

# South Korean Trade Strategies in the Post Global Financial Crisis

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### ABSTRACT

Korea has developed rapidly since the 1960s to become one of the four Asian tiger economies. Korea is an example to other nations of how a developing country can develop its economy rapidly and become industrialized. Its development strategy has mainly been based on an export oriented trade policy. As a result, its trade volume has increased from USD1 billion at the beginning of the 1960s to USD1 trillion in 2011, which is a 1,000 time increase within five decades. However, the Korean economy has experienced turbulence as well as positive changes. It has faced severe economic crises such as the Asian financial crisis in 1997 and the global financial crisis in 2008. This paper discusses Korea's trade policy and the strategies utilized over the last five decades to develop the national economy. It also explores how the government reacted and adapted its policy when the economy was hit by external economic crises. Moreover, it investigates and analyses the role that trade policy and strategy has played in developing the nation's sustainability.

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### **Key words**

Trade policy, development strategy, economic crisis, economic growth, Free Trade Agreement

## 1. Introduction

South Korea (henceforth Korea) was the 7th largest exporter in the world in 2012, registering a growth of exports of 29 percent of GDP in 1995 and 54 percent in 2012. This rapid increase in exports has contributed to the nation's growth from low income to industrialized economy status in less than 50 years. Indeed, Korea's Trade volume had already reached over USD1 trillion by 2011. Since then, Korea has joined the 1 trillion trade club along with China, the USA, Germany, Japan, the UK, France, Italy, and the Netherlands, becoming the 9th nation in world trade history to do so (WTO, 2013).

Four factors account for this success. Firstly, Korea has continuously maintained an attractive environment for doing business, particularly through its reduction of the tax burden, which is one of the lowest in the OECD. Secondly, the government has promoted exports since the 1960s and recognized their importance, while many developing countries have engaged in import substitution to develop their economies. Based on an export driven policy, Korea has been aggressively negotiating free trade agreements (FTA) with large and growing countries. Thirdly, it has also taken advantage of the economic prosperity of neighbouring countries such as Japan and China by attracting Japanese investment and investing in the Chinese market. Lastly, it has diversified its global markets (World Bank, 2010, 2012). In 2012, 25 percent of Korean exports went to China, 11 percent to the EU, 10 percent to the USA, and 5 percent to Japan. In 2009, just after the global financial crisis, China was responsible for over 85 percent of Korea's export growth. Korea's diversification of markets and its growing diversity of exported goods have contributed to its significant export growth, which was the highest in the OECD in 2009. (See fig. 1).

The government introduced trade and industrial policies during the 1960s and 1970s in order to boost exports (Frank Jr. et. al., 1975). During the 1980s, the government transformed its policies from government led to liberalization and competition led policy. Furthermore, the government switched its policy direction toward market openness, deregulation, and free trade during the early 1990s. It built on its stance of market openness and competition promotion continuously in the 2000s in order to expedite trade liberalization in pursuing free trade agreements with developing and developed economies around the world (Noland, 2007; Todaro & Smith, 2012). As a result, Korea's trade policy has been centred on the active pursuit of more FTA's than any other nation in the world since the 2000s (Lee, 2012; Solis, 2013).

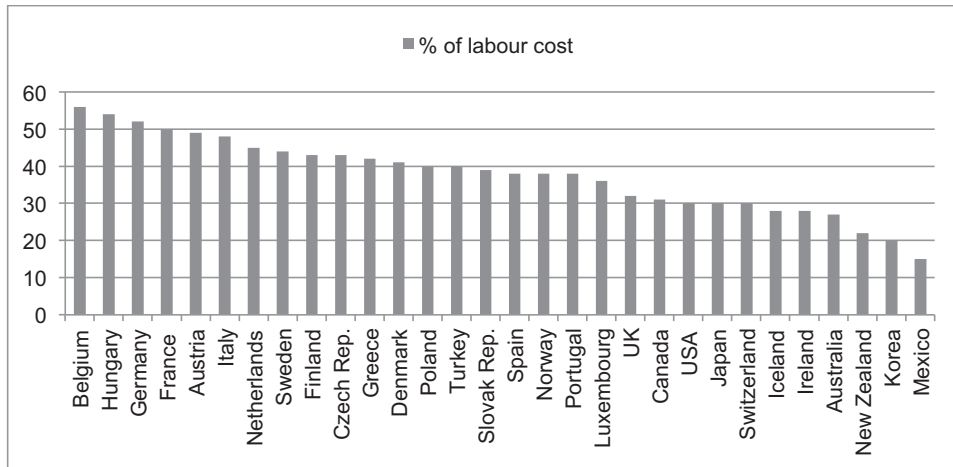
In fact, Korea's FTA policy was initially introduced as a reactive response to the rapid proliferation of preferential trade agreements around the world. Its trade negotiations were based on a defensive strategy, which focused on limiting market openness in sensitive industrial sectors. Later, Korea's FTA policy shifted towards ambitious trade strategy deals with major economic partners, minimizing exclusions, and tackling non tariff barriers. This transformation was based on institutional changes to the trade policy-making setup in the beginning of the 21st century. The delegation of trade policy to the Ministry of Foreign Affairs and Trade (MOFAT) and the efficient coordination of bureaucratic interests between various ministries has enabled Korea to become an international trade hub. At the same time, however, trade policy has been a very sensitive issue, and the government has struggled to ensure the greater inclusivity, transparency, and development of an effective safety net for disadvantaged sectors.<sup>1</sup>

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<sup>1</sup> MOFAT had been in charge of trade policy from Roh, Moo Hyoun government (2003 – 2008) to Lee, Myoung Bak government (2008 – 2013). The new Park, Keun Hye government switched the assignment of trade policy to the Ministry of Trade, Industry, and Energy (MOTIE) in 2013

This study takes a practical approach to strategy and policy analysis instead of exploring the theoretical or conceptual backgrounds of global trade. It focuses on how Korea has utilized trade strategies as policy tools to generate economic growth and overcome economic crises. One of the key research questions explored in this paper is what role has Korea's trade policies played in dealing with the global financial crisis in 2008. Moreover, this paper explores what strategies the government carried out in order to achieve economic growth during the post-global financial crisis period. Lastly, the paper discusses how important trade policy was to Korea's capacity to overcome the external economic shocks caused by the global financial crisis.

Figure 1: Total tax burden as a percentage of total labour costs in the OECD countries (As of 2008)



Source: OECD, 2009

## 2. The Changing global trade environment after the global financial crisis

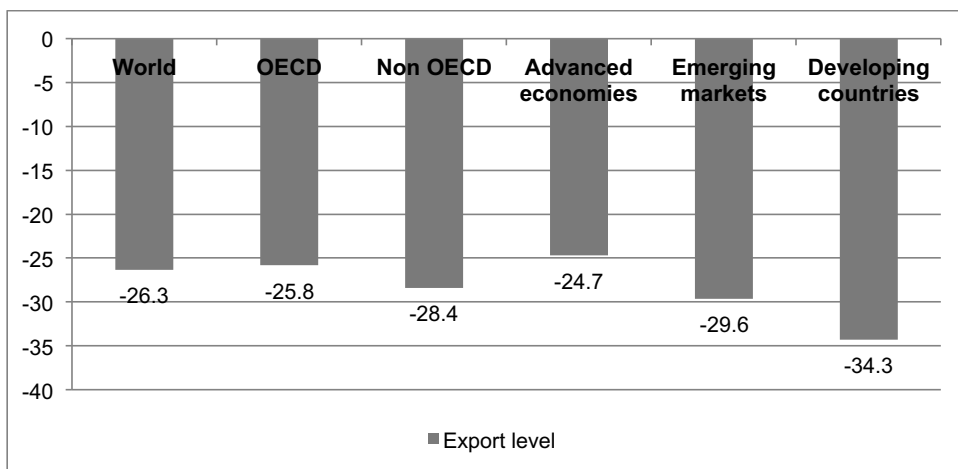
### 2.1 Background

The global financial crisis in 2008 had a significant impact on the global economy. The international Monetary Fund (IMF) projected/estimated that global economic activity would contract to 0.5 to 1 percent growth in 2009, which was the lowest level of economic growth in 60 years (IMF, 2010). The majority of countries around the world experienced a simultaneous downturn with the developed economies of North America, the EU, and Japan, falling into recession and experiencing a significant downturn in economic growth rates. This decline in economic activity caused a loss of what is estimated to be trillions of US dollars in equity markets and a credit squeeze that affected not only households and global businesses, but also world trade and oil exploration (Nanto, 2009).

The global financial crisis had a negative effect on the world labour market as well. The International Labour Organization (ILO) pointed out that unemployment had increased by 14 million in 2008 after four consecutive years of declining unemployment. However/In addition, it expected that world unemployment would increase by at least 38 million by the end of 2009 as the financial crisis continued (ILO, 2009). Moreover, the global financial crisis had a detrimental effect on exports

of goods and services. Exports of goods and services generate foreign exchange for exporting countries, which enables them to pay for imports and to repay their international debt. Trade deficit uses to depress of value of currency in the deficit country which increases the cost of debt service for governments, businesses, and households that have borrowed in international currencies. In February 2009, exports in advanced economies and emerging economies were estimated to have declined by about 25 percent compared to the previous year. However, exports in developing economies declined by more than a third in a historic contraction in trade volume which caused the shrinking of international trade, low global economic growth, and creating more poverty in the world (Nanto, 2009). (See fig. 2)

Figure 2: Percent Change of exports levels for selected regions (As of Feb. 2008 – Feb. 2009)



Source: Global Insight, Forecast Data, 2009

## 2.2 New global trade environment

The global financial crisis escalated existing anti-globalization sentiment and created opposition in liberalized trade as a result of neo-liberalist views. Under these conditions, many countries attempted to curtail imports and impose other restrictions on trade. As a result, the G-20 Leaders Summit, and the meeting of finance ministers and central bank governors agreed to oppose all forms of protectionism in trade and maintain open trade pathways ([www.g20.org](http://www.g20.org)). Despite this clear political and economic statement, the World Trade Organization (WTO) reported that there was a new trend of increased trade protectionism as a result of the deepening global economic crisis. During the peak of the global financial crisis period between September 2008 and March 2009, 23 countries imposed 85 verified trade measures in the WTO (WTO, 2009). The large majority of these imposed measures were trade restrictive, and some were in line with trade liberalization. The largest number of measures were imposed by India, and the EU, China, Indonesia, and Russia followed. In these imposed trade measures, there is a clear pattern of increases in import licensing, import tariffs, surcharges etc. Additionally, investigations of anti-dumping have increased (Ahearn, 2009; Nanto, 2009; International Trade Daily, 2009).

Protectionism or beggar-thy-neighbor policies are limited by the rules of the WTO. Despite a regulatory system based on the rules and obligations in the WTO, there is a clear trend towards increased tariffs among member nations to levels that could cause a world trade to shrink by up to 8 percent and a reduction in global welfare by up to USD350 billion (WTO, 2009). Therefore, the world's major countries have tried to adhere to the WTO rules in order to prevent a crisis similar to the Great Depression in the 1930s, when a proliferation of destructive protectionist trade measures prolonged the global economic depression (UNCTAD, 2010).

At the outbreak of the global financial crisis, all of the leaders of the G- 20 stressed that the conclusion of the Doha Round could be vital to the world economy. As a result, the G-20 leaders reached an agreement on modalities at the G-20 summit in Washington D. C. in 2008 that could lead to a successful conclusion to the WTO's Doha Development Agenda (DDA) with an ambitious and balanced outcome.<sup>2</sup> This message has been stressed continuously at subsequent G-20 summits as well as at other international meetings. However, the conclusion of the DDA has been delayed until December 2013. Finally, the WTO ministers approved the creation of a Bali Package in December 2013, which marked the first occasion that a multilateral trade deal had been agreed to by WTO members since its birth in 1995. The final agreement included three pillars such as trade facilitation, selected agricultural issues, and selected development-focused provisions (Bendini, 2013).

Owing to the long delay prior to agreement on the DDA, the number of bilateral and regional free trade agreements (FTAs) increased significantly from 2005 to 2010. There were 271 bilateral and regional FTAs in force in 2010, according to the WTO report ([www.wto.org](http://www.wto.org)). This indicates that the global business community regards bilateral and regional FTAs as a more effective means of market opening than multilateral trade negotiations. The EU and the USA are major players in FTAs, and East and South Asia usually follow these two major economies. The EU is involved in 27 FTAs, 17 of which came into force after 2000, while the USA is involved in 9 bilateral FTAs, eight of which came into force after 2000. In East and South Asia, numerous FTAs are being negotiated between major and emerging economies in the region such as China, India, Japan and Korea, which will have significant implications not only for the region, but also for the world if the negotiations are successful (UNCTAD, 2010).

There are four core reasons for the recent increase in bilateral and regional FTAs. Firstly, FTAs are preferred to multilateral trade agreements because sensitive industrial sectors can be excluded by participating countries. Moreover, partners can be selected, and the customization of the content is also possible.

Secondly, the concept of competitive liberalization, which has proliferated in recent years, particularly in Asia, has triggered an increase in FTAs. In practice, one major FTA and its market opening can change the emphasis of a country's trade policy from import competing industries to exporters, which could enable governments to reduce domestic tariffs in exchange for market opening in partner countries. The principle of reciprocity is central to the concept of competitive liberalization,. Therefore, competitive liberalization works better in a FTA framework than in

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<sup>2</sup>It is the declaration of the G-20 Summit on Financial Markets and the World Economy, Washington D. C. Nov. 2008

a multilateral framework. Additionally, market opening by partners in FTAs is more clear and immediate than in multilateral trade agreements, particularly if big trade partners such as China and India are involved (Bergsten, 1997; Baldwin, 2006).

Thirdly, developing countries regard FTAs as an effective means of attracting foreign direct investment (FDI) not only from FTA partners but also from major economies outside the FTA (UNCTAD, 2010). Lastly, FTAs have played a major role in regulating trade and investment between partners, which has facilitated a regional integration process in the East Asian region. East Asian free trade pacts codify the integrated production networks already operating in the region that are linked by expanding flows of intra regional trade and investment. This means that regional integration is evident in the market and that the governments of partners understand this and are even facilitating its future evolution (Hufbauer & Schott, 2007).

The proliferation of bilateral and regional FTAs has shaped a new trend in the international trade environment. There is an ongoing debate as to whether the new trade environment could undermine efforts to maintain a fair and equitable international trading system. The new regionalism established during the 2000s has a different structure compared to the previous form of regionalism practiced in the 1990s, which was based on strengthening trade blocks such as the EU and the North American Free Trade Agreement (NAFTA).. The former is characterized by a large number of bilateral FTAs, while the latter consisted mainly of regional FTAs. As a result, almost all of the WTO members became parties to one or more FTAs. Therefore, the most favoured nation (MFN) principle advocated by the WTO is gradually becoming an exception rather than the rule (UNCTAD, 2010).

### **3. Korean trade policy and strategy**

#### **3.1 Development of trade policy**

During the 1950s, the economic development policy in Korea was based on import substitution industrialization. This policy helped to protect domestic import substitution industries. At the same time, however, it impeded export growth. The export oriented policy was introduced at the beginning of the 1960s as the military regime came into power. This marked a major policy shift from import substitution industrialization to export driven economic development. Despite the change in trade policy, the total volume of exports in 1966 accounted for only USD1 billion because major export goods were in primary sector as well as light industrial products. During the 1970s, the government initiated heavy and chemical industrial policy in order to maximize its export volume. The government supported these industrial sectors strategically, and large companies such as Samsung and Hyundai adapted to the new policy direction by becoming conglomerates. The Korean version of corporatism between the government and private companies succeeded in producing high economic growth (Park, 1997, 2000; Park & Lee, 2004; Sakong & Koh, 2010).

In the 1980s, the government introduced the Comprehensive Liberalization Policy, including the Import Liberalization Five Year Plan. This plan was implemented from 1983 to 1988. The plan had a significant impact as the average import tariff rates declined from 23.7 percent in 1983 to 18.1 percent in 1988. As a result, the ratio of import liberalization increased from 80.3 percent to 95.2

percent in the same period. The ratio continuously rose up to 99 percent in 1995. The government transformed its trade policy from a government led to a liberalization and competition led policy in order to step up its national industrial structure. By the beginning of the WTO in 1995, Korea had strengthened its trade policy, which now focused on market openness, deregulation, and free trade (Sakong & Koh, 2010; Lee, 2012).

The proliferation of regional FTAs has played a significant role in encouraging free trade and liberalization in the world trade system since the 1980s. However, Korea's policy put more weight/emphasis on multilateral trade than bilateral and regional FTAs until the Asian financial crisis in 1997. Owing to the crisis in 1997, Korea was forced to implement structural reforms across the whole economy and promote trade liberalization (Todaro & Smith, 2012). As a result, it benefited from bilateral and regional FTAs, which impacted the whole economy through a restructuring process. Moreover, the failure to launch a new multilateral round at Seattle in 1999 created doubts about the ability of the WTO to move the liberalization agenda forward. Therefore, many governments including Korea's started to negotiate bilateral and regional FTAs as an insurance mechanism for their national economies (Sakong & Koh, 2010).

The rapid proliferation of bilateral and regional FTAs persuaded Korea and other East Asian countries to participate in this new trend in order to avoid the possible negative effects of trade discrimination, particularly since the 2000s (Mansfield & Reinhardt, 2003). If Korea did not shift its trade policy focus from multilateral trade agreements to bilateral and regional FTAs, it would be at a relative disadvantage in the world market in the short run. However, this would reduce its economic growth potential severely in the long run. Accordingly, Korea chose bilateral and regional FTAs as critical policy tools and measures for enhancing its industrial and national competitiveness in order to survive in the global market (Lee, 2012; Solis, 2013).

### **3.2 Bilateral and Regional FTAs as a trade policy strategy**

Korea began negotiations for the first bilateral FTA in its history with Chile in 1999 and completed it in October 2002. It aimed at building an extensive network of FTAs and becoming effective in FTA negotiation. Korea launched FTA negotiations with Chile because the two countries are geographically distant, and have opposite seasonal climates, could mitigate a sudden increase in agricultural imports. Despite these political and economic considerations, the FTA with Chile generated anti FTA sentiment, particularly among farmers and interest related groups, which hindered further FTA negotiations. Notwithstanding this political barrier, the government announced a FTA roadmap as part of its national economic development agenda. This indicated a trade policy shift from a passive FTA stance to an active one. As a result, Korea was able to negotiate FTA talks with Singapore in 2003 and the European Free Trade Area (EFTA) in 2004 (Park & Koo, 2008; Ahn, 2010).

The FTA Roadmap is based on two significant principles. Firstly, that Korea can recover its competitiveness in the global market and reduce opportunity costs for Korean companies by finalizing as many FTAs as possible in a short period of time.<sup>3</sup> Secondly, the FTA Roadmap pursues

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<sup>3</sup> Opportunity costs for Korean companies have been observed as rising disadvantages in the markets, where Korea did not conclude FTAs.

multi-track and simultaneous FTA negotiations with large economies. The main reason for this is to maximize economic benefits and, at the same time, minimize negative costs from FTA negotiations. Based on these two principles, the roadmap prioritises comprehensive and high quality FTAs in terms of sectors and commitments (Lee, 2012).

Based on the FTA Roadmap, nine FTAs have been ratified and these came into effect at the end 2013. The sharing of exports between these trade partners accounted for 38 percent of the total exports in 2012 (IMF, 2013). Additionally, 12 FTAs are currently under negotiation. In total, 21 trade partners had either concluded FTAs or been under negotiation with Korea by the end of 2013. The share of exports with 12 countries under FTA negotiations reached 56.1 percent of the total exports in the same year. In total, the share of exports with 21 trade partners accounted for 77.6 percent which are major trade partners for Korea (Ministry of Foreign Affairs, 2013) (See table 1).

In fact, after completing mega FTAs with major economies such as the EU, the USA, and India as well as developing economies such as Chile, ASEAN, Turkey etc., Korea's trade volume has increased continuously/considerably. In 2010, Korea's trade share with FTA partners accounted for only 14.6 percent of its total trade. This share was much lower than that of the world's average of 49.2 percent. A year later, however, Korea's trade share with FTA partners increased to 27.4 percent after the completion of FTAs with the EU and Peru. During this period, Korea's exports to its FTA partners accounted for USD166.8 billion and imports from them reached USD129.4 billion. This indicates that Korea generated a trade surplus of over USD37 billion with its FTA partners (Korea International Trade Association, 2012).

The Korean government's most prominent trade negotiations were with the USA in 2007, and this was seen as controversial by the Korean people because the then Roh, Moo Hyun government was regarded as a progressive government.<sup>4</sup> Despite its political philosophy, the government's policy aimed at generating economic growth based on trade strategies. As a result, it initiated the FTA Roadmap in 2003 (Lee, 2012). The KORUS FTA was ratified and came into effect in March 2012. After completing its FTA with the USA, Korea was able to increase its exports to the US market, while imports from the USA declined slightly. Korea's trade with the USA increased moderately and the trade surplus of Korea to the USA increased in the same year. This occurred in spite of weakening Chinese economic growth and the deepening crisis in the euro zone in 2012. Korea has also benefited more than the USA from their FTA (Cooper et al., 2013) (See table 2).

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<sup>4</sup> Progressive governments use to carry out passive FTA policy in their policy framework. However, Roh Moo Hyun government carried out proactive FTA policies in its mandate period.



Table 1: Korea's FTA Network (As of 2013)

	<b>Korean FTA Activity</b>	<b>Share of Korean Exports in 2012</b>
<b>In Effect/ Ratified</b>	Chile (2004)	0.4%
	Singapore (2006)	4.1%
	EFTA (2006)	0.4%
	ASEAN (2007)	13.3%
	India (2010)	2.2%
	EU (2011)	9.0%
	Peru (2011)	0.3%
	USA (2012)	10.7%
	Turkey (2013)	0.8%
	Subtotal: 9	38.0%
<b>Under negotiation</b>	Japan (2003; suspended 2004)	7.0%
	Canada (July 2005)	0.9%
	Mexico (Feb. 2006)	1.6%
	GCC (July 2008)	3.5%
	Australia (May 2009)	1.7%
	New Zealand (June 2009)	0.3%
	Colombia (Dec. 2009; signed 2013)	0.3%
	China (May 2012)	24.3%
	Vietnam (Sep. 2012)	2.9%
	Indonesia (July 2012)	2.5%
	China-Japan-Korea (March 2013)	31.4%
	RCEP (May 2013)	49.8%
Subtotal: 12	56.1%	
Total: 21	77.6%	
<b>Potential Agreement</b>	TPP	31.3%

Source: Ministry of Foreign Affairs, 2013, IMF, 2013

Table 2: Annual US-Korea merchandise trade (As of 1990 – 2012, billion US dollars)

<b>Year</b>	<b>US Exports</b>	<b>US Imports</b>	<b>Trade balance</b>	<b>Total trade</b>
1990	14.4	18.5	-4.1	32.9
1995	25.4	24.2	1.2	49.6
2000	26.3	39.8	-13.5	66.1
2003	22.5	36.9	-14.4	59.5
2004	25.0	45.1	-20.1	70.1
2005	26.2	43.2	-17.0	69.4
2006	30.8	44.7	-13.9	75.5
2007	33.0	45.4	-12.4	78.4
2008	33.1	46.7	-13.6	79.8
2009	27.0	38.7	-11.7	65.7
2010	38.0	48.9	-10.9	86.9
2011	43.6	56.6	-13.1	100.1
2012	42.3	58.9	-16.6	101.2

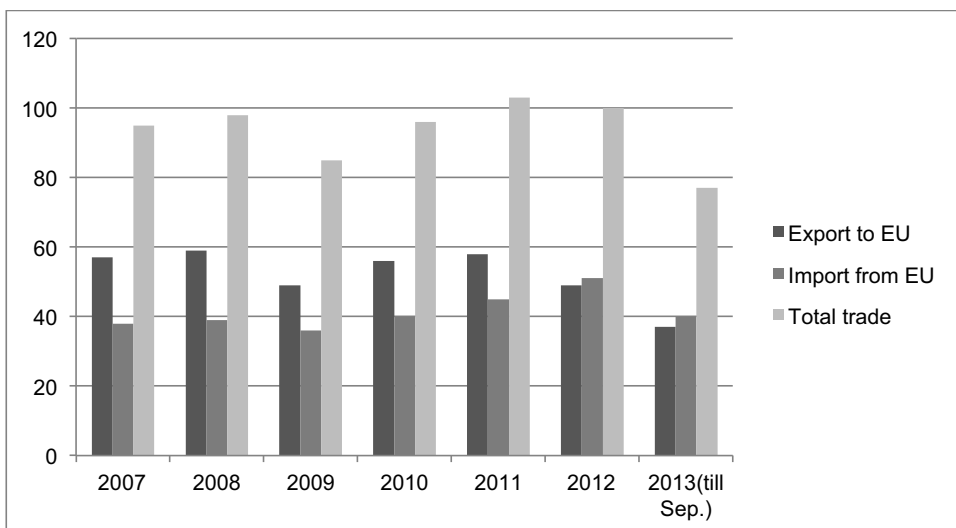
Source: Global Trade Information Service, 1996, US International Trade Commission, 2013

Shortly after their negotiations with the USA, Korea aggressively launched FTA negotiations with the EU, which was then (May, 2007) the world's second largest economy. After eight formal rounds of talks, the FTA was accepted by both sides in October 2009, and the two parties officially approved the FTA in September 2010. The agreement was officially signed in October 2010 during the EU-Korea Summit in Brussels. The parliaments of the EU and Korea ratified the FTA bills in 2011, and the EU-Korea FTA has been in effect since July 2011 (Song, 2011). The EU-Korea FTA caused less resistance than the KORUS FTA, except from the agricultural sector. The EU-Korea FTA is the world's largest FTA since the NAFTA of 1994. The EU was Korea's third largest importing and second largest exporting partner in 2007 (European Commission, 2007).

In Korea, the EU-Korea FTA was regarded as a win-win negotiation and vice versa. The EU needed a close trade partner with solid economic criteria/credibility in order to enhance market access for European companies in the highly dynamic and competitive markets of East Asia. It was estimated that the EU-Korea FTA could create a trade increase in goods and services worth EUR19.1 billion (c.a. USD24.9 billion) for the EU and EUR12.8 billion (c.a. USD16.8 billion) for Korea (European Commission, 2011).

Upon completion of the EU-Korea FTA, trade volume increased by up to USD103 billion, which is a historical record (the first time it had reached over USD100 billion) for bilateral trade between the two partners. It decreased to USD99.75 billion in 2012 due to the government budget deficit crisis in the euro zone. Despite the downturn in trade volume, the EU made a trade surplus to Korea for the first time since 2007. In 2013, the EU's exports to Korea increased considerably, while Korea's exports to the EU declined, leaving it with a large trade deficit (KITA, 2013) (See fig. 3).

Figure 3: Korea and the EU trade volume (As of 2007 – 2013, Billion US dollars)



Source: KITA, 2013

### 3.3 Strategy for comprehensive and high quality oriented FTAs

Korea is currently the only Asian country that has bilateral FTAs with the world's two major economies (USA and the EU). Since the establishment of these FTAs, Korea has made a trade surplus with the USA and a trade deficit with the EU in 2012 and 2013. Although it has a medium sized economy, Korea pursued FTAs with these two major economies because it needed them more than they needed it. In the asymmetrical economic interdependence, the USA ranked the fourth largest trade partner, the second largest export market, and the third largest source of import for Korea, while Korea ranked the seventh largest trade partner, the eighth largest export market, and the sixth largest source of import for the USA in 2012 (US Department of Commerce, 2013; Bank of Korea, 2013). In the same year, the EU was the fifth trade partner, the fourth largest export market, and the fourth largest source of import for Korea, while Korea was the 10th trade partner, the 10th largest export market, and the eighth largest source of import for the EU (Eurostat, 2013; Bank of Korea, 2013). Gaining a large increase in market access in these two major markets was not a critical priority for Korea because Korean exporters already had a significant competitive position in consumer electronics, auto mobiles etc. meaning they faced low or zero tariffs. The aim of Korea's FTA with the two major economies was to preserve its share of the market in the face of growing competition from other East Asian producers, particularly China. Moreover, Korea intended to strengthen its competitive position in the two major markets vis-à-vis Japan where the elimination of low tariffs with FTAs could create price advantages for Korean exporters' (Cooper et. al. 2013; European Commission, 2011).

Additionally, these two economies have been fostered by their own economic blocs such as NAFTA and the European Union, which disadvantage non-member countries. Therefore, it was necessary for Korea to complete FTAs with these economies even if this resulted in a trade deficit. Despite the possibility of trade deficits, Korea's FTAs with these economies can be regarded as a strategic means of extending its economic territory through partnerships with around 50 percent of the world's GDP. Additionally, Korea's total trade volume has increased continuously since it established FTAs with nine partners. Therefore, it is reasonable to conclude that Korea has established a global FTA network and become a FTA hub country in the East Asian region. As a result, it has been able to liberalise the/its market and enhance the investment environment.

In line with its trade policy strategy, Korea has pursued comprehensive and high quality commitments with its partners. Based on the eight FTAs currently in force, the average degree of liberalization in Korea's FTAs is 97.5 percent. This concession rate could vary with due consideration of sensitive sectors such as agricultural products. If some or all agricultural goods are excluded, this rate decreases slightly in the FTAs with the EFTA, the USA, the EU and India. Despite this slight decline, the average concession rate of Korea's FTAs is much higher than the average rate of the WTO which is around 90 percent (Lee, 2012, WTO, 2008, 2012) (See table 3).

Additionally, the KORUS and the EU-Korea FTAs include all sectors that can contribute to upgrading Korea's industrial structure and competitiveness, particularly in service sectors. These include goods and services, investment, MRA, competition, IPR, Investor-State Dispute Settlement, e-commerce, labour and environment. It is worth noting that the EU-Korea FTA includes regulatory transparency and a new approach to trade and sustainable development. It also includes a protocol

on cultural cooperation in accordance with the UNESCO Convention. In fact, the EU-Korea FTA is a much more comprehensive agreement than the KORUS FTA (European Commission, 2011).

Overall, the KORUS and the EU-Korea FTAs are regarded as strategically successful FTA models for Korean FTA policy because they are comprehensive and high quality FTAs. The former has a 99.8 percent degree of liberalization, while the latter accounts for 99.6 percent. Certainly, the Korea-Chile FTA has the highest degree of liberalization along with the KORUS FTA. However, it is a FTA policy test and a valuable learning process.

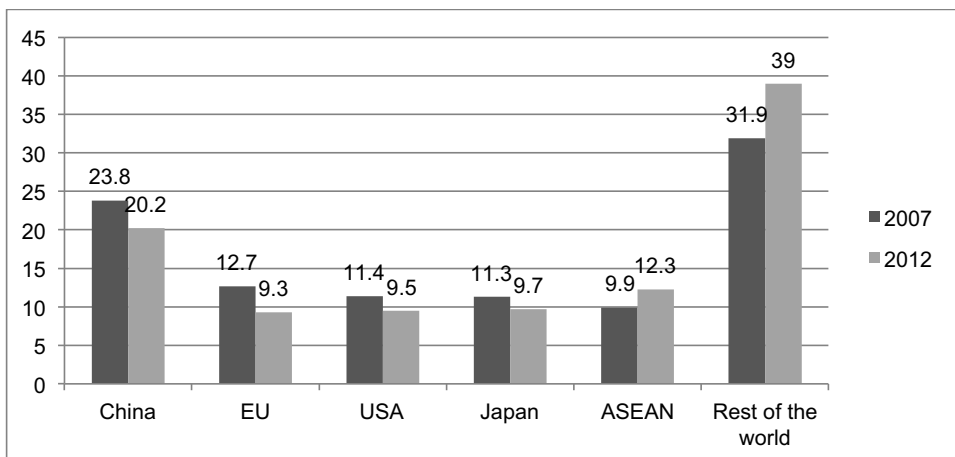
Table 3: Degree of liberalization in Korea's FTAs with partners

FTA	Degree of liberalization (%)
Korea – Chile	99.8
Korea – Singapore	91.6
Korea – EFTA	99.1
Korea – ASEAN	99.2
Korea – India	93.2
Korea – USA	99.8
Korea – EU	99.6

Source: MOFAT, 2012, KIET, 2012

Korea has been able to diversify its trade destinations on a global scale. In total, its trade share with the three major advanced economies has declined from 35.4 percent in 2007 to 28.5 percent in 2012, while its trade share with developing economies has increased from 63.6 percent to 71.5 percent during the same period (KITA, 2013). This demonstrates two key factors in the Korean government's trade policy. Firstly, the structure of Korea's trade has become more diversified since the global financial crisis, expanding its share in developing countries such as ASEAN and the rest of the world because the major advanced economies suffered a severe economic downturn. Secondly, the trade share with China declined in the same period because Korea has been keen to reduce its high trade dependency on a single country (Lee, 2012) (See fig. 4).

Figure 4: Change of Korea's trade share (As of 2007 – 2012, %)



Source: KITA, 2013

#### 4. Analysis of the trade policy strategy

Korea's trade policy can be regarded as one of the most successful measures for generating high national economic growth in many decades. In 1966, Korea's total trade volume was only USD1 billion and, by 2011, this had increased to USD1 trillion. The fact that Korea became a member of the USD1 trillion club in the midst of a global financial crisis is a tremendous achievement. The Korean experience demonstrates that an export led development strategy based on competitive advantages and structural changes is very reliable on other developing economies (Porter, 1990; Todaro & Smith, 2012). However, despite its recent success, Korean trade policy strategy faces various challenges to overcome continuously if it is analysed on evaluating the trade performance not only by quantity, but also by quality.

First of all, Korea needs to diversify its trade partners and export goods in order to reduce the risk of external economic change because its economic growth is mainly dependent on the trade in global markets. In 2012, Korea's five major trade partners were China, ASEAN, Japan, the USA, and the EU, which accounted for 61 percent of the total trade. Korea has made an effort to minimize the risk of high dependence on a small number of trade partners since the 1970s because global economic crises could have a negative impact on its economy through trade and financial channels. This effort has worked out properly. As a result, Korea has reduced its trade dependency on these five major trade partners from 85 percent in 1971 to 64 percent in 2011 (KITA, 2012) (See fig. 5).<sup>5</sup> The second challenge is that Korea's top ten export products are heavily concentrated. In 2011, its share of the total exports accounted for 60.3 percent, which was a higher concentration than in other major economies. In this regard, the share of top ten export products was 27.1 percent for the USA, 28.8 percent for China, 24.2 percent for Japan, and 34.7 percent for Germany, which were calculated in average between 2008 and 2010, while it was 51.1 percent for Korea in the same period (KITA, 2011). The reason why Korea's share of its top ten export products is so concentrated is that it has a large company oriented industrial structure. As a result, small and medium sized companies find it difficult to be competitive on the global market and export their various products compared to the major economies (Lee, 2012).

Figure 5: Korea's export share of China, USA, Japan, the EU, and ASEAN (As of 1971-2011, %)



Source: KITA, 2012

<sup>5</sup> The trade with China officially started in 1992. Between 1971 and 1991 the trade with China was mainly an intermediate trade through Hong Kong.

The third challenge for Korea's trade policy strategy is that the Korean economy needs to develop its service industry and increase its share of service exports in the global market. Korea's share of service exports in the global market only accounted for 2.1 percent in 2007 and increased slightly to 2.3 percent in 2011. This share is very low compared to other major economies. Although Korea's share of service exports has increased along with the USA and China, its capacity to increase further is lower than China's. China's share of service exports increased from 3.6 percent to 4.4 percent during the same period. From 2001 to 2011, the share of Korea's goods export to the world increased from 2.4 percent to 3.0 percent, while its share of service export rose from 2.0 percent to 2.3 percent. The former marked an annual growth rate of 13.9 percent, while the latter generated 12.3 percent of the annual growth rate. Accordingly, Korea's service exports need to be emphasized in order to strengthen its export capability although these annual average growth rates were higher than those of the world average<sup>6</sup> (WTO, 2012) (See table 4).

Table 4: Shares of services export by major economies. (As of 2007-2011)

Share (%)	2007	2008	2009	2010	2011
USA	113.7	13.4	14.1	13.9	13.9
UK	8.4	7.3	7.1	6.6	6.6
Germany	6.3	6.5	6.7	6.2	6.1
China	3.6	3.8	3.8	4.5	4.4
Japan	3.7	3.8	3.7	3.7	3.4
Korea	2.1	2.3	2.1	2.3	22.3

Source: WTO, 2012

The lower growth of Korea's services exports than that of goods exports caused a trade deficit in service balance. It peaked in 2006 with USD13.3 billion and declined to USD4.4 billion in 2011. From 2000 to 2011, Korea maintained a substantial amount of the service trade deficit. As a result, its ranking in the services export fell from 13th to 15th in the world, while the ranking in the goods export rose from 13th to 7th during the same period. This demonstrates that Korea's trade policy has been strengthened in the manufacturing sector instead of the service sector, which has caused a rising gap between goods and services in terms of trade balance. Therefore, this must be addressed wisely in order to promote balanced growth in the mid to long term. The Korean economy cannot be sustained without increasing the competitiveness of the service sector (Bank of Korea, 2012) (See table 5).

Table 5: Korea's service trade balance (As of 2000-2011, USD100 million)

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Deficit	20.4	29.7	64.4	57.9	59.6	99.5	133.3	119.7	57.3	66.4	86.3	43.8

Source: Bank of Korea, 2012=

The fourth challenge Korea faces is the deficit of high technology trade, which grew rapidly from 2001 to 2010. Since then, it has started to decline. This is a significant challenge for the continuation of Korea's trade liberalization. The technology balance of payment (TBP) indicates a

<sup>6</sup> The annual average of growth rate of goods export was 11.4 percent and that of the world services export was 10.8 percent from 2001 to 2011.

technological competitiveness on the global market as well as a capability of original technology invented by R & D activities. In the global economic system, the technology barrier has increased rapidly in order to protect intellectual property rights (IPR). Therefore, a country's technology level can be heavily dependent on others if it cannot develop its own technology. One of the most difficult challenges for Korea's trade is to tackle or reduce its technology balance of payment so that it can generate sustainable economic growth as well as a positive trade balance with advanced economies, particularly Japan (MSIP, 2013) (See table 6).

Table 6: Korea's Technology Balance of Payment (As of 2001-2012, USD100 Million)

Year	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Deficit	20.2	20.6	24.2	27.9	29.0	29.4	29.3	31.4	48.6	64.9	58.7	57.4

Source: Ministry of Science, ICT and Future Planning (MSIP), 2013

The fifth challenge is that the effectiveness of FTAs must be improved. Domestic reform measures in the distribution of services should be implemented in order to meet the expectations of consumers. Through a reduction of tariffs, domestic consumers can benefit from the price advantages of imported goods and services. Otherwise, they will not support further trade liberalization as a trade policy strategy. Moreover, it is imperative to make the domestic market more competitive in order to benefit from FTAs and maximize the utilization rates of FTAs that are in force. The utilization rates of FTAs vary to a considerable degree. The Korea-Chile FTA has a utilization rate of up to 95 percent, while the Korea-India FTA has a utilization rate of just 25 percent (Kim, 2012).

The sixth challenge for the government is to generate continuous internal constituent support for its trade policy. It would be wise for the government to enhance dialogue with a variety of groups and sectors including opponents to its FTA policies. It is very natural that winners and losers in different sectors may take place while trade liberalization moves forward although the national economy could gain the growth in total (Lee, 2012). As a result, the widening income gap between winners and losers could cause economic and political conflicts that can impede economic growth and consumer benefits. Therefore, the government must deal with this issue wisely by providing compensation measures and promoting competitiveness in specific sectors which are negatively affected by the FTA policies (Solis, 2013).

Finally, Korea is currently negotiating two external regional FTAs. It expressed an interest in participating in the Trans Pacific Partnership (TPP) at the end of 2013 after much deliberation. However, the economic benefits of Korea's negotiations with the Regional Comprehensive Economic Partnership (RCEP), which consists of 16 member nations, are estimated to be greater than its negotiations with the TPP (12 nations). However, this estimation does not include the impact of non tariff barriers, which are a major issue in the TPP negotiations (Jeong, 2012). Taking a comprehensive estimate including non-tariff barriers, obstacles to foreign direct investment and utilization rates of tariff preferences into account, the RCEP may generate more economic benefits for Korea than the TPP because of the opening of the Chinese market through the RCEP. Therefore, Korea needs to create a synergistic effect by bridging the two mega trade negotiations. If Korea can utilise these mega FTAs properly, it can expect better outcomes in opening foreign markets with higher quality trade agreements not only for the RCEP, but also for the TPP (Petri et. al., 2012).

## 5. Conclusions

Over the last five decades the Korean economy has grown tremendously. Its rapid economic growth is mainly based on an export oriented development strategy that resulted in a rapid increase in trade volume from USD 1 billion in 1966 to USD 1 trillion in 2011. As a result, Korea succeeded in becoming a member of the USD1 trillion trade club along with the world's other major economies. The Korean experience can be used by other nations as a model for the creation of high economic growth through an export based trade policy.

Korea experienced economic turbulence twice in its economic growth periods. The Asian financial crisis in 1997 had a major impact on the Korean economy, causing negative economic growth. Its currency was heavily devalued against the US dollar and the domestic market was forced to be open based on deregulation and liberalization processes. An IMF bailout package of USD 21 billion was provided to Korea, and the government established an export driven trade policy in order to maximize the advantages of its weak currency in the global market. As a result, the trade balance was reversed from a trade deficit of USD 8.5 billion in 1997 to a trade surplus of USD 40 billion and USD 19 billion in 1998 and 1999 respectively. These record high trade surpluses enabled Korea to pay back its bailout completely in December 2000.

The second period of turbulence was the global financial crisis in 2008. Since the Asian financial crisis in 1997, Korea had become one of the most open market economies in the world as a result of deregulation and liberalization processes. This meant that the market was fully dependent on the external economic environment. As a result, the national economy experienced a low economic growth rate of 2.4 percent in 2008. Although the global financial crisis is regarded as one of the most severe economic crises since the Great Depression in 1929, the Korean economy was better equipped to address the problem compared to other major economies because it had increased its foreign reserve, and industries had strengthened their competitiveness. Along with other major economies, the Korean government expanded its fiscal expenditure in order to boost the domestic economy. At the same time, it carried out an export oriented policy, which was utilized by many developing countries because most of the advanced economies had suffered an economic downturn caused by the global financial crisis. This trade policy strategy was very effective, even during the global financial crisis, and resulted in strong economic growth of 6.2 percent in 2009, which was the highest economic growth rate in OECD countries. Korea's economic growth showed the world that a small open economic system focused on active trade policy is able to overcome global financial crises effectively and efficiently.

In sum, Korean trade policy has been successful in strengthening the nation's economic growth rapidly and overcoming two major financial crises. It also created national competitiveness in global markets. Korean trade policy has focused on strategies to develop specific industrial sectors and chosen special markets in order to maximize its trade volume as well as minimize its market dependency on few trade partners. Despite such tremendous success, Korean trade faces several challenges, which must be overcome in order to upgrade the structure of trade focused on more value added products and services. Otherwise, Korea's successful model will not be sustainable because other competitors, particularly China, are developing rapidly in order to catch up with other advanced economies in the global markets. In any case, the export oriented trade policy and strategy is the most important tool for Korean economic growth.



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