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The South Korea–Chile Free Trade Agreement: History, Motivations, and Ramifications

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I. INTRODUCTION

On April 1, 2004, the free trade agreement (FTA) between South Korea and Chile entered into force following the completion of negotiations on October 24, 2004. This agreement marked the first of its kind between two transpacific trade partners and as such represents a seminal moment in the development of the international trade system. The agreement is also significant for a myriad of other reasons. From a historical standpoint, Korea and Chile have approached the issue of free trade from very different viewpoints. Whereas the Chilean government has generally been open to bilateral trade agreements, the Korean government had never adopted one prior to this FTA with Chile. Therefore, this agreement represents an important shift toward bilateralism in international trade for Korea—a shift that has continued in recent years, with FTAs being signed with Singapore, the Association of Southeast Asian Nations (ASEAN), Europe, India, Peru, and, most recently, the United States.

Since 2004, South Korea has seen many benefits from its FTA with Chile. According to the Chilean embassy in South Korea, Korean exports to Chile increased nearly sixfold by 2008. Likewise, Chilean exports to Korea increased by more than four times during the same period. However, Korea has gained much more than economic benefits from this trade agreement. In negotiating with Chile, a relatively small but globally integrated economy, Korea underwent a learning process that contributed to future larger FTAs, such as those with Europe and the United States. As expressed by Chung Hae-kwan in his Spring 2003 article from *East Asian Review* entitled, "The Korea-Chile FTA: Significance and Implications," "The successful completion of negotiations enabled the government to accumulate working-level knowledge and experience, and to gain confidence for a job well done."

Given this context, the purpose of this essay is twofold. First, it examines South Korea's motivations for negotiating and ratifying the FTA with Chile. Second, it looks at how this trade agreement served as a turning point for Korean attitudes toward bilateral trade and how this shift in attitudes influenced the ratification of the much larger FTA with the United States.

II. SOUTH KOREA'S FTA WITH CHILE: CONTEXT AND MOTIVATIONS

Cultural and Historical Context

After the Korean War armistice, it seemed as though South Korea would follow a path similar to many Latin American countries, including Chile, in its economic development. This path, known as import substitution industrialization (ISI) and developed by economist Raul Prebisch, espoused high import tariffs to encourage the development of domestic industries. Under President Syngman Rhee, ISI became a hallmark of the Korean development plan. However, as in Latin America, this plan proved largely unsuccessful, and by 1961 Korea's gross domestic product (GDP) sat at roughly $72 per capita.

Such a startling lack of economic development was in part what led to the ouster of Syngman Rhee and his cronies and to the establishment of a new market-oriented military regime. Under the new president/dictator, Park Chung-hee, South Korea undertook development by further raising tariff barriers and also by investing in industries that pushed export capacity forward. Park's agenda complemented with the interests of many businesses that believed the capacity of South Korea's domestic market was exhausted. Contrary to the domestic market, foreign market presented a tremendously lucrative opportunity for competitive growth. In this way, export-oriented growth became a central aspect of Korean trade policy from a very early stage.

Adopting such a policy was a risky decision, and one that required a large amount of cohesion among South Korea's many different industries; ultimately, however, the decision paid huge dividends for Korea's economy. The country was able to substantially grow many of its export-oriented industries and, subsequently, through participation in international institutions such as the World Trade Organization (WTO), Korea was able to quickly and substantially increase GDP. By 1970, per capita GDP had increased more than 100 times, to over $7,000.

Initially, this growth derived primarily from participation in multilateral trade groups and agreements, such the WTO and the General Agreement on Tariffs and Trade (GATT). South Korea used the WTO to promote trade with different countries and to build long-standing relationships with a number of trading partners. In addition, the country worked closely with both the United States and Japan in mostly informal capacities to push forward its economic development.

South Korea was far slower, however, to recognize the importance of bilateral trade agreements. Chile, by contrast, had come to highly value the role of bilateral FTAs in bringing about integration in the global economy and its

associated benefits. In fact, the use of FTAs to open markets for exports and promote laissez-faire economic ideals was so ingrained in Chile's trade model that it defined its foreign policy as a whole. South Korea, by contrast, had to go through serious reorientation to turn toward these kinds of agreements as a fundamental aspect of its foreign trade relations.

Perhaps the most significant shift in Korean trade policy in the last 20 years was the decision to move away from multilateral trade organizations and adopt FTAs as a matter of government policy. This shift was first promoted by President Kim Dae-jung and was subsequently expanded on in the 2003 FTA Policy Roadmap. South Korea had several motivations for undertaking this important shift. First, after the Asian economic crisis of 1997–98, and in particular with the 1999 failure of the WTO to spur a new round of trade talks, South Korea came to realize that it was vitally important for its continued economic growth to move beyond the sphere of largely ineffectual multilateral agreements and into bilateral trade arrangements. Moreover, for President Kim, under whose stewardship the FTA with Chile was negotiated, FTAs represented the path toward economic prosperity. As Chung Hae-kwan puts it,

> "[South Korea] sense[d] the impending crisis; if it [did] not keep up with the trend of regionalism, Korean companies [would] be at a great disadvantage because of the preferential treatment provided for competitors in FTA signatory countries. Going it alone would not only lower competitiveness, but would eventually isolate Korea from the global market."

President Kim outlined this ideology in his September 2006 article, "Regionalism in the Age of Asia." In it he asserted the potential benefits of regionalism for all East Asian nations. He pointed out that he had supported these sorts of FTAs as far back as 1998, when he had urged the ASEAN Plus Three countries to push forward with an East Asian Community. Moreover, his vision for these regional FTAs superseded merely economic motivations, as he saw them as a tool to strengthen democracy, eradicate poverty, and bring about peace. Clearly, he was committed to FTAs in both a pragmatic as well as a deeply ideological sense.

Why Chile?

South Korea negotiated and signed an FTA with Chile for two specific reasons. First, there was a potential for significant economic benefits for South Korea, with major increases in trade on both sides of the deal. Second, and perhaps just as important, the FTA with Chile served as an important learning process for Korean leaders.

The economic basis for the FTA is self-evident and borne out by subsequent statistics. Conceptually, since South Korea and Chile have different specializations, opposite agricultural schedules, and a complementary industrial style, it is easy to see how both would benefit from a free trade agreement. All of these factors influenced South Korea's External Economic Coordination Committee to decide in 1998 that an FTA would be negotiated with Chile.

Ultimately, policymakers were correct about the economic benefits. Trade increased between the two nations many times over between ratification in 2004 and 2008, with South Korean growth in exports being particularly robust: it increased more than sixfold over this short period, with particular benefits for cars, trucks, construction machinery, and cell phones. Chilean exports rose more than fourfold in four years, with copper, iron, steel, and fruit products being the largest beneficiaries. Moreover, many of the Korean agricultural sector's initial concerns proved to be unfounded for two reasons. According to a 2008 document on the FTA prepared by the Chilean Embassy entitled, "Fourth Anniversary of the Korea-Chile FTA: An Assessment of the results,"

> First, because Chile produces and sells agricultural products when in Korea there is little or very limited quantities from greenhouses farms, and second, Chile has always tried to have a diversified portfolio of consumers around the world following the old saying of not putting all the eggs in one basket.

In the end, Korean agriculture was not overwhelmed by Chilean products, in spite of dire predictions to the contrary.

The benefits for South Korea were not just economic. As Park Sung-hoon and Koo Min-gyo discuss in their June 2007 article, "Forming a Cross-Regional Partnership: The South Korea–Chile FTA and Its Implications," new trade theories suggest that more benefits can be reaped from trade where there are similarities in comparative advantage rather than dissimilarities. They also point out that in situations where there are large geographic distances between FTA partners, there may be only marginal positive effects for both countries. They conclude, therefore, that the economic benefits, while still providing something of an advantage, must not have been the driving force for South Korea's ratification of the FTA.

Nevertheless, South Korea's economic motivations for promoting the FTA cannot be completely discounted. In fact, when choosing which country to take on as its first FTA partner, Korea considered a number of options, including Turkey, Thailand, New Zealand, and Israel. Ultimately, it settled on Chile in no small part due to economic benefits and because South Korea wanted to gain a foothold

in the Latin American market. This was borne out in the FTA's subsequent economic benefits that the agreement brought for South Korean companies, particularly the significant benefits for the automobile and electronics industries.

On the other hand, Park and Koo's theory does largely hold, especially when comparing South Korea's motivations to those of its trading partner Chile. For Korea, a huge part of its calculations in negotiating and ratifying the FTA were the longer-term implications of reorienting foreign trade policy toward bilateral agreements. This reorientation largely envisioned new bilateral agreements with other partners in the East Asian region as well as with the European Union and the United States, reflecting South Korean leaders' concerns about the worthiness of multilateral agreements. The sacred cow of multilateralism lost its luster after the Asian economic crisis of 1997–98 and the failure of WTO talks in 1999. So South Korea turned toward bilateral FTAs, and this required a learning process that was subsequently acknowledged in the highest policy circles with the 2003 FTA Policy Roadmap.

Ultimately, this learning process is one of the more interesting factors of the Korea-Chile FTA. Many of the problems that South Korea faced in passing the FTA resurfaced in the process of passing the FTA with the United States.

The FTA Negotiation Process

From an analytical standpoint, a central part of any FTA is the negotiation process that precedes it. Any country that seeks to pass an FTA must work to assuage the concerns of both the negotiating country as well as those of domestic interest groups. In the negotiation process for the Korea-Chile FTA, South Korea ran into a number of significant problems, particularly with its agricultural sectors of fruit and rice production.

Interestingly, the negotiation and ratification process was much more inflamed domestically in South Korea than in Chile. Whereas the Chilean populace and business interests were accustomed to the benefits of FTAs and the opening of new markets, Korean people and businesses had no such prior experience. This played out in the form of protests and complaints by some segments of the Korean public, in particular the agricultural sector. Chile experienced no such problems.

Initially, South Korea tried to convince its agricultural sector of the importance of the FTA by pointing out that Chile was on a reverse agricultural schedule, given its location in the Southern Hemisphere; therefore, both the Korean and the Chilean agricultural sectors would benefit. But this argument proved insufficient. As a result, South Korea began the negotiation process with Chile

by pandering to its agricultural sector and requesting that pears and apples be excluded from the agreement. As negotiations continued, however, complaints from Korea's agricultural sector grew ever louder and the Korean government, due to inexperience in negotiating these kinds of agreements, lacked the political know-how to leverage support from those industries (such as automotive and electronics) that would benefit most from the FTA. The agreement was close to being derailed and was only rescued thanks to Chile's acquiescence on pears and apples in exchange for employing its own protectionist measures against Korean refrigerators and washing machines.

In this way, the South Korean agriculture industry was able to exert a great deal of influence over the final terms of the agreement. In addition to certain fruits being excluded, other Chilean agricultural products were given tariffs for periods of five to ten years. Vegetable juices were given a 10-year tariff, for example. Milk products were also given a very long 16-year tariff and chocolate products were given a 10-year tariff. For Chile, these tariffs were mitigated in the long term because the country would still be getting access to a new market for its goods and, most importantly, because the FTA levied no protectionist measures against the key Chilean industries of copper, iron ore, and zinc. The end agreement resulted in some important tariff limitations on the South Korean side as noted in Table 1, taken from Chung Hae-kwan's Spring 2003 article from *East Asian Review* entitled, "The Korea-Chile FTA: Significance and Implications." South Korea used this tool of tariff limitation to deal with the concerns of particular industry sectors, indicating that it had some learning to do.

Table 1. Korea's Tariff Limitation Schedule
(Unit: Korea's 10-digit HS codes, %)

Category	Total	Industrial Products	Farm Products	Forest Products	Marine Products	Main Description
Year 0	9,740 (87.2)	9,101 (99.9)	224 (15.6)	138 (58.2)	277 (69.5)	Mixed feeds, pure-bred breeding animals, silk, fabrics, coffee
Year 5	701 (6.3)	-	545 (38.1)	70 (29.5)	86 (21.5)	Bracken, roses, bean curd, wine, almonds
Year 7	41 (0.4)	1 (0.01)	40 (2.8)	-	-	Fruit juice, prepared fruit, meat of poultry or heading, soup, potatoes
Year 9	1 (0.01)	-	1 (0.07)	-	-	Other fruit juices
Year 10	262 (2.3)	-	197 (13.8)	29 (12.3)	36 (9.0)	Tomatoes, pork, cucumbers, kiwis
10S*	1(0.01)	-	1 (0.07)	-	-	Grapes
Year 16	12 (0.1)	-	12 (0.8)	-	-	Prepared dry milk
TRQ** + DDA***	18 (0.15)	-	18 (1.26)	-	-	Beef, chicken, mandarins
DDA	373 (3.3)	-	373 (26)	-	-	Garlic, onions, red peppers, dairy products
E****	21 (0.2)	-	21 (1.5)	-	-	Rice, apples, pears
Total	11,170	9,102	1,432	237	399	

* Liberalization over a transitional period of 10 years on a seasonal basis
** Liberalization with tariff quota
*** Tariff elimination schedule shall be negotiated after the end of the Doha Development Agendas of the WTO
**** Customs duty applied shall not be eliminated

III. WHAT SOUTH KOREA LEARNED: LESSONS FOR FUTURE FTAS

The process of negotiating the FTA with Chile had important ramifications for other FTAs that South Korea was considering. In particular, the agreement with Chile prepared Korean policymakers for the FTA they signed with the United States in 2007 and finally ratified in 2011 (called the KORUS FTA). The Korea-Chile FTA also educated more than just the Korean government; other major players and interest groups also learned lessons.

The FTA negotiation process between South Korea and the United States differed in many ways from the one with Chile. Most significantly, the size of the economies involved in the KORUS FTA was very different and, by implication, so was the relative bargaining power of each country. On the other hand, similarities existed between the two processes, particularly concerning the contentious issue of agricultural exports to Korea.

In its FTA negotiations, South Korea was forced, mostly because of pressures at home, to enact domestic policies that overrode the otherwise free trade interests of the government's foreign policy. In the case of the Korea-Chile agreement, Chile was for the most part satisfied that the FTA met its core interest of expanding the overall scope of its international trade relations. As a result, Chile exacted relatively less significant protectionist measures from Korea. Overall, though, Korea did change its original plan because of internal political pressures. This substantiates the theory expounded by Park and Koo that the most important factor for South Korea in establishing an FTA with Chile was political rather than economic.

When it came time to negotiate the FTA with the United States, South Korea no longer demanded restrictive measures for its agricultural goods, even though the same exact issue came up regarding the import of foreign apples and pears into Korea. This time, however, Korea promised to *reduce* its 45 percent tariff rate on apples to zero over a 10-year period. For Fuji apples—a popular product in South Korea—the parties agreed to a 20-year tariff phase-out period. Pears were dealt with in a similar manner. The FTA calls for phasing out tariffs on non-Asian pears over a 10-year period and Asian pear tariffs over a 20-year period.

How is it possible that South Korea completely shifted positions on an issue that was so contentious during negotiations with Chile? As usual, money provides at least one explanation. From the Korean perspective, the US market presents a much larger economic opportunity for its exports (in particular, automobiles and electronics) than the Chilean market does. From the US perspective, the fruit market in Korea presents a potentially lucrative opportunity, because the United States believes it can be highly competitive. Korea produces 380,000 metric tons

of apples per year, and the US share of that apple market prior to its FTA was approximately 0.001 percent. Both Korea and the United States stand to benefit greatly from their FTA, so it is not surprising that the terms of this FTA would be different than those in the Korea-Chile FTA.

A second explanation, however, lies in the concept of trade policy management and in the domestic politics of South Korea. Comparatively speaking, the drama and debate surrounding the signing of the KORUS FTA dwarfed what was seen with the signing of the Korea-Chile FTA, and many of the same parties were involved. Of particular concern were the problems that the KORUS FTA would cause for key Korean businesses in agriculture and meat (especially beef).

In the Korea-Chile FTA negotiations, Korean agricultural sectors did not have a significant enough influence to push for major concessions in the form of tariffs on products that would compete with critical sectors of Korean agriculture, particularly apples, pears, and rice. With the KORUS FTA, the stakes were clearly higher. In response, many significant opponents of the KORUS FTA rallied together and tried to more loudly and directly voice their concerns through political channels. This took many forms, including interest groups such as the Korean National Assembly Members' Caucus against the Korea-US FTA and the Korean Alliance against the Korea-US FTA, the latter a coalition of more than 300 labor unions and civil-society groups. This alliance was petitioning the US Congress to stop the passage of the KORUS FTA as late as January 2011.

That the agreement passed without the same major tariff concessions seen in the Korea-Chile FTA, therefore, can also be chalked up to improved management of public opinion on the part of the Korean government and the leveraging of interests of the parties involved. These were all lessons that South Korea learned throughout the process of negotiating its agreement with Chile. This is also a point that Park and Koo would almost certainly echo.

Interestingly, because the stakes were much higher for the KORUS FTA, and the opposition much more organized, the South Korean government was forced to make a different kind of major concessions to interest groups that had not been necessary in the Korea-Chile FTA. Most prominently, the Korean government enacted large farm subsidies. According to a Korea Policy Institute article, President Roh in 2007 "promised to set aside $119 billion to aid farmers hurt by the FTA."

This kind of concession is an example of the kind of learning that occurred for interest groups. Clearly, after the Korea-Chile FTA they had gained enough of a voice to elicit extensive government promises. The subsidies enacted go beyond the kind of exactions made in tariff limitation schedules; they are the kind of

cash-based subsidy that generally galvanizes a great deal of political support. The interest groups had learned how to be a major voice in the bargaining process and were therefore able to gain additional protectionist measures.

The government also clearly exhibited learning through both of these FTA processes. In the case of preventing tariff limitations on key agricultural items, such as pears and apples, the South Korean government showed that it can exert power in spite of public protests. However, this was not done without some concessions, as the government attempted to assuage agricultural concerns at home by offering subsidies and thereby garnering more popular support.

IV. CONCLUSION

In examining the FTA between South Korea and Chile, this essay isolates the challenges inherent for Korea in negotiating and ratifying such agreements. It also looks at the special-interest forces at play in such agreements, which resulted in substantial concessions by the Korean government. Free trade agreements only work when they make economic sense, and understanding and accepting this principle was a necessary precondition for South Korea to enter into an FTA. However, perhaps more significantly, South Korea used its deal with Chile as a testing ground from which it learned what it would take to galvanize disparate interest groups and public opinion.

This explains, at least to some extent, why the South Korean government made major concessions during the Korea-Chile FTA negotiations in spite of possible economic losses. The government, as much as anything else, was using the negotiation process to learn what it would take to successfully negotiate and ratify an FTA, both internationally and domestically.

Many of the Korean interest groups that were affected by FTA negotiations also underwent an important learning process. By the time that KORUS negotiations came along, interest groups were able to protest much more effectively than they had with the Korea-Chile FTA negotiations. They were thus able to influence the final agreement in some substantial ways, particularly regarding the inclusion of large subsidies for the agricultural sector.

In sum, it must be conceded that those in favor of FTAs in Korea won the day. With the KORUS FTA, proponents were able to enact policies that will allow for the kind of deep infiltration of foreign influence over agricultural products that was so feared in the Korea-Chile FTA negotiations. A prime example of this is that the critical items of debate during the Korea-Chile FTA—pears and apples—were not excluded from the KORUS FTA. Even though the KORUS FTA was ratified in tremendously acrimonious fashion, proponents of its passage won out

over those interest groups and political parties who opposed the FTA.

The broader results of the passage of the KORUS FTA are also worth noting. For one thing, the passage of the agreement was remarkably polarized politically. Some Korean experts claim that the entire ratification process was simply political theater, with politicians seeking to capitalize on populist anger, while others chafe at this characterization. The bill indeed passed in spite of widespread popular discontent, though both sides failed to see any merit in the arguments of the other. Party members for and against the passage of the KORUS FTA in fact displayed such a high level of distrust toward each other that ratification culminated in an almost farcical display; the KORUS FTA was passed in the dead of night, and a tear gas canister was set off in the South Korean National Assembly. The learning process discussed earlier, in which both policymakers and interest groups found better ways to further their own interests, was certainly responsible for this atmosphere in some measure. Whether the acrimony was merely a byproduct of long-standing political divides is the subject for another essay. But if nothing else, these battles played out in a very public, acrimonious, and partisan way because of what each political party was able to learn and effectively execute in the domestic negotiations surrounding FTA ratification.

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