
Theories and Realities of FTA Formation between Korea and Canada

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Abstract: Korea and Canada have negotiated over FTA formation during the past several years, waiting for the finalization. From the Korean perspective, there would be some benefits if FTA between Korea and Canada is formed. Based upon the economic and political theories on the regional economic cooperation, Industrial complementarity, Canadian experience of FTA with the United States, higher economic development level, and increasing trade volume between the two countries are expected to bring economic and political gains to Korea. However, some sensitive sectors and negotiation over automobile trade will be barriers to finalize the negotiation process. To expedite the negotiation process, some strategies can be taken. Internal consensus-building and exclusion of some sensitive sectors will be good policy instruments to overcome existing barriers.

Key words: Free Trade Agreements, Trade Creation, Trade Diversion, Gravity Model, Domestic Politics, International Negotiation, Sensitive Sectors

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I . Introduction

It has become clearer that “pursuit of regionalism has become not a matter of choice, but a matter of survival.”¹ As countries have competitively pursued regionalism, they also began to worry about being left behind the competition. The core of this new regionalism is regional economic cooperation. Regional economic arrangements are basically discriminatory in a sense that member countries get preferential treatments. Therefore, being left out of regionalism means economic losses, unless a country has no international economic sector.²

With the increase in economic regionalism, each country faces two important choices. One is related to the direction and the strategy of a country's overall foreign economic policy. In selecting a point between autarky and complete openness, each country will adopt a certain strategy to get to a specific point in that continuum. A country may pursue multilateralism, regionalism and/or unilateralism in adopting its strategy. The second is that if a country joins competition for regionalism, it has to decide with whom it will pursue economic regionalism. It also has to decide the number of partner countries for regionalism. In selecting partners for regionalism, a country has to consider goals, strategies, types, and depth of regionalism. That is, a country has to consider both economic and political goals, and both domestic and international goals. A country has to consider its strategy to achieve defined goals. A country may choose between bilateral and minilateral regionalism. A country also has to consider whether it

1. Minister of Trade, MOFAT, March 25, 2005.

2. Seokwoo Kim, “The Political Economy of FTA Formation between Korea and Japan: From the Korean Perspective,” *The Korean Journal of Area Studies* 24-2, 2006, p. 278.

will confine regionalism to trade issues, or it will expand economic integration to finance, money and/or investment. Regionalism may also result in political and military integration.³

Policy contents and directions on these issues are decided by consideration on resources possessed by a country. A rich and large country may be better equipped with resources to deal with these issues. A poor and small country will face serious limitations in pursuing diverse types of regionalism. Therefore, success or failure of regionalism, and its outcomes will be decided by expected costs and benefits of regionalism for a country, and capacities possessed by that country.⁴

At the beginning of 2005, Korea adopted a rather ambitious goal in regionalism issues. The Korean government at that time announced that it would pursue as many FTAs(Free Trade Agreement) as possible within a short time span. At the beginning of 2005, the Korean government set up four policy goals in diplomacy.⁵ One of those goals is to be an advanced trading state in the near future. As one strategy to achieve this goal, the Korean government decided to pursue regionalism more actively.

However, this announcement was somewhat surprising. Before the Korea-Chile FTA which was finally realized in 2004, Korea was the one of the only two WTO member countries in the world which didn't have any FTAs with foreign countries.⁶ Even though Korea finalized negotiations on FTA with Singapore and EFTA, Korea is still far behind in the competition toward regionalism. Despite some efforts, Korea has been unable to reach an FTA agreement and ratify it with any of its major trading partners. The fact might mean lack of capacity and/or will to pursue active regionalism in Korea. Then, it is questionable whether the

3. Ibid, p. 279.

4. Ibid, p. 279.

5. MOFAT, March 30, 2005.

6. The other country is Mongolia.

Korean government can overcome obstacles to regionalism in the coming years.

Despite some obstacles, this type of Korean FTA strategy has been continuing. At the beginning of 2006, MOFAT (Ministry of Foreign Affairs and Trade) of Korea once again adopted “economic diplomacy for an advanced trading state” as one of the Korean foreign policy priorities.⁷ The core of this policy strategy is to finalize as many FTAs as possible in a short time span. Based upon this policy continuity, Korea and Canada began FTA negotiation in 2005, and recently, Korea and the United States finalized their FTA negotiations, waiting for ratification by their congresses. As for now, it's not clear whether these negotiations will be ratified in the near future. But one clear thing is that Korea has become more active in pursuing regionalism. Korea is negotiating over FTA with European Union and other countries like Mexico and India. The success or failure of this strategy will be decided by both economic and political factors.

The major purpose of this study is to investigate desirability and feasibility to pursue an FTA with Canada from the Korean perspective. At the 12th APEC Summit Meeting in November 2004 in Santiago, Chile, Korea and Canada discussed FTA issues between the two countries. The first preliminary meeting was held in Seoul in January 2005 to assess the possibility of FTA, and the second preliminary meeting was held in Ottawa in March 2005.

At the first preliminary meeting, the two countries recognized that Korea-Canada FTA would bring gains to both countries. At the 2nd meeting, the two countries discussed details of FTA such as trade in goods, customs clearance, rules of the origins, trade in services, investment issues, etc. Both countries agreed that the FTA would be finalized by the year 2006.

7. MOFAT, February 27, 2006.

Based upon these preliminary meetings, trade ministers of Korea and Canada agreed on July 12th 2005 that the two countries would begin official FTA negotiation and that the first one would be held in Seoul in July 2005. At the July meeting, Korea and Canada agreed that the two countries would pursue a comprehensive FTA in accordance with the 24th Article of GATT and the 5th Article of GATS. So far, there have been 12 official FTA negotiations between Korea and Canada, and more negotiations are now under way. Even though Korea and Canada wanted to finalize their FTA negotiations by the end of 2007, the goal was not realized because of some unsolved disputes over automobile trade, Korean restrictions on beef imports from Canada, and Gaesung-related sensitive issues. In this paper, we will assess the possibility of FTA formation between Korea and Canada, and will discuss what kinds of obstacles are in the way to the finalization of negotiation.

This paper is organized as follows. In the second section, we will discuss regionalism issues in East Asia. In the third section, we will introduce political and economic theories on regionalism, especially on FTA. In the fourth section, based upon the existing theories, we will assess desirability and feasibility of FTA formation from the Korean perspective. In the fifth section, we will discuss current issues between Korea and Canada, which may play as accelerating or disturbing factors for FTA formation. Finally, in the conclusion, we will propose some policy measures to overcome existing obstacles to FTA formation between Korea and Canada.

II . Economic regionalism in East Asia⁸.

8. This section on economic regionalism in East Asia is originally from Kim, Seokwoo, 2006, pp. 280-283.

As it's well known, East Asian countries have been far behind other regions in terms of regional economic integration. The heterogeneity of states, hegemonic competition between Japan and China, strong tie to the United States, under-institutionalization of internal consensus-building mechanisms, lack of a strong and centralized regional institution, deep mutual distrust, and the historical authoritative international order in East Asia have been pointed out as major obstacles to economic integration in the region.⁹

Despite these obstacles, there have been some movements toward regionalism from East Asian countries. Several factors affected the policy change in East Asian countries. First, regional economic integration has rapidly widened and deepened in other regions in the world. Even the United States, which had long preferred a multilateral free trading system, adopted a so-called 'multi-track' trade policy.¹⁰ Second, economic globalization makes states more concerned about economic efficiency to survive enhanced competition in the world economy. Because one of the expected gains from regional economic integration is efficiency gains, states competitively try to pursue regional integration. Third, the international structural change from the "bipolar" system to the "unipolar" one is expected to create political and economic competition between regions.¹¹ If one ultimate goal of eco-

9. Werner Pascha, "Economic Integration in East Asia and Europe-A Comparison," *presented at the Conference organized by Seoul ASEM Institute for International Relations*, Seoul, Korea, Dec. 2, 2003; Seokwoo Kim, "Theoretical Foundations for East Asian Regionalism: Desirability and Feasibility," *presented at the 1st Joint International Conference*, Le Havre, France, May 19, 2004; Young Jong Choi, "East Asian Regionalism and South Korea's FTA Strategy," *The Korean Journal of International Relations* 44-5, 2004, pp. 85-108.

10. Seokwoo Kim, 2004.

11. For hegemonic struggle and related issues, see William Pfaff, "The Ques-

conomic integration is more cooperation in political and military affairs, it's a rational strategy for states to begin with economic integration. Fourth, it has been reported that members of regional trade arrangements have economically gained from existing arrangements.¹² Fifth, the problem of "shallow" and slow integration within the WTO has made many countries shift their policy to regional economic cooperation. And even more, as some countries began to use FTA formation as a strategy to enhance their bargaining position in multilateral trade negotiations within the WTO, East Asian countries also adopted FTA as one of their important strategies to improve their bargaining position vis-a-vis other countries in international fora.

Even though regional economic integration has become more attractive, region-wide integration in East Asia has not been well developed. Instead, countries in the region have pursued bilateral economic integration. Bilateral FTAs are more feasible than other types of economic integration. The following table shows the recent list of FTAs pursued by East Asian countries.

tion of Hegemony" *Foreign Affairs* 80-1 Jan / Feb 2001, pp. 221-232; Samuel P. Huntington, *Foreign Affairs* 78-2, March/April 1999, pp. 35-49.

12. For example, it's reported that trade between Korean and Chile has increased by 56% within a year after FTA between them was implemented in 2004. See MOFAT, March 29, 2005.

Table 1. Partial List of Free Trade Agreements (FTAs) by East Asian Countries

| Intra-Regional FTAs | Status | Year(proposed or implemented) |
|-------------------------|-------------------|-------------------------------|
| AFTA | implemented | 1992 |
| Korea-Japan | joint study | 1998 |
| EAFTA(ASEAN+3) | discussion | 2000 |
| Korea-Thailand | joint study | 2001 |
| ASEAN-China | under negotiation | 2001 |
| Korea-China-Japan | joint study | 2001 |
| Singapore-Japan | implemented | 2002 |
| Korea-Singapore | joint study | 2002 |
| Japan-Thailand | discussion | 2002 |
| ASEAN-Japan | joint study | 2002 |
| ASEAN-Korea | discussion | 2002 |
| Singapore-Mexico | under negotiation | 1999 |
| Japan-Mexico | under negotiation | 1999 |
| ASEAN-CER | under negotiation | 1999 |
| Singapore-Australia | under negotiation | 2000 |
| Singapore-Chile | under negotiation | 2000 |
| Korea-New Zealand | joint study | 2000 |
| Japan-Chile | joint study | 2000 |
| Korea-Mexico | discussion | 2000 |
| Korea-Australia | discussion | 2000 |
| Japan-Canada | discussion | 2000 |
| Singapore-New Zealand | implemented | 2001 |
| Singapore-Canada | under negotiation | 2001 |
| Korea-United States | discussion | 2001 |
| Singapore-United States | implemented | 2003 |
| Korea-Chile | implemented | 2004 |
| Korea-Singapore | implemented | 2005 |
| Korea-EFTA | implemented | 2005 |
| Korea-Canada | under negotiation | 2005 |
| Korea-United States | finalized | 2007 |

As we see in Table 1, there has been rapid increase in FTA proposals by East Asian countries. However, only a few of them have been finalized. The fact implies that FTA formation is not an easy task, and that it takes long time for states to agree upon the

final document. Table 1 also shows that there have been many discussions and joint studies on FTA done by Korea. However, only three of them (Korea-Chile, Korea-Singapore, Korea- EFTA) were implemented. Korea has lots of obstacles to overcome to pursue economic integration with more countries. Therefore, before pursuing FTAs with foreign countries, each country has to consider expected political and economic gains and losses from FTA formation. And calculations of gains and losses have to be based upon theories on FTA. We now turn to the existing theories.

III. The Theories on FTA¹³.

There are at least four theories on the selection criteria for FTAs. Two of these are economic theories and other two theories are political theories. The first economic theory is originally proposed by Jacob Viner and later developed by J. E. Meade, R. G. Lipsey and H. G. Johnson and others.¹⁴ According to the theory, FTAs or RTAs (Regional Trade Agreements) will have both trade creation effects and trade diversion effects. And the size of trade creation and diversion will be decided by the structure of comparative advantage among FTA member states. That is, if industrial structures of FTA member countries are complementary to each other, involving countries can expect economic gains from trade creation effects. Meanwhile, if many of their industries are competing each other, trade creation effects will be small. The degree of complementarity or competition depends largely on factor endowments.

The second economic theory is called the 'gravity model'.¹⁵

13. This section on the existing theories was originally in Seokwoo Kim. 2004.

14. Jacob Viner, *The Customs Union Issue*, New York: Carnegie Endowment for International Peace, 1950.

The model proposes that economic size, distance, population size and GDP per capita affect the possibility and desirability of FTA formation. According to the model, large, developed and adjacent countries are fascinating FTA partners, because FTA in this case will expand business opportunities in larger markets, and because firms can utilize the economy of scale. In addition to these, common languages and cultural similarities are regarded as important factors which facilitate 'natural' trading blocs.

One of the political theories on FTAs focuses on domestic politics. The theory argues that preferences, interests and demands of some organized interest groups decide direction and contents and public policy including the FTA policy. Contribution and votes can be exchanged for certain policies. According to the theory, a government political stance will reflect the relative political power of organized special interests and also the extent of the government's concern for the plight of the average voter.¹⁶ Robert Putnam would rather regard these situations as involving two distinct stages of strategic interaction. One is international negotiation between states over possibility and contents of FTA. The other is domestic negotiation between the government and interested groups over ratification.¹⁷ In this situation, autonomy of

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15. Chan-Hyun Sohn and Jinna Yoon, "Does the Gravity Model Fit Korea's Trade Patterns?" *KIEP Working Paper* 01-01, 2001; Gilbert, John et al., "Assessing Regional Trading Arrangements in the Asia-Pacific," *UNCTAD Policy Issues in International Trade and Commodities*, Study Series No. 15, U.N., 2001.
 16. Anne Krueger, "Political Economy of the Rent-Seeking Society," *American Economic Review* 64-3, 1974, pp. 291-303, Stephen P. Magee, William A. Brock and Leslie Young, *Black Hole Tariffs and Endogenous Policy Theory: Political Economy in General Equilibrium*, New York: Cambridge University Press, 1989.
 17. Robert Putnam, "Diplomacy and Domestic Politics: The Logic of Two Level Games," *International Organization* 43-3, 1988, pp. 427-60; Gene

the government, election procedures, the level of democracy and other political institutions will be major variables in deciding the viability of FTA formation.

The second political theory is about international politics. According to the theory, in selecting FTA partners, states have to consider power distribution between states, the level of economic interdependence, externalities of trade on security, trade implications on other issues such as human rights and democracy, and general diplomatic relations.¹⁸ For example, the theory argues for formation of FTA with alliances and democratic partners to minimize external diseconomy on security and to reduce risks accompanied with international businesses.

Overall, all these economic and political theories on FTAs are about desirability and viability(or, feasibility) of FTA formation. For example, to secure economic gains, states need to search for FTA partners which are differently endowed, and nearly located big-rich states. But to secure domestic political support and to maintain social stability, states need to seek for FTA partners which are similarly endowed and small states. On the other hand, to promote international political purposes, states have to search for democratic alliance countries as FTA partners. The problem is that economic purposes and political purposes are competing each other in many cases. Also, in other cases, domestic political purposes and international political purposes are in conflict. In short, economic desirability and political feasibility are often in conflict

M. Grossman and Elhanan Helpman, "The Politics of Free-Trade Agreements," *American Economic Review* 85, 1995, pp. 667-690.

18. Joanne Gowa, *Allies, Adversaries, and International Trade*, Princeton: Princeton University Press, 1994; Edward D. Mansfield, "Alliances, Preferential Trading Arrangements, and International Trade," *American Political Science Review* 91-1, 1997, pp. 94-107; Karen L. Remmer, "Does Democracy Promote Interstate Cooperation? Lessons from the Mercosur Region," *International Studies Quarterly* 42, 1998, pp. 25-52.

in the FTA negotiation processes. If this is the case, what is the optimal combination of these two values and which countries are the best as FTA partners? And what do these theories on selection criteria tell about feasibility and desirability of FTA formation between Korea and its potential trading partners?

IV. Feasibility and Desirability of FTA from the Korean Perspective

In this section, we will empirically investigate feasibility and desirability of FTA formation between Korea and its potential trading partners. Based upon the theories above mentioned, we tried to extract as many as variables to assess feasibility and desirability of FTA between Korea and its potential trading partners.

The following table shows political and economic indicators on Korean and its potential FTA partners. To discuss the gravity model, the population size, the GDP size, and the GNI per capita of the countries are investigated. To see aspects of international politics, we investigate the democracy level of the countries. In addition to these variables, we included two other variables: average tariff rates and existing bilateral FTAs of the countries. The existing average tariff rates will show how much economic gains are expected from FTAs. That is, if existing tariff rates are high, countries can expect more economic benefits from FTA. The variable is indirectly related to the feasibility of FTA formation between the countries. The countries who had an experience in FTA formation are more likely to repeat it. It also implies that there was no fierce domestic opposition to FTA formation in the past. Data for these variables are shown in the following table.

Table 2. Political and Economic Indicators on Korea and Its Potential FTA Partners

| | Korea | China | Japan | Singapore | Thailand | USA | Australia | New Zealand | Mexico | Canada | Israel | Chile | |
|-----------------------------|--------------|-----------|-----------|-----------|----------|------------|-----------|-------------|--------|--------|--------|--------|----|
| Distance | | 598 | 716 | 2,900 | 2,311 | 6,950 | 5,214 | 6,206 | 7,494 | 6,546 | 5,024 | 11,405 | |
| Population (Million) | 48.1 | 1,300 | 127.8 | 4.3 | 62.4 | 293.5 | 20.1 | 4.1 | 103.8 | 31.9 | 6.8 | 16.0 | |
| GDP (bil\$) | 679.7 | 1.6(tril) | 4.6(tril) | 106.8 | 163.5 | 11.7(tril) | 631.6 | 99.7 | 676.5 | 979.8 | 117.5 | 94.1 | |
| GNI/PC (\$) | 13,980 | 1,290 | 37,180 | 24,220 | 2,540 | 41,400 | 26,900 | 20,310 | 6,770 | 28,390 | 17,380 | 4,910 | |
| Exports from Korea (mil \$) | | 45,432 | 17,660 | 5,359 | 2,868 | 30,129 | 2,713 | 539 | 2,711 | 2,469 | 722 | 907 | |
| Exports to Korea (mil \$) | | 28,255 | 35,833 | 3,899 | 2,146 | 22,779 | 7,035 | 753 | 327 | 1,097 | 409 | 1,794 | |
| Exports of Industrial Goods | % of Exports | 91 | 88 | 94 | 86 | 74 | 83 | 29 | 33 | 85 | 67 | 93 | 17 |
| | % of Imports | 64 | 80 | 58 | 83 | 78 | 80 | 86 | 83 | 86 | 86 | 83 | 81 |
| Exports of Agr. Goods | % of Exports | 3 | 7 | 1 | 4 | 20 | 10 | 30 | 59 | 6 | 14 | 5 | 38 |
| | % of Imports | 10 | 8 | 19 | 4 | 8 | 7 | 6 | 9 | 6 | 6 | 7 | 8 |
| Average Tariff Rates (%) | 7.9 | 15.1 | 2.9 | 0 | 14.7 | 4.1 | 5.9 | 4.3 | 16.2 | 5.1 | - | 7.0 | |
| # of Existing FTAs | 2 | 0 | 3 | 6 | 2 | 9 | 8 | 2 | 10 | 5 | 9 | 10 | |
| Democracy Level | 3 | 13 | 3 | 9 | 5 | 2 | 2 | 2 | 4 | 2 | 4 | 2 | |

- 1) "Distance" in the table is the mileage distance between the capital cities. Data Source: www.indo.com/distance.
- 2) The data for population, GDP, GNI/PC are for the year of 2005. Data Source: World Development Report 2005, World Bank.
- 3) The data for % of industrial and agricultural goods are for the year of 1999. Data Source: World Development Indicators, 2001, World Bank.
- 4) The data for the average tariffs of the most countries are for the year of 2005. Data Source: World Development Indicators, 2005, World Bank.
- 5) The Democracy Level ranges from 2 to 14. 2 represents the most democratic country, while 14 represents the least democratic country. Data Source: FREEDOM HOUSE.

Because the above table is much complicated, it's hard to evaluate expected gains and costs of FTA formation with compar-

ison to each other. However, we can simplify it as follows. For example, according to the table, if Korea pursues economic gains from FTA, China, Thailand, and Mexico are good FTA partners in terms of industrial complementarity. Next to these countries, the United States, Canada, Australia seem to be an attractive FTA partner for Korea. China and Japan are attractive partners in terms of both geographical location and the market size. However, in the process of FTA negotiation, pursuit of FTA with the United States, Australia, New Zealand, Thailand and China will face fierce domestic opposition from the agricultural sector. When international political concerns are involved, China, Singapore and Mexico are not ideal FTA partners. In addition to these overall analyses, we can evaluate expected economic and political gains of FTA with each country.

For example, China is one of the ideal FTA partners to Korea, if we consider only economic issues. The huge population size, geographical vicinity and the big domestic market of China are attractive things for FTA formation. In terms of the export and import volumes, China is one of the most important trading partner of South Korea. Even more, the volume of exports and imports has increased very rapidly in the past several years. This implies that FTA formation between South Korea and China will expand both export and import markets in both countries much more. South Korea can also expect lots of economic gains from FTA with China, if most of the Chinese tariffs on imports from Korea are removed. Because China maintains relatively high average tariff rates, removal of those tariffs will bring lots of economic gains to Korea.

However, the facts that China is still a not-democratic country and that China has no experience in FTA yet are negative factors in the process of FTA negotiations. And because China is an official military ally of North Korea, South Korea has to consider external diseconomy of FTA with China on its own security.

In sum, FTA negotiation process is a complicated one, because Korea has to consider both economic and political issues at both domestic and international levels. Even more, if Korea pursues several FTAs simultaneously, it will make the problem even more complicated.

V. The Political Economy of FTA between Korea and Canada

We can find several backgrounds for pursuit of FTA between Korea and Canada. First, both Korea and Canada are highly dependent on foreign economic sectors in their GDP. The total trade volume over GDP exceeds 60% in both Korea and Canada, and then the two countries have recently pursued bilateral and multi-lateral trade liberalization to secure foreign markets for their products.

Second, as the recent DDA(Doha Development Agenda) trade negotiations have faced diverse obstacles to finalization, many countries have shifted their policy priority to regionalism rather than multilateralism. Both Korea and Canada also realized that they needed more regional cooperation to cope with the worst scenario, where DDA negotiations turn out to be a failure.

Third, based upon complementarity of industrial structures, Korea and Canada recognized that FTA would be a good chance to strengthen economic cooperation between the two countries. Korea has international competitiveness in the manufacturing sector, while Canada has international competitiveness in the service sector, some high-tech industries, and production of natural resources.

Fourth, Korea recognized that it could use Canada as a base to penetrate into the North American markets and Canada also recognized that it could use Korea as a base to penetrate into the

East Asian markets. With FTA between Korea and Canada, both countries can diversify their foreign markets, and reduce their trade dependence on a few trading partners.

From the Korean perspective, there are several policy goals to be pursued from the FTA with Canada. First, after FTAs with Chile in South America, with Singapore in Asia, and with EFTA in Europe, Korea can have one FTA trading partner in North America. Then, the FTA with Canada has symbolic importance. Especially, if the Korea-Canada FTA is finalized and ratified prior to the Korea-US FTA, its symbolic importance would be more significant.

Second, Canada is the 8th largest economy in the world and a member of G8. Therefore, with the FTA with Canada, Korea may capture a good chance to express its strong will for economic reforms and liberalization.¹⁹ This policy is expected to bring in more foreign investments and technological cooperation not just from Canada, but from other countries.

Third, Korea expects that the FTA with Canada may upgrade the Korean economy by improving structural inefficiencies of the Korean industry. It is also expected that trade liberalization in service sectors will enhance adaptability and competitiveness of the Korean service industries. In addition to these expected gains, Korea can secure stable sources of many natural resources such as oil, uranium, nickel, iron, gold, copper, woods, coal, etc.

Finally, it is expected that Korea may learn from Canadian experiences in FTAs. Especially, Korea can learn much from the Canadian FTA experience with the United States, because Korea also pursues FTA with economically much larger countries such as the United States, Japan and China.²⁰ Canada has enjoyed more

19. Yeonho Lee, *Public Hearings on Korea-Canada FTA*, KIEP, July 2005.

20. Myungsoon Shin and, Yeonho Lee, "Canada's Position on NAFTA and It's Implication on Korea-Japan Free Trade Agreements," Yonsei University,

trade and foreign investments with the United States and Mexico through the NAFTA. But, NAFTA also had an effect of reducing Canadian trade with countries outside the bloc. For example, in fact, trade between Canada and the East Asian countries has decreased after the establishment of the NAFTA.²¹ Therefore, from the Korean perspective, it may learn from the Canadian experience how to maximize benefits of FTA and minimize costs of FTA with larger countries.²²

Also, domestic political struggles in Canada during the negotiation process over NAFTA may give some lessons to the Korean government. Despite domestic oppositions to NAFTA such as loss of the economic autonomy, possibility of increase in the unemployment rate, more dependence on the United States in economic operation, loss of the market outside the bloc, and economic, political and social costs accompanied with economic adjustments, major supporters for NAFTA like the Canadian government, scholars equipped with neo-liberal economic theories, and business people made it possible to finalize the NAFTA.²³ The exactly same domestic politics occurred in Korea when it negotiated FTA with the United States. And Korea expects the same situation when it pursues FTA with Japan and China in the future. Therefore, the Korean government may learn from the Canadian experience how to overcome obstacles toward FTA, and how to manage domestic politics inside Korea.

Based upon the data shown in Table 2, it's hard to conclude whether Canada is a good FTA partner for Korea in comparisons with other countries. Relatively big Canadian markets, the high per capita income level, and the industrial structural differences

2002.

21. Kap-young Jeong and Yeonho Lee, "NAFTA and Canada-Korea Relations," *The Korean Review of Canadian Studies*, 2000.

22. Shin and Lee, 2002.

23. Shin and Lee, 2002.

are economically attractive factors for FTA formation from the Korean perspective. But, geographical location and the relatively low existing average tariff rates can be seen as negative factors. More FTA experiences of Canada and the higher level of democracy of Canada are politically attractive factors for FTA formation from the Korean perspective. However, Canadian agricultural and marine exports can be a serious economic and political concern in Korea, because it's very likely for the Korean government to face farmers' and fishermen's opposition to the FTA in the negotiation process.

Even though we cannot know the exact benefits and costs of FTA between Korea and Canada, some anticipations are based just upon the static analyses, considering only short-term effects of elimination of existing tariffs, and trade creation and diversion. If the analyses are extended to dynamic dimensions which include investment effects and efficiency gains from the economy of scale and specialization, both Korea and Canada are expected to gain substantially from FTA between two countries. For example, the KIEP (Korea Institute for International Economic Policy) estimated expected effects of the FTA between Korea and Canada as follows.

Table 3. Estimated Economic Effects of Korea-Canada FTA (unit: %, mil U\$)

| | welfare increase(%) | welfare increase in mil \$ | GDP(%) | export(%) |
|--------|------------------------|-------------------------------|--------|-----------|
| Korea | 0.38 | 1,502.59 | 0.48 | 0.53 |
| Canada | 0.29 | 1,629.04 | 0.40 | 0.88 |

Source: KIEP (2005)

Even though both Korea and Canada expect substantial economic gains from the FTA, there are also several hot issues which may play as obstacles to the finalization of FTA between the two countries. First, Canada is a member of the Cairnes Group, and

then one of the target sectors in the negotiation process would be the agricultural sector in Korea. The past experience of the Korea-Chile FTA negotiation shows that there would be a fierce opposition from the Korean farmers, and this would be one of the major obstacles. In addition to the Korean agricultural sector, there are sensitive sectors in both countries. Therefore, in the negotiation process, both countries have to come up with ways to solve the problems related to the sensitive sectors.

Second, some of the existing Canadian FTAs include labor and environmental issues. The Canadian government may want to apply the same labor and environmental standards to the FTA between Korea and Canada. The way of coping with these issues in the negotiation process may affect the success or failure of the FTA between Korea and Canada.

Third, Korea needs to prepare measures to induce more investments from Canada and to expand its outward foreign investments to Canada. Compared to the trade volume between Korea and Canada, the foreign direct investment volume is much smaller between the two countries. To multiply the positive effects of the FTA, both countries need to agree upon institutionalization of bilateral investments.

Fourth, Korean exports of products from the North Korean Gaesung industrial complexes to Canada may be a hot issue in the negotiation process. The Korean government wants Canada to treat those products as Korean products. However, Canada may oppose to the idea for both economic and political reasons.

Finally, as were seen in the negotiation processes, Canadian auto workers' opposition to the Korea-Canada FTA plays as one major obstacle to finalization of the FTA.

In sum, it is expected that the Korea-Canada FTA would bring economic gains to both countries. However, Korea and Canada may face some oppositions to the FTA in the negotiation process. Also, there are some hot issues to be overcome. The

success or failure of the FTA between Korea and Canada depends on how both governments manage the contending issues.

VI. Conclusions

In year 2005, the director of the Trade Research Institute at the KITA (Korean International Trade Association) provided five strategies in pursuing FTAs simultaneously. First is that Korea has to pursue FTAs with big countries to maximize economic gains. For example, FTA with the United States is recommended. Second is that Korea has to pursue FTAs with “strategic” countries located in different continents to make a basis for more trade in the future. Third, Korea has to pursue as many FTAs as possible simultaneously. He argues that the strategy will enhance the Korean bargaining position vis-a-vis other countries. Fourth, in pursuing FTAs, long-term industrial policies have to be considered. Fifth, the Korean government has to be equipped with the master plan for long-term structural adjustment.²⁴

Even though these strategies seem to be valid ones, we need to be more concerned about its feasibility. There are some obstacles in adopting those strategies for more regional economic integration. First, internal consensus mechanisms are still lacking in Korea. Second, because many of the small and medium industrial sectors are still very uncompetitive in the world market, economic integration through regional trading arrangements may seriously harm those sectors. Considering that structural adjustments need time and resources, it may not be a good idea to pursue many FTAs simultaneously. Third, the agricultural sector in Korea has been a major opposition to FTAs. Without huge amounts of financial incentives, farmers in Korea will stick to opposition to FTAs, especially with food-exporting countries.

24. The Chosun Daily, Feb. 22, 2005.

Fourth, increase in the number of FTAs causes lots of administrative costs and rules of the origin problems.²⁵ Without the solution of these problems, more FTAs may result in more confusion and chaos. Finally, there is a ratification problem. Considering the fact that many congressmen in Korea opposed to Korea-Chile FTA, it seems to be a difficult task to get ratification for many FTAs simultaneously.

Political feasibility is a quite a different thing from economic desirability. In pursuing regional economic integration, both political feasibility and economic desirability have to be considered. Even though the Korean government recently announced a very ambitious goal in FTA issues, its realization is not guaranteed. There are so many obstacles to be overcome. We need more time to assess whether the goal is attainable.

It will be useful to consider how we can overcome the obstacles. We can come up with several things.²⁶ First, institutional change may be needed in a way to give more autonomy and power to the government administration, for example the main trade negotiation authority. By this, severe bureaucratic politics can be lessened and also the government can be freer from pressure groups. The government has to play a role of a so-called 'rational dictator' which pursues national interests rather than sectoral or parochial interests.²⁷

Second, there must be a change in culture in Korea. Culture refers to a set of beliefs, attitudes, ideologies and norms in a society. Korea and its people have adopted a kind of mercantilistic culture in their international trade relationship for a very

25. Maurice Schiff and L. Alan Winters, *Regional Integration and Development*, The World Bank, 2003.

26. The following policy recommendations are originally from Seokwoo Kim, 2006, pp. 292-293.

27. Seokwoo Kim, *The Political Economy of International Trade*, Hanul, 1998.

long time.²⁸ Many people in Korea always think that the ultimate goal of any trade policy is to secure trade surplus by any means. This is not a good policy, and this kind of mercantilistic policy and thinking cannot be accepted by major trading partners. All of the related sectors including business, government, and mass media need to change their thought on trade in a way to adopt more liberal orientation. The role of mass media is important in educating people.

Third, regional and bilateral trade agreements typically exclude a few politically sensitive sectors and specify prolonged phase-in periods for some others.²⁹ Korea and Canada need to utilize this option in a process of FTA negotiations. By this, these countries can secure economic interests related to FTA without hurting critical domestic political interests.

In lieu of conclusion, it's very evident that the future Korea-Canada FTA will bring overall benefits to both Korea and Canada. Therefore, two countries must make every effort to finalize the FTA negotiation. It's not very clear whether the Korean government will pursue ratification of the Korea-Canada FTA prior to the Korea-US FTA. If the Korea-US FTA is ratified by both governments, it will be much easier for the Korean government to get ratification for the Korea-Canada FTA. However, even when the Korean government seeks for ratification of the Korea-Canada FTA prior to the Korea-US FTA, it's clear that the task would be much easier to be done than ratification of the Korea-US FTA. It's time for both Korea and Canada to finalize the FTA negotiation processes.

28. Frederic C. Deyo ed., *The Political Economy of the New Asian Industrialism*, Ithaca: Cornell University Press, 1987.

29. Gene M. Grossman and Elhanan Helpman, "The Politics of Free-Trade Agreements," *American Economic Review* 85, 1995, pp. 667-690.

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