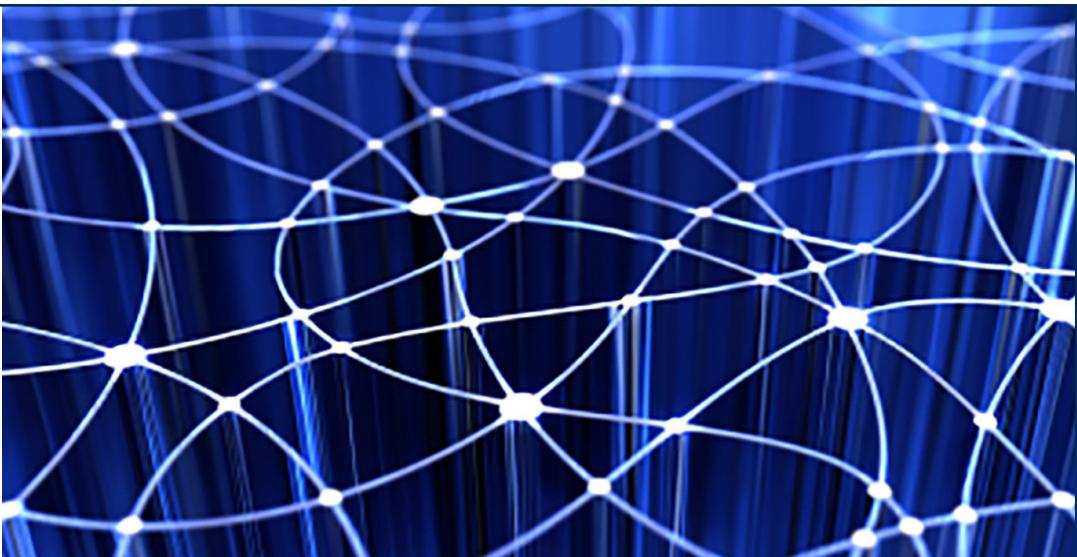




TRADE, ECONOMIC,
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Strengthening the U.S.-ROK Alliance for Job Creation and Sustainable Development

WORKSHOP REPORT

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THE NATIONAL BUREAU OF ASIAN RESEARCH

Since the 1950s, the Republic of Korea (ROK) has transitioned from one of the region's most impoverished nations to a global economic powerhouse, a member of the G-20, and a country with a thriving environment for life-saving innovations. Ranking at or near the top of any list of the world's most innovative economies, South Korea is an important example of the benefits of openness to free trade and investment. Still, the government now faces the dilemma of overcoming long-engrained domestic challenges that are inhibiting growth into global markets.

To address the question of how South Korea can build on its previous successes, the University of Seoul and the National Bureau of Asian Research (NBR) co-convened a high-level workshop, “Strengthening the U.S.-ROK Alliance for Job Creation and Sustainable Development,” with senior experts from both South Korea and the United States. Participants were asked to consider South Korea’s economic and public health outlook, the decisions facing the Moon Jae-in administration, and opportunities for enhanced U.S.-ROK ties to support South Korea’s ambitions. This report details key findings and recommendations from this dialogue.

Background

South Korea’s incredible economic rise is often highlighted as one of the central success stories for countries seeking to improve the quality of life for their citizens. In her opening remarks, Clara Gillispie (NBR) noted that over

a period of several decades South Korea undertook a series of sometimes painful domestic policy reforms that prioritized supporting long-term investments in R&D, protecting intellectual property (IP) rights, and promoting a development model that emphasized two-way trade and investment as critical tools for strengthening public health (although these reforms have occasionally fallen short in their execution). Soonim Huh (University of Seoul) argued that the dramatic evolution of South Korea's healthcare system has been one important factor in improving quality of life.

Since the 1960s, South Korea has made remarkable advances in healthcare technology and medicine, increasing life expectancy by an average of 26 years.¹ Recent studies have even found that South Korean women likely may be the first group with an average life expectancy of over 90 years, surpassing Japanese women, who currently have the longest life span.² From 1977 to 1989, the country successfully developed and deployed a robust universal healthcare system. Today, the National Health Insurance Program (NHIP) covers approximately 97% of the population, with the remaining 3% covered by the Medical Aid Program.³ At the same time, South Korea has experienced rapid economic growth since the 1960s and successfully transitioned from a developing to a developed economy. GDP per capita increased from \$158.20 in 1960 to \$27,538.80 in

2016, and South Korea now ranks as the eleventh-largest global economy.⁴

In the past decade, however, South Korea's rapid growth has slowed as it has bumped up against the productivity ceiling, a challenge faced by many advanced economies. To overcome this period of stagnation, President Moon has adopted a strategy that incorporates South Korea's successful advances in healthcare into a broader economic agenda that promotes a "welfare state" model of "living well together." The five main goals under this plan are creating (1) jobs to drive income growth, (2) a fair economy, (3) a stronger middle class, (4) the fourth industrial revolution, and (5) a sustainable environment for start-up businesses, small and medium-sized enterprises (SMEs), and innovation-led growth. In order to accomplish this agenda, workshop participants argued that policymakers must create an environment that fosters innovation and collaboration and look to industries that can help achieve the dual goals of improving social welfare and economic growth.

Drivers for Economic Growth

As the government seeks to revitalize growth through an agenda that emphasizes social welfare, June Park (Seoul National University) underlined that it must first create an environment that is welcoming to research, innovation, and entrepreneurship in order to expand the middle class and sustain lasting income gains. Creating a conducive environment for innovation and economic growth in South Korea will require understanding the important contributions of

¹ Young Joo Song, "The South Korean Health Care System," *Japan Medical Association Journal* 52, no. 3 (2009): 206–9.

² Donald G. McNeil Jr., "Life Span of South Korean Women Is Headed toward 90," *New York Times*, February 27, 2017.

³ National Health Insurance Service (NHIS), "National Health Insurance System of Korea: Universal Health Coverage for the World," 2014.

⁴ World Bank, "GDP Per Capita (Current US\$)," https://data.worldbank.org/indicator/NY.GDP.PCAP.CD?locations=KR&year_high_desc=true.

both the *chaebols* and SMEs and balancing their roles to maximize growth.

Chaebols. Much of South Korea's rapid growth has been attributed to the rise of the chaebols (family-controlled, large business conglomerates) during the Park Cheng-hee administration. The five largest chaebols—Samsung, Hyundai, LG, SK, and Lotte—are known around the world, and their combined revenue in 2017 constituted 60% of South Korea's GDP.⁵ Recently, calls for reform have been prominent in domestic debates after Lee Jae-yong, vice chairman of Samsung, was arrested for bribery and other corruption charges last year. Dr. Park and others argued that such behavior is not uncommon among chaebols. Calls for reform have further increased after Lee's prison sentence was shortened and then suspended. President Moon campaigned to sever the "too close" relationships between chaebols and the government in order to encourage economic diversification and allow SMEs to thrive. However, this may prove to be more challenging

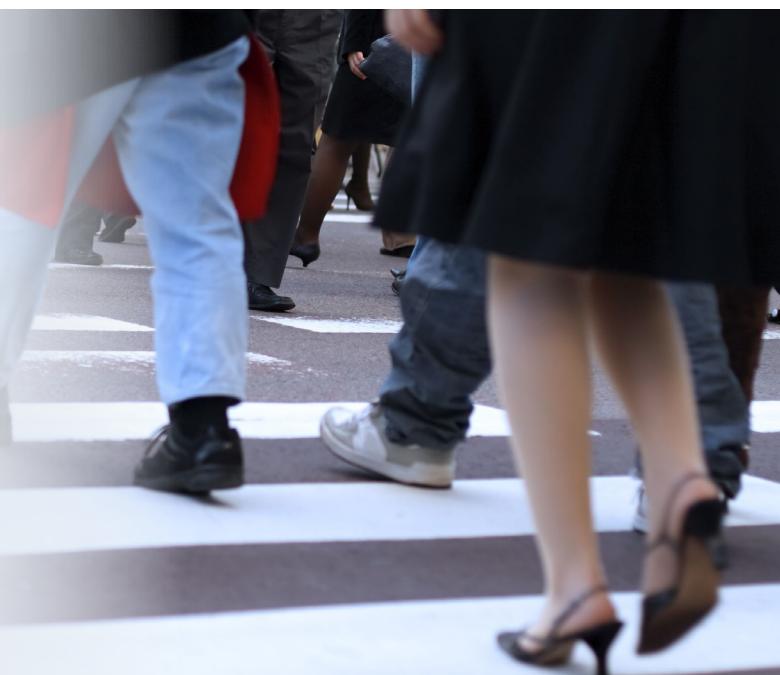
⁵ Stratfor, "Blood Runs Thicker in the South Korean Economy," February 28, 2017.

than anticipated. Chaebols still form the foundation of economic growth in South Korea and are largely responsible for funding the country's R&D for new technologies, which encourages innovation in many ways.

SMEs. Participants agreed that SMEs could also play a more significant role in strengthening the country's innovation and economic growth. Two key tenets of former president Park Guen-hye's "creative economy" agenda were to both improve the efficiency and competitiveness of SMEs and to create opportunities for collaboration with chaebols. However, the tight relationship between the government and large businesses proved to be an insurmountable obstacle during her administration, which did not address the need to balance public and private financing.⁶

⁶ As Dr. Park noted in an interview with NBR, the scandal involving President Park's friend, Choi Soon-sil, revealed that government ties to chaebols had not changed, despite the intentions of the creative economy agenda. See June Park, "Strategies, Challenges, and Considerations for Economic Growth in South Korea," National Bureau of Asian Research, November 16, 2017.

South Korean women likely may be the first group with an average life expectancy of over 90 years, surpassing Japanese women, who currently have the longest life span.



As President Moon transitioned into his leadership role, his economic plan carved out a role for SMEs in the fourth and fifth goals of his “living well together” agenda: spurring the fourth industrial revolution through science and R&D and creating an environment conducive for start-ups and innovation-led growth. He will likely face many of the same challenges as his predecessors when attempting to balance the role of traditional leaders and SMEs in realizing these goals. Dr. Park noted that two ways to help achieve this balance are enhancing the ability of SMEs to gain access to the global market and obtain patent protection for their innovations. Specific policy measures in line with these methods include allowing easier access to start-up capital and loans, providing subsidies for legal support for patent protection and litigation, and implementing tax breaks to help newly developed technologies get off the ground.

Domestic innovation ecosystems. In order for SMEs to flourish, participants also emphasized that the environment for IP rights could be strengthened significantly. As highlighted by Ms. Gillispie and others, the ROK frequently leads or ranks among the top countries in patent applications and creation, which has resulted in the dominance of many South Korean firms in global markets.⁷ However, certain institutional barriers restrict the ability of smaller companies to achieve the same success. For example, Benjamin Shobert (Microsoft, University of Washington) observed that the time allotted for disputing parties to resolve charges of IP infringement in South Korea is limited to nine months, which does not allow much time for stakeholders to identify the theft and then prepare materials for a court case. This issue

is exacerbated for SMEs, which have fewer financial and legal resources from which to draw to advance their cases in such an abbreviated time frame.

Faced at one time with similar challenges, the United States enacted reforms to strengthen the innovation environment for smaller firms. The Bayh-Dole Act, which was passed by the U.S. legislature in 1980, allowed small businesses and nonprofit institutions such as universities to keep the title of inventions that were developed under government-funded grants. Mr. Shobert noted that this law was instrumental in creating incentives for companies to take the risks necessary to develop innovative, disruptive technologies and in jump-starting the ability for smaller U.S. firms and nonprofit entities to make technological advances. He further argued that similar policies would likely improve the innovation environment in countries such as South Korea, where innovation has traditionally been dominated by a handful of large conglomerates.

Mr. Shobert also cautioned that for the life science and biotechnology sectors, in particular—industries in which South Korea has been successful and continues to show great potential—policies for pricing and reimbursement can play an instrumental role in an SME’s ability to develop innovative products. In order to reduce the risk of disincentivizing investment and pricing SMEs out of the R&D process, he argued that the government should not implement a pricing and reimbursement strategy that focuses on unit dose cost. Some innovations with higher upfront development and trial costs may have lower overall expenditures in the long term.

⁷ Soumitra Dutta et al., *The Global Innovation Index 2017: Innovation Feeding the World* (Ithaca, Fontainebleau, and Geneva: Cornell University, INSEAD, and World Intellectual Property Organization, 2017), 245.

Harnessing the Potential of Healthcare Systems

South Korea is a leader in leveraging advanced technological industries to spur development and promote public health. However, slow growth in the manufacturing sector and low birth rates, among other factors, have recently contributed to overall economic stagnation. Panelists emphasized that South Korea's healthcare and life science industry has the potential to be deployed in tandem with broader strategic and economic measures to achieve elements of Moon's "living well together" agenda.

First, South Korea's healthcare system is highly ranked in overall satisfaction. In a 2017 study by the Organisation for Economic Co-operation and Development (OECD), approximately 72% of South Korean citizens stated they were satisfied with the "availability of quality health care in the city area where they live."⁸ The OECD and others have pointed to a

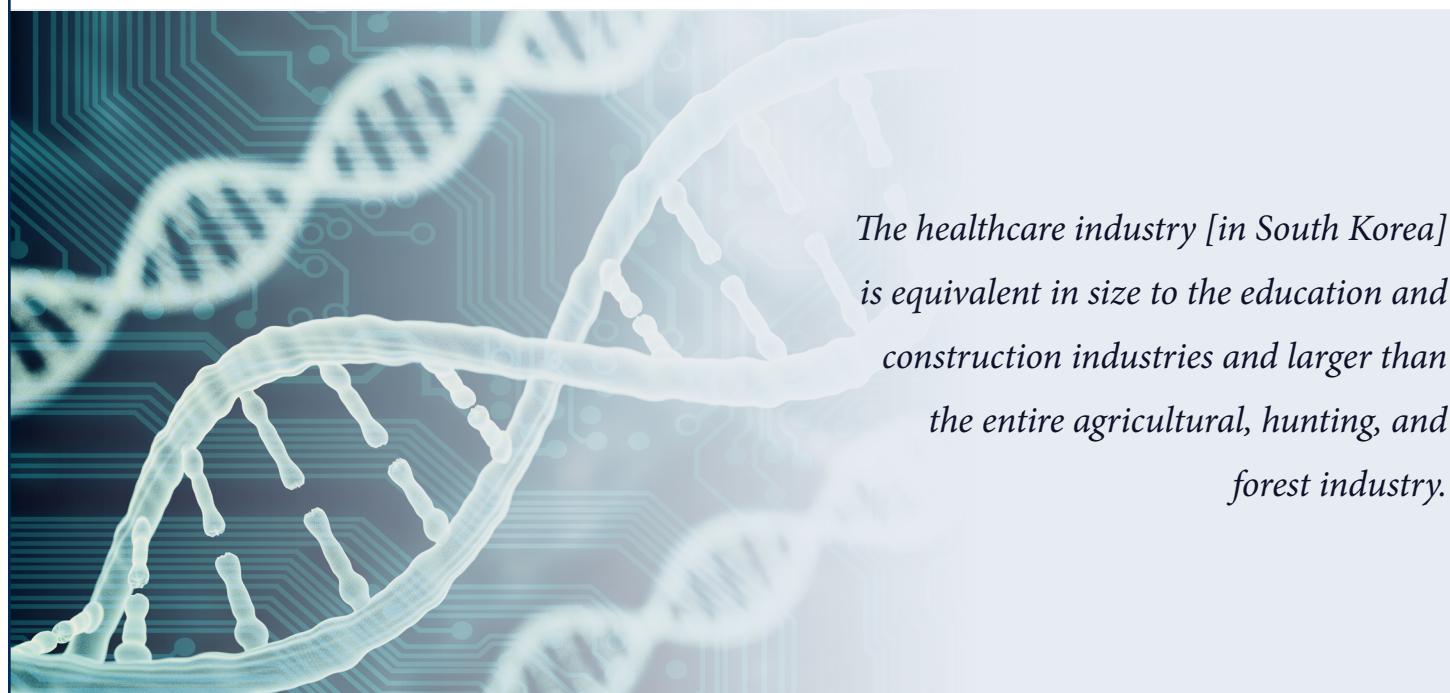
variety of factors that contribute to overall satisfaction with healthcare systems, including the general quality, coordination, and level of care.⁹ Feedback on areas that are successfully, or not as successfully, meeting social welfare priorities will be important for the Moon administration as it works to reform healthcare services to further the new agenda.

Second, as the World Bank and others have long noted, healthy populations can also spur economic growth. Labor productivity increases when workers feel better and miss fewer days, and a healthier childhood improves cognitive development, which in turn can bolster creativity and innovation.¹⁰ In addition, healthcare and social work are potential growth areas and can contribute to job creation, as exhibited by the over 81,000 jobs added in this

⁸ Organisation for Economic Co-operation and Development (OECD), *Government at a Glance 2017* (Paris: OECD Publishing), 233.

⁹ Kisoo Park et al., "Public Satisfaction with the Healthcare System Performance in South Korea: Universal Healthcare System," *Health Policy* 120, no. 6 (2016): 621–29.

¹⁰ David E. Bloom and David Canning, "Population Health and Economic Growth," Commission on Growth and Development, Working Paper, no. 24, 2008.



The healthcare industry [in South Korea] is equivalent in size to the education and construction industries and larger than the entire agricultural, hunting, and forest industry.

sector from 2015 to 2016.¹¹ As documented by the OECD, healthcare and social work account for 7% of total employment in South Korea, surpassed only by manufacturing, wholesale and retail trade, and accommodation and food services. The healthcare industry is equivalent in size to the education and construction industries and larger than the entire agricultural, hunting, and forestry industry, and it is the only industry in the top four that has seen consistent growth over the past decade.¹²

Last, significant developments in policy also play an important role in the industry's success and global competitiveness. As Mr. Shobert highlighted, one option is that the government could boost economic growth by enacting policies that reduce regulatory uncertainty and improve market access for innovative products. The K-Sunshine Act introduced in June 2017, which aims to reduce corruption and uncertainty in South Korea's pharmaceutical industry, is an example of a policy that was viewed with optimism by workshop participants.

Given these many benefits, President Moon has proposed a new healthcare plan dubbed "Mooncare." This plan will require medical insurance to cover all forms of treatment (with the exception of those that are completely optional); lower out-of-pocket expenses by capping medical expenses at one million won, or around \$930 (down from three million won, or around \$2,800), for families in the lower-30% income bracket; and increase financial support for patients to receive emergency services.¹³ These measures are expected to reduce annual medical spending for the entire population by an average of 18%.

Participants did acknowledge that harnessing the potential of the healthcare system will require significant attention to address concerns about its longevity, given the anticipated increase in demand for services and long-term care. As Jeonghee Lee (University of Seoul) and others noted in the discussion, the current amount contributed to the NHIP by the insured is still too low to be sustainable, particularly as the population continues to age at a comparatively rapid rate and there are fewer working citizens contributing to the country's social welfare programs. Monthly contributions to the NHIP by an employer are 6.1% of an employee's monthly salary, half of which is covered by the employee.¹⁴ Such contributions account for 83% of the NHIP's funding, with the government covering the remaining amount through general taxes and a surcharge on tobacco.¹⁵

Dr. Lee highlighted that the new budget submitted to the National Assembly for 2018 would increase spending on social expenditures by 10% over 2017 spending. At the same time, efforts to strengthen the public welfare system have not been matched by investments to efficiently support reforms. Dr. Lee cautioned that, without tax reform, public debt will likely increase each year, as the current system cannot sustainably support the higher cost of President Moon's proposed welfare measures.¹⁶

¹¹ OECD, "Korea," in *OECD Labour Force Statistics 2017* (Paris: OECD Publishing, 2018).

¹² Ibid.

¹³ Yoon Sojung and Lee Hana, "President Announces New 'Mooncare' Healthcare Plan," Korea.net, August 11, 2017.

¹⁴ NHIS, "NHI Program: Contributions," 2016, <http://www.nhic.or.kr/static/html/wbd/g/a/wbdga0404.html>.

¹⁵ NHIS, "National Health Insurance System of Korea."

¹⁶ The expansions outlined under Mooncare are estimated to cost an additional \$27 billion. See Jenna Gibson, "Korea Unveils Ambitious Plans for 'Mooncare,'" Korea Economic Institute of America.

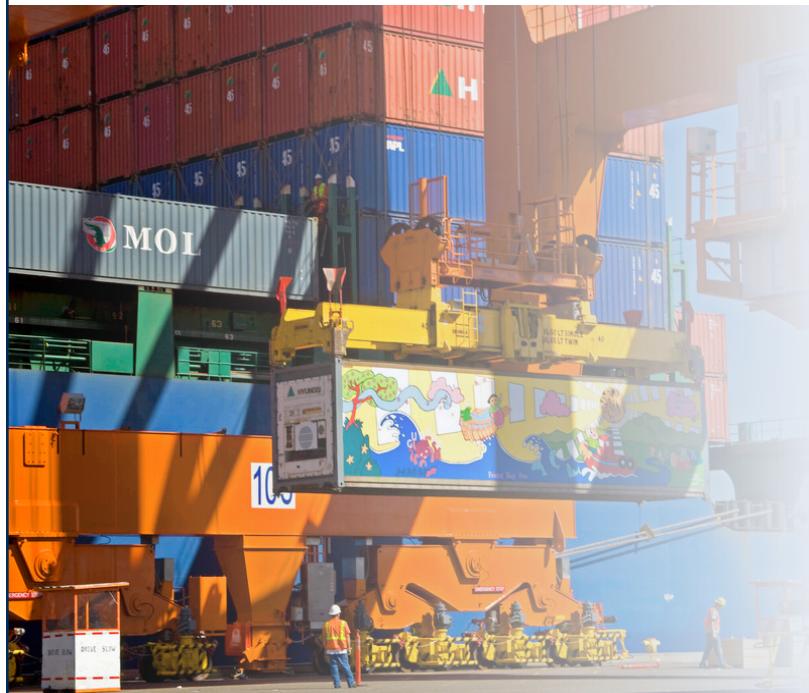
Strengthening U.S.-ROK Economic Cooperation

When considering South Korea's economic growth in an international context, Se Hyun Ahn (University of Seoul) noted the important role that the U.S.-ROK alliance has played as an anchor for stability and prosperity within the Asia-Pacific. He emphasized that the United States and South Korea enjoy a multifaceted alliance that encompasses military, political, and economic cooperation. Much of the subsequent discussion among participants focused on the economic dimension. As South Korea's economy has strengthened over the past several decades, the United States has remained one of its most important trading partners. Former U.S. congressman Charles Boustany (NBR) noted that this partnership has supported growth and laid the foundation for promoting more transparent open markets not only between the two countries but for the Asia-Pacific as a whole. Hankyoung Sung (University of Seoul) similarly emphasized that formalized economic partnerships like free trade

agreements (FTAs) can play a powerful role in fostering durable relationships.

Seokwoo Kim (University of Seoul) noted that after the Korea-U.S. Free Trade Agreement (KORUS) went into force, two-way trade grew significantly, despite the overall global economic downturn. In the first three years, trade in goods and services increased by approximately \$20 billion, with the most growth seen in industries such as automobiles, semiconductors, software, and agriculture.¹⁷ As stated by Younkyoo Kim (Hanyang University), this opening of markets has the potential to remain incredibly beneficial for both countries, particularly to advance energy security. The availability of U.S. supplies of liquefied natural gas (LNG) can be paired with South Korean demand to decrease the U.S. trade deficit, a priority of the Trump administration, while increasing South Korea's energy security. There is also potential for cooperation in laying

¹⁷ Office of the U.S. Trade Representative (USTR), "Three Years of Enhanced Opportunities: U.S.-Korea Free Trade Agreement," Fact Sheet, March 2015.



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the foundation for creating a more transparent and competitive LNG market in Asia, which would help stabilize prices and balance supply and demand. Dr. Ahn argued that such an energy alliance would further strengthen U.S.-ROK relations.

Dr. Seokwoo Kim observed that the summit between Presidents Trump and Moon in 2017 aired many of the concerns held by both sides, particularly in relation to claims of protectionist tendencies and unfair trade practices. While participants acknowledged that there is certainly room for improving areas of the KORUS agreement, they expressed concerns that a complete revision could result in a termination of the FTA. This would negate some of the most successful concessions made during the original negotiations, including the critical gains in IP standards that are imperative for increasing competitiveness in both countries.

After several rounds of renegotiation, the U.S. and Korean parties reached an agreement in principle in March 2018 that expands market access for U.S. automobiles and strengthens provisions and protections for healthcare exports.¹⁸ Based on remarks made by workshop participants, the latter accomplishment in particular has the potential to enhance U.S.-ROK cooperation on innovation and help President Moon achieve his “living well together” agenda, with important implications for public health. Yet, although the proposed amendments to the KORUS agreement keep hard-fought gains in IP standards and open up new opportunities for healthcare and the life sciences, the fluctuations of other trade policies raise new concerns for policymakers. The tariffs imposed by the United States on solar panels and washing machines and the quotas for steel and aluminum

create challenges for the trade relationship. In light of these issues, Ms. Gillispie emphasized that it is critical for policymakers in both countries to stay in close communication in articulating the benefits of KORUS and their desired areas for further strengthening the FTA as a gold standard for 21st-century trade.

Stephen Ezell (Information Technology and Innovation Foundation) provided four key conditions for successful, high-standard trade: (1) companies need access to large, global markets, (2) markets cannot be artificially supported, (3) there should not be fragmented markets for product creation, and (4) IP rights must be upheld. Policymakers have a responsibility to provide a level playing field for SMEs, but they also must avoid picking winners and losers. Mr. Shobert similarly emphasized that technical and regulatory standards need to be harmonized in order to maintain the high-quality and efficient production of goods and services. Ensuring that standards are equal across the market improves the ease of doing business and facilitates technology transfers, use of best practices, and IP protection. As two of the leading economies in the Asia-Pacific, South Korea and the United States are well-positioned to foster such harmonization of standards.

Conclusion

Participants at the workshop were ultimately optimistic about the outlook for both the South Korean economy and the U.S.-ROK alliance. Although reforms that adjust government spending and increase market access to SMEs are necessary to realize the Moon administration’s proposed goals, experts emphasized that South Korea’s leadership in R&D in innovative industries such as healthcare and the life sciences will continue to play a major

¹⁸ USTR, “New U.S. Trade Policy and National Security Outcomes with the Republic of Korea,” Fact Sheet, March 2018.

role in achieving domestic targets for economic growth and social welfare. The U.S.-ROK alliance may currently be experiencing instability following the changes in administration in both countries, but participants were confident that mutual interests will keep the two sides engaged in their joint mission to expand economic growth and job creation. Critical trade issues to monitor in the coming months will be the announcement of the final text of the amended KORUS agreement; the renegotiation of the North American Free Trade Agreement (NAFTA), which is viewed as an indicator of the trajectory of U.S. trade policy; and the legislative progress of President Moon's healthcare agenda. ♦

About the Innovative Asia Project

NBR's Innovative Asia project explores the relationship between economic growth and the life sciences and offers recommendations on how to strengthen innovation environments in Asia. In 2017–18, this initiative focuses on two countries—Japan and South Korea—and their efforts to develop sustainable healthcare systems that promote rising levels of public health and contribute to economic growth.

NBR's Trade, Economic, and Energy Affairs (TEEA) group focuses on energy security, energy and the environment, and trade, investment, and economic engagement, fostering collaborative solutions to common challenges in these areas facing the United States and Asia.

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