KOREA-U.S. TRADE TENSIONS: Brewing Conflict or Mere Politicking?

by Jong-hoon Park

Lately, the Korean media has been reporting that the U.S. is beginning to apply significant bilateral trade pressure on Korea. Given Korea's whopping $15.3 billion overall trade deficit and the hefty $11.5 billion deficit with the U.S. (based on MOTIE statistics), it is easy to understand why this is such a sensitive issue at this time. As of yet, the U.S. Government has yet to express any serious formal complaints, and most of the discussions seem to have been consultative or fact-finding in nature. However, according to several reports, the USTR is considering bringing several matters before the WTO dispute resolution body, particularly in regards to Korea's current frugality campaign.

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Where the U.S. Is Coming From

Under the Clinton Administration, the U.S. economy has fared well. According to the United States Trade Representative's 1997 Trade Policy Agenda, "More than 11 million jobs have been created, the vast majority of which are high-paying jobs. Real wages overall are on the rise for the first time in 10 years. U.S. exports to the world are up 35 percent." To back this up, the U.S. once again ranked first in the world in terms of competitiveness in the IMD's 1997 World Competitiveness Report.

The Clinton Administration feels that a large part of the reason for the strong U.S. economy has been trade. According to the USTR, the value of U.S. trade accounts for 30 percent of the GDP. Fair trade policies have been used as a tool for strengthening the domestic economy and creating a foundation for stable economic and job growth in 1997 and beyond. Trade is also seen a core tool in promoting core American values, such as democracy, rule of law and human rights overseas, as can be witnessed by the efforts to link China's WTO accession to human rights improvements. Furthermore, trade is seen as the basis for strategic economic alliances which will help project America's global leadership.

Given the importance which is being placed on trade in the Clinton Administration, it is easy to understand the U.S.'s stance in its trade policy agenda: "We must continue our strong export growth to the world. This includes tough enforcement of our trade agreement and aggressive market-opening efforts."

America's Concerns

As mentioned above, the area which has perhaps drawn the greatest concern as of late is the recent frugality campaign to reduce excessive consumption in Korea, which is being construed by foreigners as an "anti-import drive." Both the U.S. and the E.U. made complaints at a meeting of the World Trade Organization, although both have not yet chosen to lodge formal complaints that would result in bringing the matter before the WTO's dispute resolution body.

Korean officials claim that the campaign isn't necessarily targeted at imports. However, because imports are almost invariably more expensive than their Korean counterparts, the effect is the same, foreigners say. Thus, they are demanding clarification. The E.U.'s Ian Wilkinson said, "A clear public statement from the Korean government disowning all anti-import aspects of the civic "frugality" campaign is now necessary to dispel doubts about Korea's commitment to respect in full its WTO obligations."

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In addition, the Korean Government claims that it has not been directly involved in the civic campaign. The Foreign Ministry stated, "The frugality campaign is the result of private efforts by businesses and citizens' groups." However, foreigners are claiming that government officials have been stirring up anti-import sentiments by blaming foreign consumer goods for the huge current account and trade deficits, which is clearly false since such goods only account for 11% or 12% of Korea's total imports. One western diplomat was quoted as saying, "The government is creating a climate of intimidation by suggesting that Koreans who buy foreign consumer products are contributing to the trade deficit and thus are unpatriotic."

Some of the most vocal complaints have come from foreign auto importers. They claim that the Government has revived the practice of threatening foreign car buyers or leasers with tax probes in order to halt the rising import of foreign cars. According to reports, the National Tax Administration twice requested customer lists from foreign car leasing companies, in an effort to crack down on those trying to avoid taxes by leasing cars through their businesses and then using them for personal purposes. While the NTA later retracted these requests in the face of vigorous protests, the mere threat of punitive tax measures was enough to significantly discourage imports, foreigners claim. James Tessada, president of Ford Motor Co. of Korea, said, "Nobody wants to touch imported items for fear that there will be serious ramifications ... It's going to take a lot of promotion to gain consumer confidence back." As if to prove his point, foreign car sales, after rising steadily to a peak of 1,121 units in July 1996, have since fallen to under 700 units a month. The foreign importers are particularly incensed, since the threat of tax probes was an item which was specifically addressed in the Memorandum of Understanding signed between the U.S. and Korea in September 1995.

Foreign businessmen also claim that bureaucrats are using red tape and other less-obvious means to slow down imports. For example, registering new product labels, which only took two weeks in the middle of last year, now takes up to two months. Customs clearance has become more cumbersome, and new regulations or testing requirements are also being added.

Looking at the Larger Picture

For both sides, the trade issues have additional symbolic meaning beyond the actual numbers involved. For Korea, given the present economic circumstances and the fact that this is a presidential election year, it is essential that the Administration demonstrates its ability to successfully withstand foreign trade pressure, particularly from the U.S. In the past, it has been common practice for the opposition and the media to whip up popular support by accusing the Administration of being unable to stand up to the big powers and of kowtowing to their every need. It is easy to single out the U.S. because not only is the U.S. Korea's most important trading partner, but also the entity most likely to bring up trade issues, both at the bilateral level and at the

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(continued on p.20)

Current Account Quandary-cont'd

(D.J.Bhak)

self-evident. First, productivity or competitiveness in international trade has its significance through the RER. Productivity growth generally makes domestic goods cheaper and has constructive effects on the current account. Even if the terms of trade deteriorate very severely, the transient outbreak of the current account deficits can be taken care of by the recovery of the RER to the equilibrium level, as long as we let the market decide the nominal exchange rates. In fact, the terms of trade have meaning only if the nominal exchange rate remains fixed by some artificial scheme — a fixed exchange rate regime, for example. Also we should not forget that the enhancement of productivity itself improves a nation's welfare regardless of the current account situation. Increasing wages is by no means harmful to the economy if it is determined competitively in a free market. The rate of wage growth might exceed the productivity growth level if it had been undervalued in the past for any reason. The only problematic wage hike would be one that is extorted by the labor unions, overshadowing economic decisions.

Opening the financial market can be painful, especially if the lack of competitiveness has been disguised by the under-valued home currency. However, that kind of ordeal would not be long if, again, the economy can dispense with unwholesome interference. In the longer term, the lowered interest rates caused by more abundant funds will lighten the firms' cost burden and stimulate investment, enhancing the growth potential. Opening the goods market has a similar implication. It obviously increases the welfare of consumers with lowered prices and a wider variety of commodities to choose from. Producers may face a distinct disadvantage, but this sends them a strong message to sharpen their competitive edge in the medium and long run. Companies with less motivation for technology and efficiency enhancement will be kicked out of the race by the constantly competitive markets.

What about the yen/dollar rate? We must recognize that this is entirely out of our hands, and we can't keep muttering about it. If we do, we might find ourselves still grumbling ten years later when our TV makers have all gone belly up because we did a lousy job in developing HD TVs and fell behind Sony irreversibly. Although the present predicament of external imbalance hints at its own adjustment mechanism — it should be an unadulterated one, the horizon ahead still looks a little hazy. Thus we must arm ourselves with every possible kind of equipment and tool to break on through to the other side. Boosting our R&D portion to a solid 5% will have much more effect than the lip service of the "10% campaign." Concerning demolishing the walls and barrier to free trade, we should not whine since we cannot get a handicap on the links of the OECD anymore. We can no longer afford to hit like Bubba; we need to stroke like Tiger. VIP

Cost Strategies-cont'd

(C.H.Yun)

not Korean car makers will be able to recover their price competitiveness will depend on the success or failure of their efforts to reduce the perood of development for a new car.

Another part of Korean makers' efforts to reduce costs is to localize production in areas with low wages and high market potential. With the growing trend toward regionalism as manifested in NAFTA, the EU, and ASEAN, it is becoming increasingly difficult to secure overseas markets through direct exports. In order to overcome this situation, Korean auto makers are establishing a localized production system in Asia, which is becoming the world's largest auto market, and Eastern Europe. Being able to easily secure low-wage, high-skilled labor in these areas has a great effect in reducing costs. HMC has made a solo investment to build a manufacturing plant in India which will be able to produce 200 thousand vehicles a year. On the other hand, Kia is establishing a manufacturing plant in Indonesia, having been chosen as an Indonesian national car maker. Korean car makers are making steady progress in their plans to produce on the spot in Eastern Europe as a bridgehead for the EU market. It is Daewoo that is most actively pursuing this, while the other makers are also pursuing largely the same way.

The Korean makers are also developing "Asia Cars" to expand their market share in Asia. HMC has a plan to develop a low-price Asia Car called the "Asia Unique Model" which is designed to suit Asia's road and climate conditions and demand structure. HMC's Asia Car is a traditional 5-passenger sedan with a 1,300cc or 1,500cc engine. It will enter into the Southeast Asia in 1999. HMC plans to raise its market share in Asia up to 10% through this car. VIP

Brewing Conflict-cont'd

(J.H.Park)

WTO. The opposition has also been capitalizing upon the doubts concerning the liberalization entailed in Korea's OECD and WTO commitments and blaming this for Korea's current economic woes. Thus the Administration is stuck in the somewhat contradictory position of having to show strength is resisting trade pressure, while having to defend its actions in promoting the liberalization of the economy.

The U.S. has its own domestic agenda. Of course, maintaining the U.S. economy's current robust growth is the primary concern, and breaking down trade barriers is at the core of this. Some are questioning the wisdom of the free trade agreements negotiated by the Clinton Administration, especially NAFTA. To counter this minority, the Clinton Administration must demonstrate that the number of markets opened and the increase in exports outweigh any possible losses. Thus, the Clinton Administration must continue its momentum and push hard for increased liberalization and market opening from its trading partners.

In addition, the U.S., along with the E.U., seems to be the leader inthe international free trade regime. To solidify its leadership role, it must play an active role in ensuring compliance to the commitments made by its trading partners. Enforcing strict compliance among its trading partners gives the U.S. a stronger position in dealing with new issues or negotiating new agreements, since it can always say, "No exceptions can be made." Therefore, even though the U.S. enjoys a sizeable trade surplus with Korea, it cannot afford to let Korea any slack in meeting its free trade commitments.

The U.S. would seem to be on the higher ground concerning this issue. While it will be difficult find clear evidence that the Government is directly involved in the frugality/anti-import campaign, it is hard to believe that the Government is not giving at least indirect or tacit support. Whether or not the U.S. takes this to WTO is almost a moot point--the ill-will resulting from the anti-import campaign could be damaging enough in itself. The fact remains that consumption goods only accounts for 11% of Korea's imports, and the anti-import campaign will have little substantive effect on the trade and current account deficits. This being the case, the Korean Government should step forward and issue the public statement demanded by the U.S. and EU showing that it has no anti-import bias, and thereby put the ball back in its opponents court. VIP