents claim that the majority of Koreans are supporting their case. Overall, it seems that Korea's public is roughly split on the FTA. My discussions with Koreans suggest that even those who support it are skeptical about the government's sudden push to conclude a deal.

As the negotiation teams start touching sensitive issues, public opinion is likely to be swayed — farmers will protest louder, Korea's concessions will become clearer (of course, making concessions is part of any deal, and the United States will also have to give in some areas as well), and the perception of an unequal and unfair deal will likely increase. All this could lead to more skepticism and a negative attitude among the public. And as many Koreans

equate the FTA deal with opening up and change, they will likely reject those two notions further. In that sense, the FTA risks alienating the public from much needed reform tasks.

A daunting task for Korea's next leader

With discussions focusing on the ongoing negotiations, few have recognized this risk. President Roh does not seem to have grasped these longer-term implications when deciding to push for the FTA. Instead of pursuing a policy of fundamental change — careful, but steady and with clear priorities — he has chosen a piecemeal economic policy, including this FTA.

As a result, resolving Korea's interest group trap and truly opening up the country will fall to President Roh's successor. He or she should make free trade and investment part of an overall strategy of economic reform. In the best case scenario, this will be a daunting task. In the worst case scenario, such a presidential candidate will not be elected in the first place, due to the public's deeply felt skepticism against further changes and opening up.

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