

## **The Bush Administration and Korea-U.S. Trade Relations**

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### **INTRODUCTION**

The 2001 U.S. presidential election, after some uncomfortable weeks of uncertainty, finally resulted in a new Republican administration led by George W. Bush. The launch of the new administration has attracted worldwide attention because it means changes, both in domestic policy and in the external policy. Such changes in U.S. policies affect the Korean peninsula as well as the global order. Not only will they affect the general security environment of Korea directly, but a particular concern is their actual effect on the Korean economy and inter-Korean relations. This paper will focus on the impacts of possible changes in the U.S. trade policy under the Bush administration on the Korean economy and on inter-Korean economic cooperation.

It has frequently been said that the Democratic and the Republican parties do not show as sharp a contrast in their trade policies as they do in security policies. Traditionally, they both emphasize the importance of free and fair trade on which their strong market opening policies during the past decade have been

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based. For this reason, trade issues have not been highlighted in past presidential elections including the recent one. But this does not preclude the possibility of some meaningful changes in the U.S. trade policy under the Bush administration. Although the basic direction of the trade policy may be the same, the new administration will implement its own policy instruments and methodologies for pursuing policies which are different from those of the previous Democratic administration. Those differences would have remarkably different impacts upon major trading partners of the U.S. In this sense, it will be important to observe the trade policy of the Bush administration based on characteristic features and directions of trade policy of the Republicans.

The next section analyzes the background of the trade policy changes under the new administration. It will show that there are some critical factors which can cause such changes over and above the mere changes in a political power structure. The third section examines the Bush administration's basic direction and the prospects of some important trade issues. The fourth section describes future Korea-U.S. trade relations, focusing on the frequency of trade disputes and their probable areas. Impacts on inter-Korean economic cooperation are also analyzed. The final section considers a few policy recommendations in response to the changes in the U.S. trade policy and Korea-U.S. trade relations.

#### **TRADE POLICY ENVIRONMENT OF THE BUSH ADMINISTRATION**

Traditionally, the Republican Party has put more emphasis on free trade than the Democratic Party, although basic policy stances are similar between the two. In fact, analysis of the former Bush administration shows that it adopted stronger policy instruments to open up the overseas markets of its major trading partners. Moreover, a new administration tends to adopt strong policy measures in its early stage to show some visible results in a short

period. Considering these two factors, we expect that the Bush administration will implement very active trade policy measures, to create a better global trade environment in general and to open up the markets of major trading partners, in particular. In addition, the following factors will have effects on trade policies of the new administration.

First, the recent recessionary process of the U.S. economy may directly affect the toughness of its trade policy. Currently the U.S. economy is on the decline after its boom of ten years. The growth rate of the U.S. economy recorded 2.4% and 1.5% during the third and fourth quarter of 2000 respectively, down from the 4%-plus rate since 1997. The question of whether the U.S. economy will experience a soft-landing is not easily predictable, and both optimistic and pessimistic views prevail. The pessimistic view cites various factors such as wage increases caused by excess demand in the labor market, increasing inflationary pressure, concern over depreciation of the U.S. dollar, the gloomy view of the U.S. stock market, and abrupt hikes in international oil prices as the basis for its argument. On the other hand, the optimistic view emphasizes the positive signals of continued productivity improvements, particularly in the information and technology industry, and the prevailing sound macroeconomic fundamentals of the U.S. economy. Considering all these factors together, a soft-landing after a slow decline appears possible. However, in spite of the possibility of a soft-landing, the growth rate of the U.S. economy this year will fall to around 2-3% or below,<sup>1)</sup> and this growth reduction will lead to a tougher trade policy stance, as the Bush administration looks for a way out of its economic difficulties.

The second factor affecting the U.S. trade policy is the increasing trade deficit of the U.S. Current external trade imbalances are said to be one of the most serious problems of the U.S. economy, and

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1) Kim Hyung-joo, "The Prospects of the U.S. Economy after the Presidential Election," Manuscript, LG Economic Research Institute (December 2000), pp. 7-10.

recently, the trade deficit is expanding even more rapidly, exceeding \$400 billion in 2000. As a consequence, we will see increasing pressure to move the trade policy of the new administration toward a more active and aggressive one.

The third factor is the weakening leadership of the U.S. in the liberalization of global trade. Since the launch of the World Trade Organization (WTO) in 1995, the U.S. has been ineffective in extending free trade, both in regional and global contexts. For example, it has failed to expand the North American Free Trade Agreement (NAFTA) through the participation of Chile, and also failed to conclude the Multilateral Agreement of Investment in the OECD. More importantly, the global trading system is staggering under the effects of the failed WTO ministerial meeting in Seattle, in December 1999, which was held to launch a new round of negotiations for further reducing trade barriers and writing new international economic rules.<sup>2)</sup> The failure leaves a huge question mark over the U.S. role in world trade liberalization. Since President Bush and the Republican Party prefer to realize a powerful America through their external policy, the new administration will pursue changes toward stronger trade policies to restore U.S. leadership in the global free trading system.

### PROSPECTS FOR THE TRADE POLICY OF THE BUSH ADMINISTRATION

#### *General Prospects*

One of the characteristic features of U.S. trade policies since the late 1980s has been the active and aggressive nature by which it has

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2) Cho Yong-kyun, "Seattle Ministerial Meeting of the WTO and Prospect of a New Round," *Analysis of Major International Issues*, Institute of Foreign Affairs and National Security (IFANS) (December 23, 1999).

pursued the opening of overseas markets and hence, improved the market access of U.S. firms. This policy has been maintained since the former Bush administration and throughout the Clinton administration. The new administration will also maintain them, thus continuing the bipartisan nature of the fair trade policy in the U.S. The new administration, while it will minimize government intervention domestically, will strengthen its policy of trade liberalization by continuously pursuing the market opening of its major trade partners externally. During the election campaign last year, President Bush consistently maintained that the key to future economic growth and prosperity is the free flow of goods and services and ideas. He has also said that he would be a “free-trade president,” who would work tirelessly to open up markets for goods and services all over the world.<sup>3)</sup> With this position, the new administration will also take an active stance for various global and regional free trade agreements, such as a new WTO round, the NAFTA expansion and the Free Trade Areas of the Americas (FTAA).

A look at the cabinet members of the new administration is even more convincing evidence of the Bush position. Major economic- and trade-related positions have been filled mainly with two types: one for high-level officials of the former Bush administration and the other for members of business sectors. The Economic Advisor, Lawrence Lindsey, the Secretary of Agriculture, Ann Veneman and the United States Trade Representative (USTR), Robert Zoellick belong to the first group, while the Secretary of Treasury, Paul O’Neill and the Secretary of Commerce, Donald Evans belong to the second. Both groups tend to respect the autonomy of a private sector economy, as reflected in the tax-cut policy. They also tend to be very aggressive in opening up foreign markets and in liberalizing global trade, both in multilateral and in regional contexts.

However, some constraints could hamper the new

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3) Issues 2000, “George W. Bush on Free Trade,” *Every Presidential Candidates’ View on Every Issue* [<http://www.issues2000.org/>].

administration's goals. Although the Republican Party won the majority both in the Senate and in the House of Representative in the last election, its margin of seats has narrowed. Therefore, the Bush administration will not be totally free from Congressional pressures, at least in its trade policies. Compromise will be inevitable to a certain extent. Moreover, it is quite likely that in the next Congressional election, less than two years away, the Democrats may regain a majority. Under the circumstances, they will have less incentive to cooperate for the next two years in pushing various programs through Congress, while President Bush will make every effort to realize major policy initiatives through cooperation with the Democrats.<sup>4)</sup> In the process, the new administration will likely attempt to meet, to a certain extent, the demands of Congress for some protective policies, such as import restrictions and anti-dumping measures, to protect domestic industries. This will be particularly true if the decline of the U.S. economy accelerates, and if it results in increasing domestic unemployment.

Another feature of the trade policy of the Republican Party, which distinguishes it from that of the Democrats, is a higher dependence on bilateral and unilateral trade measures. In other words, it tends to lay less emphasis on multilateral measures than the Democrats. President Bush and many Republicans have maintained the stance that multilateral trade negotiations within international organizations is nothing but an instrument to attain goals and to enhance national interests. Instead, other means, such as regional instruments, as well as bilateral and unilateral measures should be utilized if necessary. In this sense, trade policies of the new administration will be highly aggressive; similar to those of the late 1980s through early 1990s, in which the U.S. was most active in opening up overseas markets. If the WTO is not successful in

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4) C. Fred Bergsten, "The Economic and Foreign Policies of the New U.S. Administration and Congress," *Occasional Paper Series* 00-10, Institute for Global Economics, Korea International Trade Association (December 2000).

launching a new round in the near future, the U.S. will probably undertake strong bilateral trade policies regarding its major trading partners, such as Korea, Japan, China and the EU.

Traditionally, the Republican Party has maintained closer relations with business in the U.S., so the new administration will be more active in reflecting opinions of the business sector than the Clinton administration was. It will be all the more probable if the economic growth rate in the U.S. declines rapidly or if the U.S. trade deficit deteriorates further.

#### *Individual Trade Issues*

The general nature of the trade policy of the new administration, stated above, will be reflected in various current trade issues which the U.S. is now facing.

Whether labor and environmental standards should be linked to trade negotiations or not is one of the most remarkable differences in trade policies between the two parties. The Republicans oppose the linkage, maintaining that labor and environmental issues are not essentially related to trade, and therefore, such a link runs counter to the spirit of free trade. Furthermore, if we restrict trade based on those standards, actual trade volume of the U.S. would shrink considerably. On the other hand, the Democrats argue that labor and environmental standards are inherently important values that supercede all others, including trade, and that if we ignore them, lower-cost products from foreign countries, produced according to lower standards, will flow into the U.S. and threaten domestic production and employment opportunities. With the different positions being considered, the launch of the Bush administration is expected to result in a remarkable change of the U.S. attitude in future trade negotiations. If the U.S. should withdraw its insistence on linkage, it will function as a positive factor to trigger some trade negotiations, such as the FTAA and the WTO new round, in which labor and environmental issues have so far been major obstacles.

Another trade issue in which changes are expected under the new administration is the reestablishment of the Fast Track Authority. After Congressional passage of the Uruguay Round Implementation Act, the U.S. government has lacked this trade-negotiating authority since 1994. The Clinton administration tried to reestablish that authority through Congress several times but failed because of conflicts of opinion between the two parties, and the strong opposition of labor and environmental groups. Interestingly, disagreement did not stem from conflicts between free trade supporters and protectionists, but essentially from the conflict over the issue of whether it included binding provisions on labor and environmental standards in trade agreements. The new administration desperately needs this authority because of important negotiations ahead, which require fast-track for their effective pursuit: free trade with Chile and other steps toward the FTAA, and scheduled negotiations under WTO and a new round. Conditions are more favorable than before.<sup>5)</sup>

Third, a new round may gain a momentum under the Bush administration, and negotiations for the launch of a new round will probably start soon. Since the suspension of the WTO Ministerial Meeting in Seattle 1999, there have been only sporadic discussions for the launch of a new round, and those have been limited to a few major players of the WTO. One reason for this poor progress is, among others, the passive attitude of the U.S. concerning domestic politics. The Bush administration, however, will take a more active position for the launch of a new round to strengthen rules and systems of global free trade. In addition, the administration is much less likely to link labor and environmental standards to trade negotiations. Furthermore, the prospect of restoring fast track authority will activate external trade negotiations of the U.S. and will work as a positive factor for the early launch of a new round.

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5) I. M. Destler, "The Need for Fast-Track Authority," *Issues in Focus*, Institute for International Economics (September 1997), [<http://www.ile.com/TESTIMONY/fasttrack2.htm>].

Fourth, the negotiations for the FTAA will be reinforced. The idea of the FTAA came originally from the Enterprise for Americas Initiative (EAI) which former president Bush proposed in 1990. President George W. Bush also emphasized repeatedly, during his campaign, the importance of accelerating the negotiations successfully to strengthen strategic relations with Latin America. In April 2001, the fourth Summit of the Americas, to be held in Quebec, Canada, will provide the momentum for the FTAA process, along with such factors as the solid recovery of the Latin American economy and the more probable renewal of the fast track authority of the U.S.

Lastly, reform efforts for international financial organizations will be strengthened. Both President Bush and the Republicans have put more emphasis on the reform of the IMF/World Bank system for improving their capabilities to solve the current international financial problems in response to the rapidly globalizing financial markets.<sup>6)</sup> They insist on the removal of bureaucratism within the organizations through transparent management and anti-corruption reform. President Bush criticized the IMF's current methods of financial assistance to crisis-hit countries, because he feels it increases, rather than reduces, the financial dependence of related countries by causing moral hazard. Thus the new administration will pursue comprehensive reform of institutional feature as well as management funds.

## KOREA-U.S. TRADE RELATIONS

### *Current Status of Korea-U.S. Trade Relations*

Flows of trade and investment between the two countries

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6) B. Eichengreen, "Chapter VII: What the IMF Should Do," *Toward a New International Financial Architecture--A Practical Post-Asia Agenda* (Institute for International Economics, 1999), pp. 97-121.

continue to increase. For Korea, the U.S. is currently the largest trading partner both in exports and imports, and the largest investor in Korea as well. On the other hand, Korea was the sixth-largest exporting country and the eighth-largest importing country for the U.S. in 2000. In terms of total trade volume, Korea is now the seventh largest partner of the U.S., up from the eighth in 1999. Korea had long maintained a trade deficit with the U.S. until 1996, but a Korean surplus has been maintained since the economic crisis of 1997, with last year's surplus figure amounting to more than \$6 billion.

Currently, there are a few pending trade issues between the two countries. Sincere implementation of the Memorandum of Understanding (MOU) in the automotive trade, the stronger protection of Intellectual Property Rights (IPRs) in Korea, anti-dumping measures by the U.S. against a Korean and the early conclusion of the Bilateral Investment Treaty (BIT) are important ones among them. However, in spite of those issues, overall trade relations have been smoothly managed in recent years. Trade relations since Korea's economic crisis have been positive with the Korea's deregulation and structural reform efforts on the one hand, and the long-lasting boom of the U.S. economy on the other. But the United States expects more liberalization and institutional improvements in the process of the Korea's economic reform.

#### *Prospects of Bilateral Trade Relations*

Korea-U.S. trade relations in the near future depend on the trade policy changes of the Bush administration, changes in the overall situation of the U.S. economy, and macroeconomic policy responses to them.

First of all, an aggressive position of the Bush administration in its trade policy will bring about considerable changes in trade relations between the two countries. The U.S. business community, one of the traditional support groups of the Republican Party, will increase its demand for various import restriction measures as well as the opening

of overseas export markets such as Korea. On the other hand, the new administration emphasizes the importance of small government and the importance of effective operation of a market mechanism. Such a position will be reflected in the trade policy. Thus, under the new administration, import restrictions are expected to be lifted to some extent, but active policies to open up overseas markets will be strengthened. Korea will not be an exception. While its bilateral trade surplus is not as large as those of China and Japan, it is increasing. Moreover, most of the major Korean exports to the U.S. market—automobiles, steel, telecommunications equipment, and agricultural products—are strategically very important for the U.S. economy. For these reasons, the frequency of trade disputes between the two countries is more likely to increase. Another point to keep in mind is that, under the Clinton administration, priority areas for fostering international competitiveness were information and telecommunication industries, but the Bush Cabinet indicates that in addition, it may undertake greater efforts to restore the competitiveness of other traditional industries. This may lead to increased conflicts over Korea's exports to the U.S.

We also expect changes in strategies for settling trade disputes when they occur. Many of the trade disputes between Korea and the U.S. so far have been effectively brought to the Dispute Settlement Procedure of the WTO.<sup>7)</sup> The new administration, however, will likely prefer bilateral instruments for settlement of trade disputes, particularly if WTO procedures do not satisfactorily maintain U.S. interests.

The decline of the U.S. economy, currently worsening, may have a negative effect on bilateral trade relations. If the current recession

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7) For example, since the launch of WTO in 1995, the total number of WTO disputes in which Korea was involved was 15. Among them, there were ten disputes with the U.S. It reflects that both countries have tried to settle bilateral trade disputes through multilateral channels. *KIEP Weekly Review*, Korea Institute for International Economic Policy (November 2000), pp. 13-8.

continues, or becomes even worse in the near future, it will cause a considerable decrease in import demand of the U.S., which will in turn deteriorate the Korean export market, amounting to over 21% of the total volume of Korean exports. The current status of the U.S. economy itself is also important in the sense that macroeconomic policies of the Bush administration in response to the current decline will have direct effects on the Korean economy. For example, the tax-cut policy of the Bush administration has some implications. In the short run, the policy can expand import demands by stimulating domestic business activities in the U.S., but if it could aggravate inflationary pressures on the U.S. economy and lead to a raise in the interest rate, the situation could be worse.<sup>8)</sup> Consequently it will bring about decreasing inflow of foreign direct investment to Korea and a serious deterioration in the Korean stock market.

#### *Prospects of Inter-Korean Economic Cooperation*

Inter-Korean economic cooperation will be affected, directly or indirectly, by changes in the external policies of the Bush administration. The U.S. has been employing an engagement policy with North Korea, and the basic stance of that engagement policy will not change under the new administration. But President Bush and his foreign policy advisors seem to believe that the engagement policy should be realistic rather than romantic,<sup>9)</sup> and insist on the imposition of a firm principle of reciprocity. If North Korea rejects this, diplomatic pressure will follow. However, it does not necessarily mean that the U.S. will implement strong coercive

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8) KIEP, "The Economic Policies of the New U.S. Administration and the Implications on the Korean Economy," Manuscript, Korea Institute for International Economic Policy (December 2000), pp. 59-60.

9) Kim Sung-han defines a romantic engagement policy as simple appeasement, while a realistic engagement policy is based on the imposition of a strict principle of reciprocity. Kim Sung-han, "Foreign Policy of George W. Bush," *The Korea Herald*, December 20, 2000.

measures against the North, since South Korea is unwilling to risk increasing tensions on the peninsula, mainly because of its economic interests.

In any case, it is not expected that the Bush administration will provide significant momentum to improving the U.S.-North Korea relations, at least in its early period. Then, how would it affect the inter-Korean economic cooperation? First, consider a possible scenario in which the inter-Korean relations are negatively affected by the worsening relations between the U.S. and the North. If North Korea is not cooperative in solving the nuclear and missile issues, and if policy coordination between South Korea and the U.S. is firmly maintained in dealing with the North, conflicts may increase between the two Koreas. The strict policy of the U.S. toward the North itself will discourage investments in the North, thus deteriorating inter-Korean economic cooperation. Such a stagnation may continue unless the Bush administration changes its policy toward the North. But this scenario is not highly plausible. Neither Korea nor the U.S. wants tension increasing on the peninsula and, above all, both share the position for maintaining an engagement policy with the North.

There is another scenario in which the deterioration of U.S.-North Korea relations could cause Pyongyang to move toward more cooperation with Seoul. In this situation, North Korea would want to exploit inter-Korean economic cooperation to the maximum, not only as a means of obtaining economic benefits but also as a means of exerting pressure on the U.S. for a policy change. U.S.-North Korea relations would become worse, while inter-Korean relations would improve. But this scenario is not highly probable either, and even if it were to occur, the situation would not last long. From the long-term perspective, inter-Korean cooperation cannot proceed without the assistance of the international community, particularly that of the U.S. Economic cooperation between the two Koreas is neither a purely economic phenomenon nor is it a bilateral issue confined to the two Koreas. Cooperation with the North requires a huge amount

of capital which is far beyond the capacity of the Korean economy alone. Therefore it is necessary to secure various types of assistances from international organizations and to induce large-scale investments of international private investors.<sup>10)</sup> Again, this is impossible without the active participation of the U.S., and yet it will not actively assist the North until current U.S.-North Korean issues are settled. In the final reckoning, U.S.-North Korea relations and the inter-Korean relations are inextricably bound together.

Considering these two scenarios, neither highly probable, it is safe to say that inter-Korean economic cooperation will not likely to show much progress under the Bush administration. Investments by South Korean firms to the North will increase to a certain extent with North Korean leader Kim Jong-il's visit to Seoul, and inter-Korean relations will gradually improve. But economic cooperation with the North will face clear limitations in the financing of necessary capital, and thus, will progress slowly. In the near future, the Korean government will inevitably play a dominant role in mobilizing investment resources. On the other hand, the role of the private sector in the South will be limited, not only because economic goals and profit motives have no application to the North Korean economy, but also because South Korean firms will not have sufficient capacity to meet the demand, particularly under the current receding economy of the South.

### CONCLUSION

Maintaining amicable trade relations with the U.S. is extremely important to Korea. For this, Korea must take proper, short-term policy measures in response to the trade policy changes of the Bush

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10) Cho Yong-kyun, "Economic Cooperation between the Two Koreas: Sources of Investment in North Korea," *IFANS Review*, Institute of Foreign Affairs and National Security, Vol. 8, No. 1 (June 2000), pp. 35-37.

administration, and must also establish mid- and long-term strategies to maintain stable bilateral relations.

First, Korea must prepare itself for increasing trade disputes with the U.S. More trade disputes are expected in such areas as automotive trade, pharmaceuticals, agricultural products, and intellectual property protection. This is so, not only because the Bush administration will be more active in opening up overseas markets, but because such a policy is reinforced by increasing trade deficits and the worsening U.S. economy. Specifically, we should strengthen stable and continuous channels of communication with the new administration and with the Congress. At the same time, we also need to maintain communication channels with the U.S. business community in Korea because many of the trade disputes between the two countries originate from the complaints they raise.

Second, Korea should make use of the multilateral trading system centered around the WTO. For this, it must strengthen cooperation with the U.S. for the early launch of a comprehensive new round. Since the Bush administration is expected to take an active position in launching a new round, Korea has greater prospects for cooperation on this issue than before.

Third, an institutional device should be considered for maintaining the stability of bilateral trade relations over the mid- and long term. Above all, to maintain the rapidly-increasing inflow of foreign investments and to enhance the level of international credit of the Korean economy, the early conclusion of the Bilateral Investment Treaty (BIT) between Korea and the U.S. is necessary. Korea should go a step further and seriously consider a bilateral free trade agreement (FTA). It is clear that the Korea-U.S. FTA would have both positive and negative effects. Economically, it provides the momentum for export increases and thereby, could lead the way to an advanced economy. At the same time, it places an additional burden on the market opening to a few industries such as agriculture and services. In terms of politics and security, it strengthens the alliance with the U.S. and thereby contributes to

enhancing peace and stability on the Korean peninsula. On the other hand, we should also consider the fact that a closer relationship with the U.S. may hinder Korea in its relations with other countries like China and the ASEAN countries. Therefore, a comprehensive and rigorous analysis of the Korea-U.S. FTA is necessary in order to evaluate its overall effects, and to choose among various FTAs currently under consideration.

Fourth, inter-Korean economic cooperation will not be seriously affected by the changes of the Bush administration's external policy. Continuous and effective cooperation between the two Koreas is important, not only for building a Korean economic community, but for tension reduction and peace building on the Korean peninsula. But, since it would be hard to secure the assistance of international organizations at least in the short-run, Korea will face limitations in financing necessary capital for the cooperation. Investing in the North is still very risky. Without a mechanism through which such risks can be effectively avoided, South Korean firms should be a little more cautious in their investments. At the same time Korea should try to build a better economic environment by inducing more assistance from the international community.

Last, we should make every effort to enhance the competitiveness of the corporate sector and the international credit level of the Korean economy by reinforcing current restructuring efforts. We expect that the U.S. economy will progress toward a soft-landing, but its growth rate will clearly decline. In this process, various uncertainties and financial instabilities will negatively affect Korea's major macroeconomic variables, such as stock prices, interest rates, and exchange rates, as well as trade and investment. Therefore, to prevent these effects or to minimize them, Korea must maintain stable macroeconomic management.