

The US-South Korea Economic Relationship

By Troy Stangarone

In 1979, Deng Xiaoping rose to power in China and began the process of economic modernization that has seen China develop into the world's second-largest economy and become one of the United States' largest trading partners. As significant as China's economic development has been, much of what has been achieved in China follows prior economic successes in East Asia by Japan, the Republic of Korea—more commonly known as South Korea—and the other three “Little Dragons”: Hong Kong, Singapore, and Taiwan.

In the last six decades, South Korea has grown from a war-torn nation mired in abject poverty and dependent upon US aid into one of the world's leading industrial nations. In the span of one lifetime, a nation where hunger was often commonplace in the years following the Korean War has largely eliminated abject poverty and now boasts some of the world's most successful companies: Samsung, LG, Hyundai, and Kia.

South Korean products and culture are increasingly becoming a part of everyday life in the United States. Hyundai and Kia produce some of the best-selling passenger cars in the United States, including the Hyundai Sonata and Elantra and the Kia Optima. The consumer electronics section of any store is filled with flat-screen televisions from Samsung and LG, along with refrigerators and other appliances. If you use a smartphone, you are likely using something from South Korea. Not only is Samsung's Galaxy series among the best-selling smartphones, but US tech giant Apple's iPhones run off of processors made in South Korea.

From a cultural perspective, PSY's international hit “Gangnam Style” may be South Korea's most well-known cultural export, but South Korean dramas and food are increasingly growing in popularity in the United States. *Kimchi*, a popular Korean dish made of fermented cabbage, is readily available in major US grocery stores and is emerging as a garnish for traditional American foods, such as hamburgers. South Korean dramas, which are highly popular throughout Asia, are popping up in the US and even have their own dedicated channel on the online entertainment service Hulu.

As South Korean products have grown in popularity, South Korea has grown into one of the world's great trading nations. Its economy is the world's eleventh-largest by purchasing power parity and fifteenth-largest in nominal terms. In 2011, South Korea became only the seventh nation in the world to conduct \$1 trillion in two-way trade in a single year.

Throughout South Korea's economic development, the United States has played an important role as a source of aid, trade, and investment. At the same time, the nature of the relationship has evolved over the last six decades. As South Korea's economic relationship with the United States has transitioned from one of dependence on US aid to vibrant two-way trade and investment, Seoul is also becoming one of the United States' most important partners in global economic forums, such as the G-20.

The United States' Early Contact with the Korean Peninsula

For most Americans, the United States' history with South Korea begins with the division of the Korean peninsula at the end of the Second World War or the United States' participation in the Korean War. However, initial contacts between the government of the United States and the Korean peninsula date back to 1871.

As with other parts of Asia, the United States' primary interest in the Korean peninsula centered on the development of commercial ties. In

the case of Korea, the establishment of commercial ties was first considered in 1845 when Congressman Zedec Pratt submitted an amendment for the purpose of extending US commerce to Japan and Korea.¹ The first US expedition to the Korean peninsula would come in 1871, when five US warships were dispatched to Korea to learn the fate of the merchant ship *General Sherman* and to support a diplomatic delegation that had been sent to Korea to establish trade and commercial ties.

The 1871 expedition ended in conflict with the Battle of Ganghwa, but a little more than a decade later, the United States would establish its first political and economic ties with Korea in 1882 with the Treaty of Amity and Commerce. The treaty provided for most favored nation status in trade, requiring each party to provide the other with the highest level of market opening it provided other nations, as well as provisions for mutual defense if either the United States or Korea were attacked.

While the United States sought to develop commercial ties on the Korean peninsula, Korea hoped that the United States would provide a strong partner that did not harbor territorial ambitions. Throughout much of its history, Korea has been subject to invasion from China and Japan, and the government in Korea hoped that the United States would help ward off any territorial ambitions by China, Japan, or Russia. However, in 1905, Korea became a protectorate of Imperial Japan, only to be formally annexed as a colony in 1910.

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The intervening years of Korea's colonization by Japan would play a significant role in shaping the domestic politics of South Korea and its approach to international relations. Prior to the Treaty of Amity and Commerce with the United States, Korea had been largely isolationist in its international orientation, often being referred to as the “Hermit Kingdom.” The experience of Japanese colonization and the need for economic development would shape the internationally oriented South Korean state that exists today. At the same time, the early contacts between the US and the Korean peninsula have helped shape the economic and political relationship that exists today between the Republic of Korea and the US, including concerns that the US would abandon Korea.

While fears of US abandonment of South Korea would become prominent in later periods of US-Korea relations, such as when President Richard Nixon withdrew US troops from South Korea without prior consent from the South Korean government, concerns over US abandonment date back to the early periods of US-Korea relations. As part of the Taft-Katsura agreement of 1905, the US agreed to recognize Japan's dominant position on the Korean peninsula.²

South Korea's Economic Development and the United States

In the aftermath of the Korean War, South Korea was in ruins. Much of the industrial capacity on the Korean peninsula built up during the Japanese occupation in North Korea, along with much of the mineral wealth. The level of poverty was harsh; many children lived off of powdered milk supplied with US aid. The state of sanitation was so dire that children often had to be sprayed with DDT by American soldiers to kill lice.

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Faced with dire circumstances, the government of Syngman Rhee focused largely on the consolidation of the state and reviving the economy in the wake of the Korean War. With the majority of the prewar industry in the North, South Korea remained a largely agrarian society. The prospect that South Korea would develop and not require continued US assistance was seen as so grim that General Charles Helmick, the deputy military governor of the US occupation forces, said that “Korea can never attain a high standard of living. There are virtually no Koreans with the technical training and experience required to take advantage of Korea’s resources and effect an improvement over its rice economy.”³

General Helmick’s skepticism could be seen in South Korea’s own imports. During the 1950s, South Korea was heavily reliant on foreign aid, which financed 70 percent of its imports. The majority of this was financed through US foreign aid, with a small portion of support also from the United Nations, with “three main objectives: to prevent starvation and disease, to increase agricultural outputs, and to provide essential consumer goods.”⁴ As a result, very little of South Korea’s imports during this period were focused on acquiring the capital goods and technology needed to move the economy beyond being an agricultural exporter.

In the long run, turning South Korea into an agricultural exporter was unlikely to be a promising path to development. With a rugged and mountainous terrain, South Korea lacks the arable land necessary to become a major agricultural exporter. As a result, modern-day South Korea imports upward of half of its food. While some measures were put in place during the 1950s, a major shift in South Korea’s economic policies occurred in the 1960s after Park Chung-hee’s coup in 1961. While the new government put in place an export-oriented economic policy designed to begin developing South Korea’s industrial base, it faced many of the challenges of the prior government. There was a lack of capital to finance the basic infrastructure that would be needed for development. At the time, South Korea’s electricity consumption was only 2 percent of the US, while South Korea produced less electricity as a whole than Ford Motor Company did in Detroit.⁵

To resolve the issue of finance, Park took a series of steps. While most nations have sought foreign capital for development through foreign direct investment, South Korea was unique in that it borrowed capital from abroad to finance its development. Park also found funds to finance South Korea’s economic development by normalizing relations with Japan in 1965. As part of normalizing relations, Japan agreed to provide Korea with a direct grant of \$300 million and another \$200 million in loans. Private Japanese firms provided an additional \$300 million in investment. These were significant sums at the time, injecting \$800 million into an economy that only had exports of about \$200 million. However, just as important as funds provided by Japan was the access to Japanese technology, as Japan allowed South Korea to pursue its first major industrial venture: the Pohang Iron and Steel Company (POSCO). This set the stage for South Korea to move from the production of light industrial goods, such as clothes and toys, to globally competitive production of high-end industrial products, such as automobiles and ships.⁶

Perhaps more significant for South Korea’s economic development was the capital injection it received for its participation in the Việt Nam War. Seeking to lift South Korea out of poverty and help ensure continued US engagement on the Korean peninsula, Park actively worked to send South Korean soldiers to Việt Nam to fight alongside the United States. For his efforts, South Korea benefited economically in multiple ways. The United States paid for the modernization of the South Korean army, provided multimillion dollar contracts to civilian companies that helped jumpstart businesses, and expanded trade opportunities with South Việt Nam. All told, during the eight years South Korea was actively engaged in the war, it is estimated to have earned \$5 billion.⁷

In addition to foreign aid and financing through the Việt Nam War, the United States played an important role in South Korea’s export-led development as a market for South Korean goods. From 1965-1969, the US was the destination for 45 percent on average of South Korea’s exports. Export levels to the United States tailed off somewhat during the 1970s as they fell from a high of almost 50 percent in 1971 to 29.05 percent in 1979. Exports to the United States began to pick back up as a share of South Korea’s total exports in the 1980s as they moved from textiles to higher-value products, such as automobiles and integrated circuits, peaking at approximately 40 percent in 1986.⁸

South Korea’s Modern Economic Relationship with the United States

South Korea’s economic relationship with the United States today stands in stark contrast to the relationship immediately after the Korean War. No longer dependent upon US aid and a global economic power in its own right, South Korea has grown into one of the United States’ most important economic partners in the Asia-Pacific and an important ally in global economic forums, such as the G-20.

The trade and investment relationship that has developed between the United States and South Korea over the last sixty years is a robust and diverse one. In 2012, two-way trade in goods and services between South Korea and the United States amounted to \$134 billion, making South Korea the United States’ seventh-largest trading partner and the United States South Korea’s fourth-largest trading partner after China, Japan, and the Association for Southeast Asian Nations (ASEAN).

The US exports a series of high-tech products, such as electronic devices, airplanes, chemicals, and machinery to South Korea. South Korea is an especially important market for US agricultural exports. Agricultural exports to South Korea in 2012 were just over \$6 billion, or only about \$4 billion less than all US agricultural exports combined to the twenty-seven-member European Union. In return, the United States imports products such as automobiles, TVs, and smartphones.

The US and South Korea also engage in a significant investment relationship. The US remains the largest foreign direct investor in South Korea, though China is rapidly catching up with American investment. In 2011, the US invested \$1.5 billion in South Korea primarily in manufacturing, finance, professional, scientific, and technical activities, as well as wholesale trade. At the same time, South Korea invested \$6.2 billion in the United States primarily in finance and insurance, as well as mining. In prior years, South Korea has made significant investments in auto and television production facilities in the United States.

Tensions in the US–South Korea Economic Relationship

With the growth and diversification of trade with South Korea have also come tensions in the economic relationship. In the 1980s, South Korea’s movement up the value chain to higher-value products such as integrated circuits and automobiles began to cause concerns in the US. For much of South Korea’s economic development, the United States looked the other way as Seoul kept its market closed to imports to help develop its own domestic industries. However, as South Korea developed

economically and began competing more directly with US products, economic disputes rose between the two countries.

The US-ROK disputes remained fairly pronounced throughout the 1980s but would begin to recede in the late 1990s. The key turning point was the Asian financial crisis. The crisis pushed South Korea to the brink of bankruptcy. Having financed much of its economic growth through loans, many of the *chaeböl* (South Korean conglomerates) were highly leveraged; and as dollars fled the South Korean economy during the crisis, they found financing their loans, which were often denominated in US dollars, increasingly difficult. To help South Korea through the crisis, the International Monetary Fund (IMF) provided a loan under the condition that it undertake market liberalization.

The implementation of regular meetings between the two countries to address economic concerns also helped relieve tensions in the economic relationship, which were further decreased as South Korea embarked on one of the world's most aggressive free trade programs, beginning in the early 2000s.

While disputes still exist over products such as beef and automobiles, perhaps the best example of a modern economic dispute between Seoul and Washington is in the area of smartphones, which demonstrates both the competitive and complementary nature of the economic relationship. Since August 2011, Samsung and Apple have been locked in a series of disputes over the use of intellectual property rights on four continents. While Apple successfully launched the modern smartphone, Samsung has become their primary competition in global markets. While the two companies compete internationally for market share and engage in legal disputes, they also work together, with Samsung having provided many of the processor chips for Apple's iPhone.

The US-Korea Free Trade Agreement

Although the US-South Korea mutual defense treaty has been in place since the end of the Korean War, trade liberalization has primarily occurred through the World Trade Organization and the IMF agreement rather than an overarching bilateral agreement. While discussions of a free trade agreement (FTA) go back to the United States' FTA with Canada, serious consideration of an FTA between the United States and South Korea did not begin until the early 2000s.

In 2006, the United States and South Korea began negotiating the US-Korea Free Trade Agreement (KORUS FTA) and initially signed the agreement in June 2007. However, because of continuing concerns over the access of beef and automobiles in the South Korean market, passage of the agreement was put on hold.

In December 2010, the United States and South Korea reached an additional agreement that helped address the concerns of US automobile producers and workers, along with a series of other issues allowing the agreement to move forward for consideration by the South Korean National Assembly and the US Congress. The agreement, which came into effect March 15, 2012, is the most advanced free trade agreement negotiated by the US and serves as the template for the ongoing negotiations for the regionally based Trans-Pacific Partnership free trade talks. In terms of scale, the agreement is estimated by the US International Trade Commission to increase US exports to South Korea by \$10-\$11 billion while also increasing South Korean exports to the United States by \$6.3-\$6.9 billion.

The Global Financial Crisis, the Seoul G-20, and International Economic Cooperation

Beyond the growing trade and investment relationship, the United States and South Korea have also developed a growing partnership in international economic forums. When the global financial crisis hit in 2008, South Korea played a key role in supporting US efforts to contain the crisis by calling for nations to avoid the mistakes of the Great Depression and refrain from undertaking protectionist measures.

As the role of global economic management shifted from the G-8 to the G-20, the US and South Korea developed a cooperative relationship in dealing with ongoing financial challenges in the global economy. With the support of the US, South Korea took the lead in the G-20 in 2010, becoming the first non-G-8 nation to host a G-20 summit and drawing on its experience from the Asian financial crisis to help shape measures dealing with the creation of financial safety nets to protect nations in the event of another financial crisis, while also utilizing its own development experience to add the issue of development to the G-20 agenda.

In addition to the G-20, the US and South Korea are increasingly cooperating in the area of development assistance. As the only nation to move from an aid recipient to a member of the OECD's Development Assistance Committee, South Korea is now playing a more prominent role in aiding poor nations.

Conclusion

After the Korean War, South Korea was one of the poorest nations in the world. In the span of a single lifetime, it has managed to move from a state dependent upon foreign aid for survival to one of the world's leading economies. While South Koreans are primarily responsible for their success, the United States played a key role over the last six decades as a guarantor of South Korea's security, a source of foreign aid, and a growing trade and investment partner.

While the United States' economic relations with China or Europe receive more attention, Americans have developed a significant economic relationship with South Korea. This relationship has grown into a broader economic partnership that is helping shape economic relations in the Asia-Pacific and global standards and norms through the G-20. A relationship that few would have imagined after the Korean War has become a mutually beneficial one with global consequences. ■

NOTES

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