

## MOUNTING PRESSURE IN KOREA-US AUTO TALKS

by Jong-Hoon Park

### *No Results This Round*

The U.S. and Korea recently concluded two days of working-level negotiations on auto issues in Seoul toward the end of August. The talks were basically brought on by pressure from U.S. auto makers complaining about non-compliance with the bilateral memorandum of understanding (MOU) signed in September of 1995. The two sides came away with no real results beyond agreeing to hold another round of talks in Washington next month. While the talks were not designed to produce substantive results, according to a Korean trade official, it would appear that subsequent pressure will increase, which does not bode well for Korea. The U.S. has hinted that Korea may be designated as a priority foreign country (PFC) in the auto sector under Super 301 legislation.

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### *The U.S. Perspective*

At the Korea-U.S. Business Conference held in Washington, D.C., from June 8-10, Andrew Card, president and CEO of the American Automobile Manufacturers Association (AAMA) gave a report summarizing the U.S. side's grievances. He noted that the official name of the MOU was the "U.S.-Korea MOU to Increase Market Access for Foreign Passenger Vehicles in the Republic of Korea" and that Korea's efforts to substantially increase market access for foreign autos was extremely poor. According to U.S. statistics, imports increased from 6,921 units in 1995 to 10,315 in 1996, with the market share increasing

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from 0.4% to 0.6%. He also felt that Korea's efforts to improve consumer perceptions in Korea of foreign cars were also weak, citing the anti-import nature of the so-called "frugality" campaign. While acknowledging that the Korean government did issue a statement disavowing any anti-import bias, he said that the damage had already been done. Against this background, he said that Korea's aggressive auto export stance, with over 200,000 units exported to the U.S. in 1996 alone and plans to boost this to 450,000 units by 2000, was alarming and would not be tolerated by many. In conclusion, he proposed the following amendments to the 1995 MOU: 1) tariff reduction from the current 8% to the U.S. level of 2.5% on passenger cars; 2) tax structure based on fuel usage; 3) movement to self-certification by 2000; 4) roll back in new safety standards; 5) specific timetable for liberalizing financing restrictions; 6) inclusion of market share formula; and 7) movement toward multilateral regional sector trade agreement.

The key demand of the U.S. is reducing the tariff from 8% to the U.S. level of 2.5%. Korea currently imposes thirteen types of taxes on autos, of which three are based on engine size (the special excise tax, the automobile tax and the subway bond purchase requirement). Since imports tend to have larger engines, this 8% tariff imposed on imported cars is magnified considerably in a consumer's final costs. According to Andrew Card, the price differential in the U.S. between a Ford Mondeo and a imported Hyundai Sonata (with the U.S. tariff of 2.5%) is only \$73, but here in Korea, the difference is a whopping \$2,600, largely thanks to the tariff and the cascade effect of the tax sys-

tem. The U.S. estimates that the net effect of the tariff and subsequent taxes is a minimum 14% and possibly higher, regardless of engine size, although Korea claims that it is only 9%.

*The Korean Perspective*

Of course, Korea's point of view is that it has been faithfully abiding by the MOU. At the same Conference, Thomas Dongho Lee, a representative of the Korea Automobile Manufacturers Association, rebutted by saying that according to Korean statistics, the foreign market share had nearly tripled from 0.88% in 1994 to 2.34% in the first quarter of 1997. (The difference in figures stems from the different tallying methods; the U.S. compiles stats on a registration basis, while Korea uses a customs clearance basis.) He pointed out that in 1995 and 1996, imports increased by more than 30% annually, while Korea's auto market only grew by 0.02% and 5.7%, respectively. And in the

first quarter of 1997, domestic auto sales slumped 20.7%, but imports actually increased by 13.4% over the same period last year.

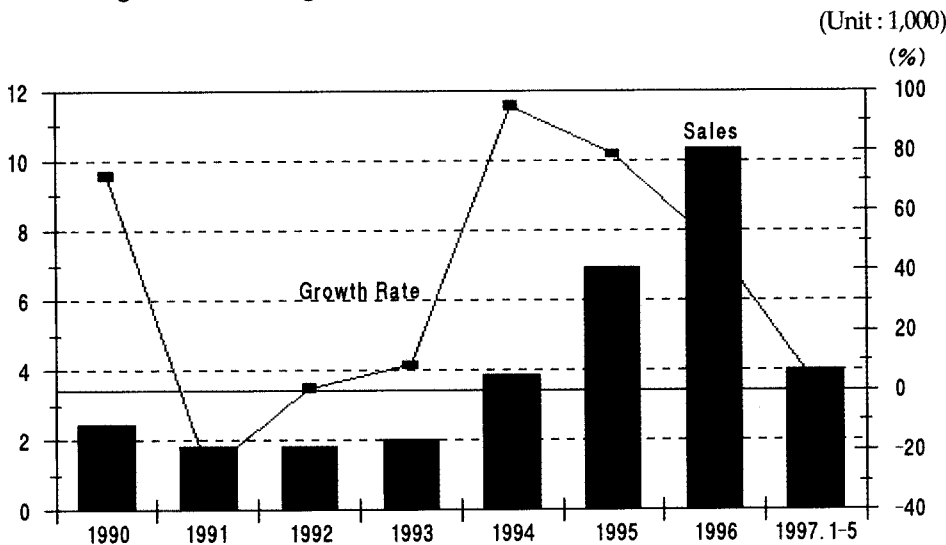
The problems with imports, he said, was not so much the lack of Korean efforts but rather the import structure, with imports being concentrated in cars with engines of over 3000cc, which account for only 0.5% of the Korean car market. For importers to increase their market share, they should concentrate on consumer needs and focus on passenger cars with engines 2000cc or less, which comprise 85.7% of the market.

Regarding the tariff issue, he noted that Korea's tariff rate on passenger cars of 8% was lower than the EU's 10%, Canada's 9.2%, and Australia's 22.5%. Furthermore, Korea's 10% tariff on commercial vehicles is even lower than the U.S.'s 25%, incidentally the highest rate among the Quad countries. He also pointed about that criticisms of the discriminatory tax system and tax investigations of auto lessees were unfounded, since they are not specifically

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<Figure 1> Foreign Import Sales and Growth Rates



Source : Hyundai Motors(1997), "Automobile Industry in 1997."

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biased against imports. Already there have been significant tax reductions, and the Korean government voluntarily stopped such tax audits as a goodwill gesture. About the frugality campaign, he emphasized that the government had no involvement whatsoever with this spontaneous civic movement and had made its position clear in public regarding imports.

### *The Larger Picture*

While the current actions have been largely spurred by the complaints of the Big Three, this auto issue has even greater importance given the U.S.'s overall priorities concerning trade, especially concerning Asia. Secretary William Daley of Commerce has outlined five priorities to pursue strengthening the U.S.'s hand in the global economy and to encourage fair and open trade, with the first two being "1) enforce full compliance with existing trade agreements and with laws against unfair trade practices; and 2) continue aggressive trade promotion and advocacy on behalf of American firms competing abroad." The U.S. government's position is that the U.S.-Korean relationship should be a two-way street with companies on both sides allowed the same level of access and has stated that it will focus on levelling the playing field in two key sectors: automobiles and telecommunications. In other words, regarding autos, the U.S. wants U.S. auto makers to face the same conditions in Korea that Korean makers face in the U.S.—hence, the demand for the tariff reduction to 2.5%.

At the Conference, Stuart Eizenstat, the Under Secretary of State for Economic Affairs, indicated that the U.S. will not tolerate anything less than fair and equal treatment for its exports to Korea and emphasized that the U.S. will not allow Korean markets to be closed to U.S. goods while Korean goods flow freely into

the U.S. market. He also stated that future trade agreements between the U.S. and Korea that do not meet these standards will not be signed by the U.S. government.

### *Analyzing Their Positions*

One of the key points the U.S. has emphasized is that the 1995 MOU was intended to be a starting point for future progress in this area, implying that even if Korea has managed to fulfill most of its obligations entailed under the MOU, that is still not good enough and room for complaint exists. On the other hand, the Korean side seems to view the MOU as more of a binding and conclusive agreement, feeling that all the necessary (and final) concessions have already been made. The attitude seems to be, "We have kept up our end of the bargain; why is this still an issue?"

The U.S.'s unhappiness over the tiny market share of foreign autos seems justified; Korea is the world's third biggest auto exporter (after Japan and the EU nations) and cannot really be considered a developing auto market. And while there may be discrepancies in the statistics, the American point is that no matter which statistics are used, the absolute numbers are unacceptably low. Even Japan, traditionally the poster-child for closed auto markets, has a much higher import penetration rate than Korea (around 6% in 1996). While conceding that the growth rates may be superficially impressive, as Andrew Card puts it, "the real numbers are so small that it's embarrassing."

On the other hand, given the current downturns in consumption and domestic auto sales, the fact that foreign sales have been increasing at a significant rate is noteworthy. And the Korean side does have a point in that the foreign import share could be boosted even further if imports were geared more toward small-

er, low-cost models rather than higher-end vehicles beyond the price range of most households. Furthermore, it is almost unseemly that the U.S. is focusing so much unilateral pressure on Korea in a specific sector when considering the larger picture; Korea has a sizeable trade deficit with the U.S. (\$11.46 billion in 1996 according to Korean statistics), one of only two such Asian economies.

### *What Should Happen*

It appears that the U.S. would like to see these matters resolved with a minimum of fanfare. The auto sector has traditionally been a contentious issue in the past, and the U.S. seems to realize that an overly vocal or confrontational approach could touch off a wave of virulent criticism against U.S. economic "imperialism" or "aggression" among the domestic press and the public and therefore prove counterproductive. Indeed, while garnering much attention earlier in the year, the U.S. criticism seems much more muted as of late.

Whether or not Korea will be able to resist the U.S. demand to lower the 8% tariff at the talks in Washington this time around remains to be seen. However, it seems to be only a matter of time before Korea is forced to give in on this matter, be it this year, next year, or even 5 years from now. While Korea's need to dig in its heels on this issue is understandable, the Korean auto industry should be preparing for more intense competition from foreign makers as each import barrier, whether it is targeted at foreign makers or not, is stripped away. The Korean market is already saturated even before Samsung's imminent entry, and a substantial increase in foreign imports would most likely come at the expense of Korean makers. While the Korean auto companies have realized this and have recently introduced new higher-end

luxury and sports-car models, this will not be enough. Besides investing more in R&D, they will need to develop better marketing and sales strategies, provide consumers with more options in terms of products and financing, and strength their services such as A/S if they are to successfully compete against foreign makers.

From a trade perspective, Korea is not totally defenseless. Some of the barriers cited by the Americans are not intentionally biased against imports, such as the cascading tax system, and to make concessions in these areas would be inappropriate. Regarding the tariff issue, Korea does have a legitimate basis for defense; only the U.S. and Japan have lower import tariffs on passenger cars. Furthermore, the existence of the WTO should make it easier for Korea to withstand unilateral pressure from the U.S. Some feel that U.S. unilateral trade pressure does not exert the same weight that it used to given multilateral options like the WTO and changes in the international economic order. Then again, given the aftermath of the Kia crisis on the entire economy, the mere threat of slapping sanctions on Korean auto exports is enough to make most Koreans uneasy, if not queasy.

Even if Seoul manages to hold off Washington this time around, the auto issue will raise its head over and over again in one form or another until foreigners do retain a substantive market share. In the short term, the Korean government should make every effort to clarify its stance on gray areas like the frugality campaign or tax audits to assure foreigners that there is no anti-import bias, at least on an official basis. In the longer run, cultivating more trade specialists and negotiators would certainly not hurt. However, if Korea is to ever free itself fully from being vulnerable to such unilateral trade pressure, it must further enhance its competitiveness and restructure the economy to make it less dependent on a single trading partner and a single industry. VIP

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**Banking Crisis (con't from p.12)**

(J.C.Kim)

The role of the government is enough if it merely facilitates the private sector's market entry and exit. Financial institutions need to be managed effectively by avoiding non-profitable businesses. To lend their money to profitable businesses, financial institutions should be able to accumulate and analyze information about a specific firm's credit and business feasibility. From the aspect of the firm, restructuring management and strengthening one's financial position is required. Investment decisions must

depend on a business' profitability, and the dependency on external financing must be reduced as well.

Along with each sector's efforts, it is also necessary for the government, central bank and financial sector to cooperate closely and counter any elements both home and abroad that damage the stability of the financial market. For this it is vital to establish reform principles and carry them out while firms should expediate large-scale, drastic self-reforms before hitting a dead end. This is the only way to survive these times of instability. **VIP**

〈HRI's Latest Revised Economic Forecasts in 1997〉

(Unit: 100 million dollars, %)

	HRI's Revised Forecasts		
	1st half (Actual)	2nd half (Forecast)	Year-end (Forecast)
GDP Growth Rate	5.9	6.6	6.3
Total Consumption	4.7	5.2	5.0
Private Consumption	4.6	5.2	4.9
Fixed Capital Formation	-0.6	1.7	0.6
Equipment	-1.5	-3.4	-2.5
Construction	0.2	3.7	1.7
Current Account Balance	-98.2	-60.8	-159.0
Trade Balance	-60.6	-20.7	-81.3
Export - Import	-91	-43	-134
Export (Customs based)	652	757	1,409
(Growth rate, %)	(0.8)	(16.4)	(8.6)
Import (Customs based)	743	801	1,544
(Growth rate, %)	(2.2)	(3.2)	(2.7)
Growth Rate of CPI (%)	4.0	4.3	4.3
Corporate Bond (%)	11.75	11.5~11.8	11.5~11.8
Won/\$ (Won)	888.1	880~890	880~890
Yen/\$ (Yen)	114.6	111~115	111~115
Unemployment Rate(%)	2.8	2.4	2.6