

U.S. Trade Tensions with Japan and Their Implications for Korea

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At least since the early 1980s, American trade policy has gradually been shifting away from its earlier stance of uncompromising adherence to the open multilateral trading system and toward increased reliance on one-on-one bargaining with individual trading partners alongside continued participation in GATT, and now the WTO.

One-on-one bargaining has taken place with a number of countries and over a variety of issues. Typically, the USTR has determined an agenda of trade acts by a trading partner that it deems unacceptable, and then meets for "trade talks" with the country's trade ministry. At those talks, USTR indicates trade practices that it finds unacceptable, and "demands" relief. I shall call the U.S. trade policies and practices carried out in this way "unilateral" to indicate that they are one-on-one, and that the U.S. seeks actions on the part of others, while turning a relatively deaf ear to any complaints others might have about U.S. trade policy.

It is these American unilateral trade policies, and especially unilateral trade policies with Japan, that are the subject of my talk today. Right away, I should make my position clear: from a global viewpoint, an open multilateral trading system is vastly superior to any set of discriminatory trading arrangements, and

actions which undermine that trading system are in themselves therefore to be deplored. Moreover, in my judgment, American self-interest lies in such a system, and in reliance upon the system for multilateral solutions to its perceived grievances with its trading partners.

To develop the argument, I will start by explaining why the open multilateral trading system deserves support, and briefly trace the evolution of the system under American leadership until the 1980s, and the consequent spectacular growth of the world economy during that period. That will lay the basis for considering the shift in American policy and the reasons for it. I can then turn to the current trade tensions with Japan, and finally conclude by considering the implications for Korea.

The Emergence of the Open Multilateral System

As the Second World War was ending, consideration was given by many, especially the British and the Americans, to the construction of a postwar international system designed to prevent a recurrence of the ills of the pre-war era. Alongside the vivid and bitter memories of the Great Depression were memories of competitive devaluations, of the Smoot-Hawley tariff, and of "beggar-thy-neighbor" tariff increases on the part of one country after another, each hoping to increase domestic employment at the expense of its trading partners but instead contributing in turn to further downward pressures on demand and employment. Indeed, in many minds, these acts breaking down the international economy were a major contributor to the severity of the Great Depression, if not even to its causation.

The principle guiding the architects of Bretton Woods was therefore to form an international monetary system (under the aegis of the International Monetary Fund) to coordinate exchange rate arrangements (to permit exchange rate realignments for a country in “fundamental disequilibrium” while simultaneously avoiding “competitive devaluations”) and an International Trade Organization to oversee an open multilateral trading system.

Although the charter of the ITO was never ratified, the key provisions pertaining to trade were rendered operative by Executive Decree in the United States and by corresponding acceptance in other countries.

The General Agreement on Tariffs and Trade (GATT) was the result. Key principles relevant for the present discussion include non-discriminatory trade (the “most favored nation principle”), the commitment to remove non-tariff barriers to trade, provisions for signatories to resort to anti-dumping (AD) and countervailing duty (CVD) measures under specified circumstances, and procedures for dispute settlement.

In addition, successive rounds of multilateral trade negotiations were to be undertaken under GATT auspices, with contracting parties negotiating with their key trading partners for reductions of tariffs on items they exported in return for “concessions” on items of interest to their trading partners. Once tariff concessions were agreed, they extended to all contracting parties (the most favored nation, or non-discrimination, clause).

The tariff rates were subsequently “bound” so that tariffs could not later be raised unless the “escape clause” had to be invoked.

The principle that each country should offer “concessions” on

its own tariffs in order to gain something (tariff reductions from its trading partners) flew right in the face of international trade theory, which shows that tariffs hurt most the countries that impose them.

However, for purposes of analyzing some of the problems associated with the increasing U.S. resort to unilateral bargaining, the principle of reciprocal concessions has important political economy implications which require stressing. That is, when bargaining is reciprocal, the interests of exporters in a given country will support the agreement and make it politically more acceptable than would be the case if unilateral tariff reduction were to be undertaken by a country. When, for example, in the Uruguay Round, the United States and other developed nations undertook to dismantle the Multifiber Arrangement over the next decade, that commitment was politically easier because American exporters of goods such as machinery supported the agreement because of promised reductions in tariffs in importing countries.

While the GATT Articles may not represent "good economics", in the sense that reducing a tariff unilaterally helps the trade-liberalizing country, those articles do represent good politics, in tying export interests to political support for trade liberalization. I return to this point below.

I need hardly remind a Korean audience of the spectacular success of the world economy under GATT auspices, and the successive rounds of multilateral trade negotiations.

Prior to the Dillon Round of trade negotiations in 1949, Europe was still enmeshed in quantitative restrictions as well as tariffs, and most European currencies were inconvertible.

Japan also was still reliant on quantitative restrictions and exchange control. Tariffs on goods averaged around 40 percent (including in the United States — the residual of the Smoot-Hawley tariff provisions).

With the Dillon Round, there started a long period of spectacular world economic growth: a quarter century that will probably go down in history as achieving the highest rate of growth of real world GNP of any comparable period in history.

In other countries, I have frequently pointed out that Korea achieved a greater percentage increase in real per capita incomes in the decade between 1963 and 1973 than the most rapidly growing country in the world did in the entire 19th century! Other countries, although their growth may not have been as dramatic, also experienced accelerated growth.

A "virtuous" circle was underway. Trade liberalization permitted more rapid growth, which in turn created a political climate in which further tariff reductions could be negotiated. Those reductions, in turn, contributed to more rapid economic growth; and so on. Tariffs, which as I said had averaged over 40 percent in the late 1940s, averaged less than 6 percent by the beginning of the 1990s. GATT was truly successful in permitting a great liberalization in manufactures.¹⁾

That trade was a leading engine of world economic growth

1) GATT was not as successful with regard to agricultural trade and services. By the 1980s, barriers to trade in these areas were clearly more of a distortion to international trade than barriers to trade in manufactures aside from the Multifiber Arrangement. It was for this reason that the Uruguay Round was so important. For purposes of analyzing current U.S. trade policy, however, those issues are not central to the analysis.

can be seen from inspection of even very basic numbers. During the 1950 - 60 decade, world GDP is estimated to have grown at about 4.5 percent annually, while world trade grew at over 8 percent. During the 1960 - 70 decade, the same sort of performance was repeated: trade growth averaged over 10 percent while world GDP averaged almost 5 percent.

Throughout those years, the United States was a staunch supporter of GATT and non-discrimination among trading partners. Indeed, during negotiations between the British and Americans leading up to the GATT articles, the United States had even opposed Article XXIV — the GATT article permitting preferential trading arrangements provided that they meet certain conditions,²⁾ while the British had fought for preferential arrangements because of their desire to maintain Commonwealth preferences.

Of course, the United States was also economically dominant, with about 25 percent of the world exports in the late 1940s. At that time, U.S. bilateral bargaining power on trade issues was doubtless very great, but American policy was instead to support multilateral trade liberalization and institutions. In part, this support resulted from foreign policy concerns, and recognition that a healthy international economy was essential for American allies given strategic concerns. In part, however, it was based on a genuine belief in the optimality of free and

2) Those conditions are: i) a preferential arrangement must provide for 100 percent reduction in duties among signatories; ii) it must be "substantially" across the board and applicable to all sectors of the economy; and iii) there must be a set timetable for attainment of the first two conditions.

open trade for both the United States and the world economy.

While the U.S. did not practice 100 percent free trade, the American economy was highly open, and there is little doubt that trade barriers in the U.S. were significantly lower than for most U.S. trading partners. It is hard to remember that, until the 1970s, even the American labor unions officially supported free trade.

It was only in the 1970s that cracks began to appear in the U.S. position. At first, these appeared relatively minor, as protectionist legislation was proposed in Congress, but nonetheless defeated.

The 1974 Omnibus Trade Bill weakened somewhat the criteria under which AD and CVD duties could be imposed on U.S. trading partners. Political pressures to make the Multifiber Arrangements more restrictive intensified. But, throughout the 1970s, these protectionist pressures did not significantly alter the U.S. support of the open multilateral system. Indeed, when developing countries sought preferential treatment under GSP in the late 1960s and early 1970s, the United States opposed preferences on grounds of principle, although GSP treatment was granted by the late 1970s.

With the 1980s, however, a large number of factors contributed to further weakening of support for the open multilateral system. A major contributor was the Reagan tax cut of 1981, and the subsequent (unintended) stance of U.S. fiscal policy. It had been anticipated that the cut in tax rates would not result in a larger fiscal deficit because of the responses to the tax cut on the supply side. When that did not happen, it was left to monetary policy to contain the inflationary pressures

that would otherwise have resulted from the budget. As a consequence, interest rates rose, and the U.S. dollar appreciated as capital inflows to the U.S. financed the deficit.³⁾

The consequent pressures on U.S. traded goods sectors were enormous as the dollar appreciated in real terms more than 30 percent over the next four years. As is well known, the U.S. trade and current account deficits mushroomed. With that, protectionist pressures in a number of the affected industries intensified.

Simultaneously, of course, the U.S. share (and therefore dominance) of international trade was diminishing as a consequence of the success of the open multilateral trading system. Many Americans were shaken by the degree of foreign competition, the difficulties some industries had despite their earlier unassailable positions (such as automobiles), and by the magnitude of the current account deficit in a country which had been a major provider of capital to the international markets a short time before. This has been termed by some the "diminished giant syndrome", pointing to the loss of a degree of preeminence in world markets. And, according to political analysts, this loss of relative position mattered in that political support for the system diminished.

In the 1980s, the earlier relatively small erosion of the American commitment to the multilateral system turned into a

3) The evidence strongly suggests that pressures for protection in the U.S. are highest when the dollar is most appreciated and when unemployment is high. Both of these factors were at play in the 1981-84 period. The recession in the U.S. was the most severe since the Second World War while simultaneously the dollar appreciated rapidly in real terms.

virtual avalanche.

There first came some specific pressures: the difficulties of the U.S. auto industry were reflected in pressures in Congress to restrict imports of automobiles into the U.S.; bilateral negotiations with Japan resulted with the consequent "voluntary export restraint (VER)" agreement of the early 1980s. The steel industry, as well, succeeded in obtaining first "trigger pricing" and then a VER with several producers. As early as 1982 - 83, the semi conductor industry pressured for relief, but no actions were taken until 1986. All these actions and others, were outside the GATT framework. Each was bilateral.

Something that was, at least in part, an accident, also contributed. In the 1982 GATT Ministerial meeting, the new USTR pushed hard for a new round of multilateral trade negotiations. Little preliminary work had been done, and no agenda established. Other countries, caught unawares by the U.S. proposal and lacking the staff work that normally preceded ministerial agreement on these issues, rebuffed the U.S. proposal. USTR, interpreting the rebuff as a lack of interest in further trade liberalization, then announced that the U.S. was abandoning its 100 percent support for the open multilateral system and instead would henceforth follow a 2-track approach: it would support strengthening the GATT insofar as negotiations would permit, and it would simultaneously attempt to go further with trade liberalization with "like-minded" trading partners in preferential trading arrangements. It was this announcement which officially marked the end of U.S. support for non-discrimination.⁴⁾

At a more systematic level, in 1979 and again in 1984, U.S.

trade legislation was amended so that relief under AD and CVD provision was more readily come by. Responsibility for determining dumping and CVD margins was shifted from the pro-free trade Treasury to the much more protectionist Department of Commerce. Simultaneously, standards for injury determination were further weakened. The new limits on a renewed MFA were much more restrictive of import growth than earlier MFA restrictions had been. Congress passed an Export Enhancement (EEP) bill, which effectively subsidized U.S. wheat exports, on the argument that other countries (primarily European) were "unfair" in their treatment of agriculture.

And, gradually, the codeword for the U.S. trade policy stance shifted from support of "free" trade to support of "free but fair" trade, words used by President Reagan in a speech in 1986. Although dollar appreciation (and with it, presumably, the height of pressure on American traded good exercised through the exchange rate) reached its peak in 1986, institutional and ideological defenses of the open multilateral trading system had been greatly weakened.

By the mid-1980s, USTR, goaded in part by the Congress, was negotiating bilaterally over trade issues with a large number of countries, including, of course, Korea. By and large, the issues over which bargaining took place were placed on the agenda by the United States. A first line of rhetorical defense for these

4) At about the same time, the U.S. unilaterally extended preferences to Caribbean Basin countries, waiving tariffs on imports of goods from them. Although this also represented a departure from the GATT principles, it was not seen at the time as a departure from the MFN principles.

measures was that these were not protectionist in many instances because the thrust of U.S. policy was to insist on "market opening" of trading partners, on the supposition that American markets were more open and that the U.S. therefore somehow had the moral right to insist that other countries open their markets.

The rhetoric of AD and CVD was well suited to this sentiment, and "administered protection" of U.S. imports began rising sharply. By the late 1980s, the U.S. was the leader in raising protection through use of those measures, with more AD and CVD filings than any other country in the world.

Despite the depreciation of the dollar after 1986, the appeal to fairness and the protectionist pressures that had built up could not readily be reversed. To be sure, the Uruguay Round was launched with support from the United States. Nonetheless, in 1988, the Omnibus Trade Bill that passed the U.S. Congress contained "Super 301", which instructed USTR to investigate the trading practices of other countries, and to report to Congress those countries and those practices which were "unfair" trading measures.

In addition, USTR was to analyze the intellectual property rights protection accorded in other countries and, again, to report to Congress on situations deemed unsatisfactory. When the USTR pinpointed such measures in its report to Congress, it was instructed to negotiate (bilaterally) with the trading partner's government to seek relief from the "unfair" practices. In the absence of a successful negotiated solution, USTR was to impose punitive tariffs on designated imports from the offending country.

Super 301 was clearly inconsistent with the GATT articles, where dispute procedures were/are available for GATT-inconsistent practices. Moreover, having bound tariffs under GATT, the U.S. could not legally raise those tariffs because other countries took actions (not sanctioned by GATT) it deemed inappropriate.

Undeterred, USTR began negotiations with a large number of countries, raising whatever issues were deemed significant for the U.S. These included a wide variety of measures with a large number of countries. In the event, Brazil, India and Japan were the three countries cited as “unfair traders” in the USTR report to Congress, but only after a number of other countries — including Korea — yielded to pressure from the USTR on a number of trading practices. Super 301 was quietly dropped from the Trade Act of 1990, although President Clinton reinstated it in the winter of 1994. It typifies the current U.S. tilt toward unilateral actions: while USTR may pinpoint any action or set of actions that it wishes to see altered, the trading partner has much less leverage — if any — with the U.S. and cannot effectively insist upon reciprocal concessions.

Indicative of continuing U.S. schizophrenia, the Super 301 bill was passed while the Uruguay Round was under negotiation. When negotiations were successful to begin covering services, agriculture, and intellectual property rights under a new WTO, many of the U.S. complaints about hiatuses within the GATT system were met. Yet, in the U.S., many claimed that that would diminish U.S. sovereignty.

Trade Tensions with Japan

As already mentioned, VERs with Japan on steel and autos had already been agreed in the early 1980s. In 1986, the U.S. semiconductor industry succeeded in pressuring the U.S. government to enter into a Semiconductor agreement with Japan, under which there were a number of undertakings. One of these was that the Japanese undertook not to sell their chips in the U.S. at less than a specified price; another was that the Japanese would not sell in third markets at less than the same price; and still another (reported to have been contained in a "secret" letter, the contents of which have never been revealed) was a Japanese "understanding" that the foreign share of the Japanese semiconductor market would increase to not less than 20 percent.

This was surely unilateral action at its worst: not only did the U.S. negotiate outside the GATT framework with Japan; the U.S. insisted that Japan raise its price *vis-a-vis* third countries! When subsequently the Europeans protested, the third-country part of the agreement was disbanded; when, at about the same time, the world ended up with a shortage of semiconductors and U.S. user firms were unable to obtain an allocation, that part of the agreement as well was abandoned, leaving only the 20 percent market share undertaking.

Whether Japan agreed to the 20 percent import market share or not is a subject of dispute. What is clear is that the agreement set a precedent. A next step was the "MOSS" (market opening strategic sectors) talks, in which USTR again listed trade practices of the Japanese it deemed unfair.

By 1993, when the Clinton Administration took office, it indicated its intent to resume these negotiations, indicating that past talks had yielded unsatisfactory results (from the viewpoint of the administration) and insisting that “quantitative indicators” of Japanese progress be agreed upon.

The rest is well known. After painfully slow negotiations, settlements were reached with respect to several U.S. demands, but the Japanese were unwilling to yield to U.S. insistence that Japanese practices with respect to imports of autos and auto parts be changed. The particulars of the demands (that dealership practices in Japan be altered, that the U.S. government representatives be permitted to talk directly with Japanese automobile manufactures, and so on) are not important.

What is important is that the U.S. has threatened under Super 301 to impose punitive (100 percent) tariffs on Japan should agreement not be reached within 30 days (which will be before the end of June). Raising these tariffs is hardly consistent with U.S. obligations under WTO; and, while Japan has said that it will take the U.S. to the WTO, the U.S. has insisted that it would go forward with its unilateral measures while simultaneously complaining to the WTO about “nullification and impairment” by Japan of tariff concessions because of “unfair” trading practices. The preponderance of opinion among international trade lawyers is reported to be that Japan appears to have a reasonably strong case against the U.S., while the American claims against Japan are considerably more doubtful.

Before turning to the implications of all this for Korea and for the international economic system, it is worth pausing to attempt to understand why there is such intense pressure by

the Americans on the Japanese. While there are undoubtedly aspects of Japanese policy that discriminate against imports (and are therefore deserving of negotiations under WTO), there are arguably at least as many aspects of European policy that give rise to objection.

Moreover, the argument most frequently used by the U.S. (after "unfairness"), that the U.S. has a very large bilateral trade or current account deficit with Japan, does not withstand analysis. Regardless of their political and economic views, all economists agree that the overall current account position of a country is a function of its savings and investment decisions; changes in the current account cannot take place unless the savings-investment balance also changes. Moreover, bilateral balances are not meaningful: it is very likely that measures which might reduce American imports from Japan would increase American imports from third countries and, at the same time, by inducing some degree of dollar appreciation, would reduce American exports to Japan (and elsewhere) somewhat.

Another explanation which has been offered centers on U.S. perceptions of stagnation in the real wages of unskilled workers, and their association of that stagnation with increased imports from Japan of goods highly competitive with American workers in "rustbelt" industries. This explanation is close to the "diminished giant syndrome" explaining the increase in American protectionist pressure more generally.

Yet, a third explanation is that U.S. pressures *vis-a-vis* Japan are but one more tactic used by protectionists who believe that they can persuade the American public, and therefore American politicians to adopt protection by appealing to the "unfairness"

of the Japanese. It has been pointed out that, until fairly recently, Europe was a significantly larger trading partner of the U.S. than was Japan, and that U.S. pressures on Japan may have been greater simply because Japan was more susceptible to U.S. pressure than were the Europeans.

Implications for Korea

The implications of U.S. trade tensions with Japan are much the same as the implications for other open trading nations: to the extent that the U.S. continues to exert unilateral pressures, it is undermining support for the open multilateral trading system that is so important for all the world's economies. As such, all countries have a considerable stake in attempting to remove U.S.-Japan trade conflicts from bilateral negotiations and in placing them in the context of the WTO.

For Korea, the stakes are many: first, should the U.S.-Japan disputes result in a weakening of the WTO, a weakening of the multilateral trading system will automatically result. As a country highly dependent on a healthy international economy for its growth prospects, Korea has a great stake in the success of the WTO.

Secondly, Korea has a stake in helping to formulate "rules of the game" under the WTO, and abiding by them, rather than dealing one-on-one with the United States. Even when the U.S. is insisting on a form of market opening that is in any event in Korea's self-interest, it is probably more satisfactory for Korea politically to undertake that market opening in the absence of direct U.S. pressure.

Third, there is always the risk that U.S. insistence will go beyond things that are in any event conducive to greater liberalization and therefore economic efficiency in Korea, and may extend to demands for actions that are inimical to economic growth. In addition, when the U.S. bargains unilaterally, issues are chosen which are of greatest concern to Americans, often without regard to the effects on third countries. Korea may wind up as a third country, harmed as a by-product of U.S. negotiations with a Korean trading partner.

Finally, and perhaps most important, if the U.S. succeeds in bargaining on issues of its choosing on a one-on-one basis, the political pressures within the U.S. that have supported the open multilateral system will be further eroded. When American exporters believe that they can achieve advantage through USTR negotiations with Japan, for example, they are less concerned about multilateral bargaining. When their concerns diminish, so too does their support for the process. That, in turn, enables politicians to go further down the unilateral road, thus further distancing the U.S. from its earlier unequivocal support of the open multilateral system.

Achieving these ends is not something Korea, or for that matter, any country, can do by itself. However, all countries can contribute to the desired outcome by their own support for the open multilateral system and pressures to use WTO mechanisms, rather than bilateral fora, for dispute settlement. This means, first and foremost, providing as much economic and diplomatic support as possible for the fledgling WTO, even including representations to the U.S. regarding Korea's stance with respect to unilateral trade actions. After all, if the U.S.

performed until MITI raised the targets for small firms. This is neither a market system nor efficient trade. In fact, comparative advantage in chips has changed enough so that the U.S. right now is exporting more advanced chips so that the 20 percent target is met. However, that is just a coincidence. Second, there is nothing in economics that tells us what the share of the consumption of any particular country of any commodity should be imported. And, to set these diplomatic targets doesn't make any economic sense. What does make sense is to agree upon processes and procedures multilaterally. If there are problems, we will then take them to the WTO where there is strength in the dispute resolution procedure. As it happens from what I understand in the case of auto-parts, first off, according to U.S. lawyers whom I have talked to, there seems to be an agreement that there is nothing illegal about how the Japanese are dealing with their automobile dealers compared with how the U.S. is dealing with U.S. automobile dealers. If that is true, what is the basis of the objection? The United States has advanced auto-parts as the subject of negotiation and to get into these issues seems to me to be the antithesis of market-based open economies. It is not conducive to economic efficiency and, if anything, it is conducive to cartelization of those particular sectors. Therefore, my first answer is if there are practices that we believe are not consistent with fair, open multilateral trading system, let us agree under the WTO that we are not going to follow these practices. If one of us believes that another country is cheating, then let us take that to the WTO and we are then all on equal terms. Otherwise, you get a big country like the United States deciding that it doesn't like, for example, what

Korea is doing. I think this is a formula for going further and further down the road until some country, like Japan or maybe Europe, says "enough is enough" and tariffs are raised by the U.S. and eventually leading to a trade war which would damage everybody.

Now, you asked about the current account deficit in the U.S. The U.S. has to the lowest savings rate of any OECD country. The problem in the U.S. is low savings relative to investment. The U.S. has to increase its savings and that has to be done by the public sector because the public sector is identifiably a large source of negative savings. The current account is equal to the difference between domestic expenditures and domestic income which means that the U.S. is spending more than its income. As long as the U.S. starts doing that, no amount of protection or anything else is going to change the U.S. trade balance or the current account balance. In fact, to a first approximation, even if the Japanese took 10 billion dollars more of U.S. imports, arguably that is not going to affect very much the trade imbalance in anything more than the shortest of runs. What will happen is that there is going to be an exchange rate change and there will be more imports into the U.S. and there will be a whole mess of other reactions and most of that 10 billion dollars will be quickly dissipated. The U.S. has to do something to cure its own imbalance.

Q Mr. Soon Hwan Cho (Member of the National Assembly)

I understand that Secretary Christopher recently proposed the Trans-atlantic Free Trade Area which involves merging NAFTA

and the EU. Would you give us your view on this? Also, if TAFTA is formulated, I think China, Japan, Korea and ASEAN countries will try to make some kind of anti-western economic alliance. Would you comment on this?

A Professor Krueger

Well, I find the whole idea of overlapping trade areas difficult. In fact, in some of my recent works, I have been critical. Secretary Christopher did mention TAFTA and the whole idea was not to merge it with NAFTA, but have TAFTA, NAFTA and APEC. In that regard, I believe that those who talk about this have not begun to think through what would be involved in the multiple overlapping trade areas. And, my argument is very simple. If we are going to have TAFTA, NAFTA and APEC, why don't we have it through WTO and avoid all this silliness. It seems to me it is taking my case for me.

I am very nervous about this for many reasons. Free trade areas are not customs unions and free trade areas have rules of origin. Rules of origin are difficult to administer and I can just imagine the fun and games when you have different rules of origins for different countries. It seems to me that the only people who would gain would be the international trade lawyers who specialize in rules of origin. This is no way to run a world. The estimate is that even when it was just European Free Trade Area and EU and these two groups had a free trade agreement between them in manufactures, European free trade exporters preferred to pay a tariff of 5-6 percent, rather than try to satisfy the rules of origin within the EU. A good estimate of the cost

of the protective equivalent of rules of origin was 5-6 percent of the CIF price. Many Mexican exporters claim that they are worse off now entering the U.S. even when they have 0 percent tariff than they were before because of the rules of origin. So, once you get down the free trade area route there are all kinds of technical complications that seem very serious. I do think the polarization of the world and having disputes between the U.S. and Japan context are very dangerous ways for the world economy to go.

Q Dr. Kap Soo Lee (Research Fellow,
POSCO Research Institute)

A client working as an economist at IIE said on *The Asian Wall Street Journal* that the U.S. unilateral sanction against Japan was truly absurd and awkward. He added as evidence that the market share of Germany in Japan is 4 times as high as that of America in Japan. If Japan accepts the American request of expansion of German car dealership network, but does not accept the request for auto parts, what would be the strategy against Japan?

A Professor Krueger

I only know what I read in the newspapers. But, it is my reading that the Clinton Administration miscalculated. They expected what happened before would happen again and they would go around brandishing their big stick. And, the Japanese could accede to something making it possible for the Clinton

Administration to be victorious and use that politically in the U.S. There are a number of reasons for thinking this as absurd and there are many reasons for believing that perhaps the Japanese would not yield this time and that we will see a 100 percent tax and other distressing events.

One of the more distressing in my opinion is that if the WTO takes up the Japanese complaint that the U.S. actions are WTO illegal, the concern is that the WTO will follow the normal timetable and that its findings will come right in the middle of the U.S. presidential campaign. That would be politically dangerous because trade policy, unfortunately, is not something of which the average voter is well informed. So, I think there is ground for concern if the dispute goes on. However, even if the dispute is resolved, I am concerned that this will happen the next time and we will get there anyway. And, what is worrisome here is this unilateral method which is the way U.S. trade policy is organized.

Q Mr. Sang-Seol Lee (President, Woljeong International)

I am an independent international marketing consultant. Is Korea a fisherman benefitting from U.S.-Japan trade frictions or a small shrimp being crushed by the fight between the two big whales?

A Professor Krueger

I have not followed the particulars of the Korean policy. However, it is my impression that trading country representa-

tives have been supportive of the Japanese position in open fora precisely because they recognize their vulnerability. Certainly, the Europeans in public have been most supportive of the Japanese use of the WTO processes. I think the support for Japan has been unanimous for what I think for largely the right reasons, namely the belief that this is undermining the system. What Korea is doing otherwise I don't know and whether Korea is benefitting I am certainly not aware.

If Korean policy thinks that it can benefit from this trade dispute, I think that is tragically mistaken even in the intermediate run. I do not think that is a path that will lead to gain because this is a path that will push us further along the path of unilateralism.

Q Mr. Gilles Dufresne (Commercial Attache,
French Embassy in Korea)

You talked about some preferential agreements regarding some industries between Japan and the U.S. What do you think about some financial industries and the current negotiations going on with Japan regarding financial services?

A Professor Krueger

As you may know, in the Uruguay Round agreement it was determined that every country should have a submission on what it would do in terms of financial services. And, this should be negotiated by June 30 of this year. As of the last I saw, that negotiation was not going as well as it might have and I

judge that to be very important. The problem with services is that barriers to each kind of services are different. And, in a sense, they should be determined on a service-specific basis which is a fact that makes those negotiations very difficult. The U.S. was initially supportive and is saying that it will withhold the nondiscriminatory aspect of services unless other countries give as much as the U.S. want. This is part of the same move toward the unilateral. I am a little bit more optimistic that in a short run it can be resolved and that the system can go forward. I don't like the unilateral aspect of it and certainly it is not the policy I would advocate. Unless things go worse than was projected in the beginning of June, I am not as concerned that we will weaken the whole system if we don't get further at this stage.

Q Dr. Sang-Jun Chun (Research Fellow,
Hyundai Research Institute)

In view of the current U.S. pressure on Korea in bilateral negotiations, there doesn't seem much scope for Korea to avoid ever-increasing demands. Do you have any suggestions for the Korean government, especially for those participating in trade negotiations in dealing with USTR officials within the rules of the WTO system?

A Professor Krueger

That is a hard question and it is hard for two reasons. If I knew everything I should know it still would be very hard.

However, since I don't know everything I should know it is just about impossible. As I tried to say in my talk, if I were in the Korean trade ministry, I would try and anticipate things that were sort of red herrings that the U.S. could pick on and try to get rid of those before the US gets there, partly because some of these things probably don't do much good for the country anyway and would attract unilateral action.

Certainly, I think the most important thing Korea can do is to do everything they can diplomatically to support the WTO. This could be wrong, but my sense is that most trading nations, including Europeans, are so used to U.S. leadership that they are standing back and assuming that the WTO will work. And, I do sense that they could give much more constructive support and thought concerning what is happening in Geneva now. My sense is that, in a way, the folks over in Geneva are pretty isolated in trying to get things going. And, there might be ways whereby some of the important trading countries, not Japan and U.S., Europe, could be very important as a source of support. I was once an international civil servant and I can tell you about more than one occasion when the support of a country like Korea was much more important than you might have guessed.

Q Dr. Yen Kyun Wang (Professor, Choong-Ang University)

I have a long time dream about the world trade imbalance being solved. We know that, as a mathematical rule, Japan will have to have a trade deficit and U.S. a trade surplus in order to save the world. Otherwise, the U.S. and capitalism will go

bankrupt. When do you think the reverse will happen and what will be the main factor?

Some have suggested the aging of the Japanese population.

A Professor Krueger

Well, I don't know. One comment is that when I was a graduate student one of the books I read for my international economics course was the *Dollar Shortage*. A lot of literature at that time talked about what in the international economy meant that the U.S. would always have a huge technological lead and that other countries could never compete with the U.S. Of course, even as I was studying this, the U.S. was shifting away from its preeminence. My suspicion is that there are several things going on in the world right now that are changing things *vis-a-vis* Japan and we are sitting here thinking about that problem when it may be on the way to resolution.

You mentioned the aging of the Japanese population and I have not studied that carefully, but the numbers I have seen are impressive. There is bound to be some changes in that direction. In addition, the Japanese are marvelous tourists and they do see what life is like in the rest of the world and we all know that the Japanese in some degree have neglected their own infrastructure — roads, schools, housing. And, it would not surprise me to see that coming in just at the time of the aging of the population which will again move again in the same direction.

The third thing though and the irony is that if the U.S. is right and if the Japanese practices are anti-competitive as the

U.S. says and if we all really believe in markets the Japanese won't do very well in the foreseeable future because those impediments will do them in. And, if I really believed the U.S. line and if I were a USTR then I would be asking Japan to cartelize their industry and be anti-competitive because they would be the surest formula for U.S. success in the long term. If you believe that the Japanese have all these restrictive practices, then that is going to do them in unless they change them. I think there are many things going on here and I do hope that the Japanese continue to do well and to do so they have to open up their markets anyway. To open up, I think, means paying more attention to infrastructure and other things that will pull resources out of trade and in to home goods. And, by the time I add that together I think we can come back here in 2005 and talk some other nation's dominance.

C Dr. Il SaKong (Chairman & CEO,
Institute for Global Economics)

If the current administration is able to solve these problems, I am sure that one of these days the U.S. president will draft Professor Krueger to head the USTR, whether she likes it or not. But, in any case, being the president of the American Economic Association, she will exert leadership and will be very effective in influencing U.S. trade policy.

