

# Creating Korea's Future Economy: Innovation, Growth, and Korea-US Economic Relations

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# AsiaPacific

## I S S U E S

**Analysis from the East-West Center  
No. 111  
January 2014**

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**S U M M A R Y** The Korean government's "creative economy" agenda reflects growing consensus that Korea's future growth and prosperity depends on its ability to become a global leader in developing and commercializing innovative new products, services, and business models. To succeed, the Korean government must address regulatory, structural, educational, and cultural obstacles that have constrained Korea's ability to fully utilize its innovative capacities. This new emphasis on innovation brings Korea into closer alignment with the United States, which has long focused on innovation in its growth strategies. Moreover, it comes during the early stages of implementation of the US-Korea Free Trade Agreement (KORUS), which intersects with important areas of Korea's innovation framework policies. Policymakers, businesses, and researchers in both countries should examine potential new opportunities to increase cooperation around initiatives aimed at fostering innovation and growth, both within the bilateral context and at a global level.

*What are the most effective roles for governments in promoting innovation?*

South Korean President Park Geun-hye has made the development of a “creative economy” the core of her administration’s economic agenda. This focus is closely linked with the goal of promoting economic democratization to reduce widening societal imbalances, coupled with demographic trends and slowing growth. The shift is an important, positive development. It reflects increasing recognition that Korea has reached the limits of its previous “fast follower” economic strategies, and that its future prosperity depends on becoming a global leader in developing and commercializing innovative products, services, and business models. To succeed, these policies require a focus on addressing regulatory, structural, educational, and cultural obstacles within Korea’s innovation ecosystem.

The creative economy agenda has important implications for Korea’s economic relations with the United States. Together with the implementation of the US-Korea Free Trade Agreement (KORUS), it offers new venues for the two countries to increase cooperation around fostering innovation. Policymakers, businesses, and researchers in both countries should explore these opportunities, both within the bilateral context and also to advance mutually beneficial goals at a time of accelerating regional economic integration.

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**The Creative Economy and Innovation Policy**

Park has defined “creative economy” as the concept of creating new industries and employment through “the convergence of science and technology with industry, the fusion of culture and industry, and the blossoming of creativity in the very borders that were once permeated by barriers.”<sup>1</sup> More important than the term itself is the Park administration’s recognition of the importance of cultivating the ecosystem needed to foster the innovation that will facilitate this vision.

Innovation is the “implementation of a new or significantly improved product (good or service), or process, a new marketing method, or a new organization method in business practices, workplace organization or external relations.”<sup>2</sup> It includes not only R&D, but

also intangible assets such as organizational management, human capital, workforce training, marketing, design, and intellectual property (IP). Innovation is a dynamic and disruptive process, and ranges broadly from incremental innovations that improve upon existing products and processes, to radical innovations such as new technologies and breakthrough ideas.<sup>3</sup>

There are two fundamental questions to consider in Korea’s creative economy agenda: First, what are core components of innovation-focused growth policies? And second, what are the most effective roles for governments in promoting innovation? Innovation ecosystems are shaped by a broad range of framework policies and economic conditions, and the interactions among a diverse group of institutions from which innovations emerge. Actors include government; small and large businesses; universities and researchers; and legal, financial, and other professionals engaged in the innovation process. Framework policies include R&D, education, and physical and regulatory infrastructure, along with tax burdens and incentives, trade and investment, IP, standards-setting processes, labor mobility, and government procurement.<sup>4</sup> There is growing consensus that the most effective roles for government are to facilitate and shape the framework conditions, coordinating among the broader networks of actors and policies involved in order to create the most conducive environment for innovation.<sup>5</sup>

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**The Creative Economy in Context**

The creative economy agenda marks a natural progression for Korea at its current advanced level of development. Korea’s gross domestic expenditure on R&D is among the highest in the world, and it is the world’s fourth-largest source of triadic patents, an important indicator of the quality of its innovation capabilities. A global leader in patents related to information and communications technology (ICT), Korea has one of the strongest Internet infrastructures of any country.

But Korea’s ICT prowess and the global leadership of its largest manufacturers risk overshadowing imbalances within the country’s innovation ecosystem.<sup>6</sup> For example, in 2010 three-quarters of Korea’s R&D

was conducted by the private sector, primarily by large companies and predominantly in the category of applied research. Eighty-eight percent of R&D was in the manufacturing sector, of which 48 percent was in the single category of radio, television, and communication equipment. Although a leader in ICT patents, Korea rates comparatively lower among OECD (Organisation for Economic Co-operation and Development) economies in patents for biotechnology and nanotechnology—sectors in which basic research is important. Korean public and university R&D activity is weak, as is R&D conducted by small and medium-sized enterprises (SMEs) and R&D related to services.<sup>7</sup>

These indicators reflect disparities that emerged during Korea's rapid industrialization, when the government focused on export-driven growth by chaebol (family firms) while neglecting SMEs and the services sector. Today SMEs make up 99 percent of Korean businesses and nearly 90 percent of employment, and services comprise the majority of Korea's GDP, yet the productivity of these sectors is low and underdeveloped. The resulting distortions have contributed to growing wage and productivity disparities. Korea's slowing economic growth rate in recent years is exacerbated by these factors, together with an interrelated range of social challenges. These trends contribute to rising inequalities that have fueled recent political discourse around the need for economic democratization.<sup>8</sup>

Park has said that "for the creative economy to truly blossom, economic democratization must be achieved." Studies have long pointed to SMEs, particularly young startups, as fertile sources of innovation and job creation. However, their ability to develop innovative capabilities has been limited by their role as primarily suppliers and subcontractors in the vertically integrated corporate structures typical of large Korean companies. These structures have not been conducive for spin-offs and other innovations generated by synergies between large companies and entrepreneurial small firms. Other factors include high levels of trading within chaebol, opportunistic practices by large companies towards SMEs, and lack of access to financial, human, and other resources.<sup>9</sup>

Also related are educational and cultural challenges. Korean students rank near the top globally in math and science test scores. However, Korean experts have long urged improvement in the quality of education and research, especially at the university level, and called for increased focus on vocational training and creative problem solving.<sup>10</sup> Rapidly escalating unemployment among recent university graduates and concerns of skills mismatches are a rising challenge.<sup>11</sup> Additionally, there is considerable societal pressure on young people to pursue stable careers in government or large companies.<sup>12</sup> Although recent surveys find relatively positive views among Korean respondents towards entrepreneurship, they reveal a high fear of failure and negative perceptions of entrepreneurial skills and opportunities.<sup>13</sup> Fostering an environment in Korea in which more people feel empowered to explore entrepreneurial opportunities and take risks is key to the success of the creative economy agenda.

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### **The Creative Economy Blueprint**

Korean policymakers have long recognized these challenges. What sets the Park administration apart from previous governments is the degree to which it has placed innovation and the theme of creative economy front and center on its policy agenda. One of Park's earliest actions as president was to establish a new Ministry of Science, ICT, and Future Planning for the purpose of leading the development, coordination, and implementation of creative economy policies within the government. Park and her administration have championed the value of innovation and entrepreneurship to the Korean public, including through highly-publicized site visits to startups and meetings with renowned entrepreneurs and futurists to seek their insights.

The "creative economy action plan" announced by the Korean government in June 2013 represents the Park administration's comprehensive approach to advance this agenda.<sup>14</sup> The goals of this plan are to create new employment and industries through creativity and innovation, strengthen Korea's global competitiveness, and establish a society "where creativity is respected and manifested." It includes significant

*Park and her administration have championed the value of innovation and entrepreneurship*

*The creative economy action plan aims to foster a 'Silicon Valley-like' venture funding ecosystem*

focus on eliminating financial and regulatory barriers to entrepreneurs and SMEs, and aims to foster a “Silicon Valley-like” venture funding ecosystem by improving the environment for financing and increasing the investment capital available to entrepreneurs.<sup>15</sup> Action steps include tax incentives to stimulate angel investment and reinvestment by successful entrepreneurs in new startups; new funds to support startups and mergers and acquisitions (M&As), including through crowdfunding; and regulatory reforms to remove barriers to technology-related M&As. The plan reaches beyond Korea’s borders with incentives for overseas Koreans to invest in and provide mentorship to domestic entrepreneurs, creation of an “entrepreneur visa” to encourage highly skilled foreigners to start businesses in Korea, and support for startups entering global markets. Other components include upgrading industry productivity through ICT and software convergence; improving linkages among industry, academia, research institutions, and local governments; increasing basic research funding by 40 percent by 2017; and improving infrastructure for generating, protecting, and using IP.

Closely linked are measures to improve SME productivity. Goals include increased funding and support for SMEs to enhance their technology development and commercialization capabilities; fostering new synergies between large and small companies; and strengthening legal frameworks to prevent IP and technology leaks. The Korean government has pledged to prioritize SMEs in transferring publicly funded technologies from universities and institutes, and to support them in recruiting, training, and retaining skilled workers.<sup>16</sup>

These proposals are encouraging and demonstrate recognition of the need for a holistic approach to enhancing Korea’s innovation ecosystem by removing regulatory, institutional, and cultural barriers. Many proposed measures have been discussed or attempted before by previous Korean governments. However, the focus and urgency with which the Park administration is pursuing this agenda could help to build momentum.

Moving forward, it is important that the Korean government stay focused on the fundamental goal of

creating the most conducive environment possible for innovation, and recognize its own limitations.<sup>17</sup> Its focus on improving financing for startups and SMEs is positive, but requires caution so as not to create new dependencies on public funding. Implementing regulatory, tax, and other reforms that reduce risks for entrepreneurs and encourage businesses small and large to invest in R&D and create new jobs will be beneficial. Given the dynamic and disruptive nature of innovation, it is important that the Park government avoid new regulations and directives that could inadvertently create barriers to the potential unexpected surprises that could present Korea’s next great success story.<sup>18</sup>

Park’s ability to build strong public consensus around the value of innovation and the creative economy agenda is essential for the long-term feasibility of these initiatives. This is not only to encourage more people to consider entrepreneurial opportunities, but also to frame and build public support for more comprehensive and politically sensitive education, labor, social welfare, and other structural reforms essential to enhancing Korea’s innovation ecosystem and addressing sources of economic and social disparities. The success of many of these policies requires a long-term commitment, well beyond Park’s five-year term as president, but important foundations can be constructed now. Also important for the success of the creative economy agenda will be expanding Korea’s trade linkages and openness to foreign direct investment (FDI), which facilitate innovation through introducing new technologies, processes, business models, and knowledge spillovers across international borders, and opens potential opportunities to engage with US partners in advancing creative economy goals.

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**The Creative Economy in Korea-US Economic Relations**

The creative economy agenda presents a new lens through which to consider Korea’s economic relationship with the United States. Innovation approaches in Korea have long been shaped by interactions with the United States. Korean firms developed innovative

capabilities through learning-by-doing in joint ventures and as original equipment manufacturers, along with reverse engineering and licensing agreements. Later, they ramped up R&D, recruited Koreans with US degrees working for major US companies, established Silicon Valley satellite offices to obtain access to training and research opportunities, and acquired technology through small US firms willing to sell to them in order to bridge the gap with international competitors in sectors including semiconductors and autos.<sup>19</sup>

More recently, Korean and US firms have cooperated to bring breakthrough technologies to market, expanding the flows and network of innovation between the two countries. Korea's selection of US-based Qualcomm's Code Division Multiple Access (CDMA) digital wireless standard as its national mobile telecommunications standard in 1992 led to its launch of the world's first CDMA 2000 (an early form of 3G mobile phone technology) service in 2001. Korea's early adoption of CDMA and experience with the technology enabled the development of mobile media services not yet available elsewhere, and attracted US firms including Motorola and Lucent to establish R&D facilities in Korea in order to access Korean expertise.<sup>20</sup>

Broader dynamics in the Korea-US economic relationship also factor in. One is the increasing flow of trade and investment between the two countries. The United States is the largest source of FDI in Korea, and Korean FDI in the United States is accelerating. As the two economies become increasingly integrated, how each country pursues innovation policies will affect businesses and researchers in both countries. Additionally, there is increasing alignment on addressing shared challenges, such as IP protection, in Asia and globally.

Like the Park government, the Obama administration has emphasized innovation and entrepreneurship as core to new economic growth and jobs. Korean policymakers have often looked to successful US cases for models; a glance at Korea's creative economy action plan reveals several such measures, including those intended to replicate Silicon Valley's venture funding ecosystem, and R&D set-asides for SMEs

like the US Small Business Innovation Research (SBIR) program. While specific policies will differ, outcomes and experiences could offer mutual learning opportunities and reveal potential areas for cooperation and synergies.

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### **KORUS and Korea's Innovation Framework**

It is important to consider how the provisions of KORUS, effective in March 2012, intersect with broader components of Korea's innovation ecosystem, and ways that KORUS implementation will support the goals of the creative economy agenda and facilitate Korea-US economic collaboration around innovation. Some of these include:

**Intellectual Property (IP):** The provisions to enhance IP protection and enforcement in KORUS are some of the strongest included in any bilateral trade agreement. They include bringing Korea's IP protections up to the level of global standards defined in the World Intellectual Property Organization (WIPO) Copyright Treaty and WIPO Performances and Phonograms Treaty, along with new standards protecting IP for emerging technologies.

**Standards:** KORUS contains commitments by Korea to make the development and implementation of technical regulations and conformity assessment procedures more transparent and predictable. It includes provisions ensuring technology and telecommunications standards are determined by the market and consumer choice, and commitments to promote the use of consensus-based international standards. It also increases opportunities for US companies to participate in the development of standards and technical regulations in Korea, and gives national treatment to US testing and certification bodies where the Korean government allows nongovernmental bodies to perform procedures for compliance with technical regulations. These provisions are important for Korea's innovation ecosystem because they could reduce transaction costs, redundancies, and market barriers to introducing innovative technologies and services, both in Korea and for Korean firms globally. They could also help facilitate new opportunities for collaboration in areas such as

*Recently, Korean and US firms have cooperated to bring breakthrough technologies to market*

smart grid that bring together diverse technologies and standards.

**Competition Policy:** Under KORUS, Korean regulatory bodies will be independent from public telecommunication and technology services providers, and will not have management or financial interests in them. These and other strong competition policy provisions will enhance opportunities in the Korean market for breakthrough products and services that could spur new domestic innovations.

**Investment and Regulatory Transparency:** KORUS opens industry sectors in Korea previously closed to FDI, and guarantees fair and equitable treatment, national treatment, and a binding investor-state dispute resolution mechanism. It includes commitments to improve regulatory transparency and predictability, which have presented barriers in Korea to foreign investors and FDI. KORUS includes cross-border data transfer provisions that allow for regional integration of data processing, important for financial institutions operating globally, and others that could facilitate innovations in Korea's financial services sector. Simplified customs procedures, including increased transparency in customs laws and significantly reduced clearance time for most express shipments, will ease doing businesses for Korean SMEs and startups working with US partners.<sup>21</sup>

*Getting KORUS implementation right is important for achieving the goals of the creative economy agenda*

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#### **Areas for Korea-US Cooperation**

There are several areas in which Korean and US policy stakeholders should explore opportunities to increase cooperation around innovation and Korea's creative economy agenda:

**Encourage increased private sector collaboration through full implementation of KORUS.**

Getting KORUS implementation right is important for achieving the goals of the creative economy agenda. The structural reforms that Korea is undertaking to implement KORUS will enhance the environment for innovation, and for businesses more broadly, encouraging new FDI. Entrepreneurs and SMEs in both countries should consider opportunities to leverage KORUS to bolster their global competitiveness and explore new partnerships. Korea-US cooperation around innovation has long been driven

by the private sector, and with many businesses exploring areas to expand collaboration, the Korean and US governments should work to address any regulatory and other barriers that may hinder implementation, while celebrating success stories.

**Leverage the Trans-Pacific Partnership (TPP) agreement to advance shared goals.** The Korean government has expressed interest in joining the TPP, which includes the United States, Japan, and 10 other Asia Pacific economies covering about 40 percent of global GDP. As they consult with the United States and other TPP partners about possible entry into these negotiations, Korean policymakers and businesses should consider how provisions likely to be included in TPP could augment and advance the creative economy agenda. This is particularly the case with the IP, standards, regulatory coherence, investment, competition policy, and other chapters that build upon provisions included in KORUS.<sup>22</sup> If Korea joins TPP, it should engage closely with the United States to leverage it together with KORUS, advancing shared goals in international frameworks.

**Identify innovation as a priority within bilateral economic dialogues, and explore synergies.** With increasing focus in both Korea and the United States on innovation in their economic agendas, it would be beneficial for the two governments to identify it as a shared priority and to explore related topics and areas for cooperation through bilateral dialogues.

At a time when both governments face time and resource constraints, it is important to consider meaningful ways to pursue this goal that produce measurable outcomes. Existing initiatives that cover various components of the innovation ecosystem and framework policies are a practical place to start. These include, for example, clean energy technology activities conducted between Korea's Ministry of Trade, Industry, and Energy and the US Department of Energy. Working groups established under KORUS provide another platform. These and other bilateral dialogues may overlap and complement each other in areas related to innovation, and the two governments should explore opportunities to build synergies among them.

Korea and the United States should consider new dialogues addressing innovation and creative

***Cross-border networks play an important role matching Korean innovation and US capital***

economy–related issues that may not be covered under existing initiatives. For example, a new bilateral Information and Communication Technology Policy Forum, which convened its first meeting in November 2013, aims to promote ICT development in both countries and broaden related bilateral exchanges. Topics of discussion included regulatory policies to support the creative economy, startup support, best practices in cloud computing and big data, and cooperation in areas such as spectrum management, R&D, and international standardization organizations.<sup>23</sup> A US-Japan dialogue on innovation, job creation, and entrepreneurship that has increased discussion among policymakers, business leaders, and experts in both countries on ways to work together to foster entrepreneurship could also be a useful model for Korea-US engagement on these topics.

**Engage diverse stakeholders and creative approaches.** Bilateral engagement around innovation should be actively pursued through the diverse and extensive private sector, research, and people-to-people networks bridging Korea and the United States.

Bilateral business frameworks offer one venue for collaboration. For example, the American Chamber of Commerce in Korea established in 2012 a Council on Innovation for the Future to discuss policies that the Korean government could implement to promote innovation and to identify mutually beneficial strategies for forming new partnerships between

Korean and US companies. It has conducted “innovation camps” in Busan, Daegu, and Kwangju, at which US executives mentor and advise Korean university students on how to make themselves competitive for the global workforce.<sup>24</sup> The US-Korea Business Council, an organization of senior executives of US companies that promotes stronger business ties between the United States and Korea, is establishing a working group to explore and address innovation and creative economy–related issues within the bilateral economic relationship.

Cross-border networks, including many developed by Koreans who have studied and worked in the United States, play an important role matching Korean innovation and US capital to commercialize innovative technologies and services.<sup>25</sup> A recent conference in California provided Korean startups a first-of-its-kind platform to introduce their products and services to the Silicon Valley tech and venture capital community,<sup>26</sup> and the Korea Entrepreneurship Foundation partners with the Kauffman Foundation to organize the annual Global Entrepreneurship Week in Korea. Expanding university-level research and cooperation, and bringing together Korean and US partners around initiatives including prize competitions, mentorship opportunities, and entrepreneurship education represent just some approaches through which Koreans and Americans can work together to bring the creative economy agenda from concept to reality.

## Notes

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<sup>2</sup> Organization for Economic Co-operation and Development (OECD), *Ministerial Report on the OECD Innovation Strategy. Innovation to Strengthen Growth and Address Global and Social Challenges. Key Findings* (Paris: OECD Publishing, 2010), <http://www.oecd.org/dataoecd/51/28/45326349.pdf>, 1.

<sup>3</sup> Dieter Ernst, *China's Innovation Policy is a Wake-Up Call for America*, Asia Pacific Issues, no. 100 (Honolulu: East-West Center, 2011), 2.

<sup>4</sup> Robert D. Atkinson, Stephen J. Ezell, and Luke A. Stewart, *The Global Innovation Policy Index* (Washington, DC: Information Technology and Innovation Foundation and Kauffman Foundation, 2012), 9–18.

<sup>5</sup> A more detailed analysis is in Sean Connell, *Innovation and Growth Policies in Japan-US Economic Relations: Considering Areas for New Engagement*, RIETI Policy Discussion Paper Series, 12-P-018 (Tokyo: Research Institute of Economy, Trade and Industry, 2012), 4–7.

<sup>6</sup> A more extensive discussion of these topics is included in Sean Connell, *Building a Creative Economy in South Korea: Analyzing the Plans and Possibilities for New Economic Growth*, Academic Paper Series, 62 (Korea Economic Institute of America, 2013), 2–7.

<sup>7</sup> OECD, “Korea,” in *Science, Technology and Industry Outlook 2012* (Paris: OECD Publishing, 2012), [http://www.keepeek.com/Digital-Asset-Management/oecd/science-and-technology/oecd-science-technology-and-industry-outlook-2012/korea\\_sti\\_outlook-2012-59-en#page1](http://www.keepeek.com/Digital-Asset-Management/oecd/science-and-technology/oecd-science-technology-and-industry-outlook-2012/korea_sti_outlook-2012-59-en#page1), 336–9.

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- <sup>9</sup> Linsu Kim, *Imitation to Innovation: The Dynamics of Korea's Technological Learning*, (Cambridge, MA: Harvard Business Press, 1997), 171, 189, 197.
- <sup>10</sup> Kim, *Imitation to Innovation*, 64.
- <sup>11</sup> David McNeill, "After Decades of Building Colleges, South Korea Faces a Lack of Students," *Chronicle of Higher Education* 58, no. 15 (2 December 2011): A14.
- <sup>12</sup> "What do you do when you reach the top?" *Economist*, 12 November 2011, <http://www.economist.com/node/21538104>. This topic also came up in several conversations during the author's visits to Seoul in April and May 2013.
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- <sup>18</sup> Connell, *Building a Creative Economy in South Korea*, 9–11.
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- <sup>20</sup> Andrew Salmon, *American Business and the Korean Miracle: US Enterprises in Korea, 1866-the Present* (Seoul: American Chamber of Commerce in Korea [AMCHAM Korea], 2003), 181–2, 248.
- <sup>21</sup> For the full text of KORUS and details on its provisions, see Office of the United States Trade Representative, "US-Korea Trade Agreement," <http://www.ustr.gov/uskoreaFTA>.
- <sup>22</sup> See also Troy Stangarone, "Considerations for Korea and the Trans-Pacific Partnership," *Korea's Economy 2013*, 29 (Washington, DC: Korea Economic Institute of America, 2013), <http://keia.org/publication/considerations-korea-and-trans-pacific-partnership-1>, 35–36.
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ISSN: 1522-0966

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This paper is based on research he conducted while a POSCO visiting fellow at the East-West Center in spring 2013.