

The Uruguay Round, NAFTA, and U.S.-Korea Economic Relations

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Good morning. I am extremely honored to be invited to participate in this meeting, and I want to extend my thanks to Dr. SaKong and his colleagues for enabling me to be here today. I have learned a great deal from Dr. SaKong about Korea and the Korean economy over the years that I have known him and during his tenure at our institute in Washington. There is much knowledge in his new book, which I greatly commend to you.

I hope this morning to reciprocate, to a small extent at least, by offering you some views on trade negotiations both in the GATT and in North America, presenting to be sure an American perspective but hopefully one that will provide better insights on implications for U.S.-Korea relationships and for the Korean economy. I should note that my remarks, although I was formerly a U.S. government official, do not necessarily reflect those of the U.S. government -- but they should!! My work is designed to try to influence the U.S. government to achieve a much more open and internationalist trade policy.

By way of introduction, I would like to discuss the geographic pattern of U.S. trade; in some important respects it is comparable to the Korean trade pattern. It is very diverse; there is no distinct regional focus for U.S. trading interests. Indeed, the Pacific Basin accounts for almost 35% of total U.S. trade, with U.S. regional partners in North America accounting for only a little more than a quarter, and Western Europe for a little less than a quarter. U.S. export shares are fairly evenly divided between the Pacific Basin,

North America, and Europe; by contrast, U.S. imports are much more skewed toward the Pacific Basin, thus accounting for our very large regional trade deficit. In fact, most of our trade deficit is generated by countries in the Pacific Basin.

I mention these data to draw three very simple policy conclusions about U.S. trade policy. First, the U.S. has global trading interests. It thus has a big stake in maintaining and strengthening the GATT system. Second, concerns about the United States refocusing its trade policy and its trade priorities towards its neighbors in North America, or even more broadly in the Western Hemisphere, are greatly exaggerated. U.S. trade with North America and South America combined is still slightly less than our trade in the Pacific Basin. Third, U.S. trade policy will continue to focus on the Pacific Basin, if for no other reason than this is the region where we have large bilateral trade deficits. As an economist, I know bilateral deficits are not a good guide for economic policy -- but they are a leading indicator of current and potential trade friction. The large bilateral deficits with Japan, with China, and with Taiwan will continue to generate protectionist pressures and market opening demands by the United States with a strong regional flavor.

The U.S. - Korea trade relationship will undoubtedly be affected by these pressures, but I expect bilateral disputes to receive a much lower political profile. Nonetheless, there is scope for some sideswipe as attention is focused on the Pacific Basin.

I think those three points need to be kept in mind in discussing the Uruguay Round and the NAFTA (North American Free Trade Agreement). Taken together, those three policy conclusions imply that multilateral initiatives and regional initiatives are complementary. They are not an

"either/or" proposition.

Indeed, regionalism and multilateralism have coexisted throughout the post-war period and have reinforced each other. The reason, I believe, is because there has been on-going multilateral trade liberalization, which has provided an important umbrella for regional trade liberalization. Regionalism in the absence of a successful multilateral trade liberalization, however, can provide disincentives to further liberalization and thus can be dangerous. With that brief introduction, I would like to turn to the Uruguay Round.

THE URUGUAY ROUND

Because of U.S. global trading interests, the Uruguay Round -- which has been underway for almost seven years now -- should remain the top priority of U.S. trade policy. GATT trade reforms could yield very large long term dividends for the United States and for the other participating economies. Indeed, a study done a few years ago by the U.S. Council of Economic Advisors estimated that the global benefits, after a ten year period, from a successful Uruguay Round would yield an increase in global output of about five trillion dollars; for the United States there is a large stake both in terms of efficiency gains and increased output. Such large numbers explain why extensive efforts are urgently needed to bridge the remaining differences so that negotiations can be successfully concluded in Geneva, hopefully by the end of this year.

What is the current status in Geneva? Right now the negotiations are in suspended animation. Uncertainty about the upcoming French elections and about the extension of U.S. fast-track negotiating authority have caused the talks to

grind to a halt. Participants are clearly waiting a signal from the United States and the European Community to resume the talks -- which has been the case literally since the United States and the European Community reached a tentative agreement on agriculture in November 1992 (which hopefully will lead to a successful GATT package later this year). But, to date, that agreement has been blocked within Europe by French opposition.

I fear that the French will continue to pose a problem in the Uruguay Round in the coming months, even after their election, because the likely victory by the conservative party in the parliament will lead to the type of gridlock that one has seen in the United States in recent years between the Republican president and the Democratic Congress. In France there will probably be a socialist president and a conservative parliament. The French call this cohabitation, but what it really means is gridlock. Cohabitation implies a degree of intimacy between the two partners, which will probably be lacking in this case since intimacy was tried before in an earlier period and resulted in one partner taking political advantage of the other. And so I believe that French politics will pose problems for Europe and complicate the conclusion of the Uruguay Round.

To hold together European support for the Uruguay Round, and in particular for the agricultural agreement which lays the foundation for a broader GATT accord, the United States and other countries will have to push for a speedy resumption of the talks and hopefully a fast movement towards resolving the remaining differences outside of agriculture in the coming months.

I think the United States will soon give a strong positive signal for the resumption of talks, and that President Clinton will seek an extension of fast-track authority both

for the conclusion of the Uruguay Round and for the negotiation of free trade agreements with other countries in the future. He is likely to seek a very limited term for the extension for the GATT talks, perhaps six to twelve months to put pressure on the negotiators to conclude, and a longer authority (several years) for bilaterals -- which leaves open the possibility for future expansion of the NAFTA or other bilateral free trade agreements between the United States and other countries around the world, as well as initiatives in Latin America and in the Pacific Basin that have been underway for a few years.

Two risks arise if the Uruguay Round talks are delayed and drift well into 1994. First, industry or sector-specific actions to address long standing disputes could complicate the negotiations. One can already foresee problems arising because of the steel anti-dumping cases, and maybe disputes over semi-conductors as well, perhaps more with Japan now than with Korea after the announcement yesterday. The second risk is that the longer the negotiations drift, the more the French have an opportunity to try to unravel the agriculture deal. This will be a prime objective of the conservatives in the French parliament, and if that deal put together last year unravels I think it will be very difficult to put the Uruguay Round package back together again.

Given that forecast, what needs to be done in the Uruguay Round to reach a successful conclusion? I think in the coming weeks, one will see a resumption of the negotiations between the United States and the European Community. I am cautiously optimistic that there will be some progress between the two elephants of the trade negotiations, but I issue a warning for Korea and other countries: just as bystanders can get hurt when elephants fight, they also can get rolled when the elephants make love. One has to be

particularly concerned about this if the United States and the European Community get together in the areas of anti-dumping and textiles, because it could have significant implications for the agreements worked out to date in the Uruguay Round.

For that reason, I think the proper role for Korea and other major trading countries should be to get more involved in the GATT negotiations right now, to take initiatives regarding trade liberalization in goods and services sectors, to promote compromises among the other important trading nations, and to keep the elephants on the proper path of multilateral trade liberalization.

What needs to be done? I think the final Uruguay Round package should incorporate much of the Dunkel draft that was issued in December 1991. The Dunkel draft catalogued the impressive results that had been achieved ad referendum in Geneva over the first 5 years of the negotiations, and offered compromise solutions for those areas (notably agriculture) where agreements had not yet been reached. However, the Dunkel text is incomplete. Unless it is augmented with additional market access commitments in both goods and services sectors, including additional details on commitments regarding agriculture liberalization as well, the Uruguay Round package will have not reached the critical mass needed to insure its ratification in the major trading countries.

In addition, I think certain draft accords reached in Geneva will need to undergo various stages of fine-tuning. At the top of this list I would put the amendments to the GATT anti-dumping code. They satisfy neither exporters nor importers; they don't take care of the demands of developing countries nor of developed countries; they are basically not worth the political battles they provoke and should be

dropped. I think the best solution to the anti-dumping problems in the Uruguay Round is to rely on existing rules for the time being, and then restart negotiations in the next round with more of a focus on competition policy aspects rather than a focus on trying to augment the already intricate rules on anti-dumping.

More modest revisions are also required in the GATT text on intellectual property, on sanitary and phytosanitary standards, and on the provisions for a new multilateral trade organization. Despite concerns in some developing countries, and despite strong opposition by major components of the U.S. industry, I believe the draft accord on textiles, though imperfect, should not be reopened. Any attempt to change it will lead to an unraveling of that central agreement and make it much more difficult to piece together a liberalization package in the Uruguay Round.

Finally, I believe the Uruguay Round package will have to assuage the concerns of environmental lobbies that the nexus of trade and environmental issues will be more adequately addressed in future GATT negotiations. To that end I believe the GATT should commission a new Wiseman's group, much like was commissioned in the mid-1980s to recommend terms of reference for the Uruguay Round negotiations, to cover new issues as trade and the environment, to lay the foundation for discussions of competition policy, to supplement the initial negotiations on investment issues which to date have yielded rather meager results, and to deal with other items left unresolved in the Uruguay Round. The Wisemen should submit their report within six to nine months after the conclusion of the Uruguay Round, with the aim of launching new negotiations by the end of 1995. I think this would maintain the momentum for trade liberalization and respond to concerns that, although some

issues will not be fully resolved in the current negotiations, a new process will soon begin (thus not repeating the lengthy period of time between GATT negotiations that has occurred in the past).

Korea and other developing countries should urge the G-7 leaders to institute a full-court press to resolve these remaining issues in the coming months. The Tokyo Summit provides a useful opportunity to promote compromises that can then contribute to the successful negotiation of the Uruguay Round package of agreements in Geneva in the latter half of this year. I remain cautiously optimistic that we will see a success in the GATT talks by the end of this year or early 1994.

THE NORTH AMERICAN FREE TRADE AGREEMENT

My optimism also carries over to the issue of the North American Free Trade Agreement. It is worth spending a few minutes to give you at least the highlights of the NAFTA based on my new book, *NAFTA: An Assessment*. It is important to understand what the agreement does and how it affects existing relationships. To a large extent, I think the proponents of the NAFTA have exaggerated its benefits, and the critics have exaggerated its costs -- and that holds for both the domestic debate in the United States and also for foreign criticisms and comments on the implications of the NAFTA for trade between the United States and non-member countries.

In essence, the NAFTA is a new, improved, trilateral version of the Canada-U.S. free trade agreement. In large part, the agreement is about Mexico joining the existing club, and thus involves commitments by Mexico to trade and investment reforms comparable to those undertaken by the

United States and Canada in their bilateral free trade agreement. However, the NAFTA goes even farther by augmenting much of the unfinished business of the U.S.-Canada talks, including coverage of intellectual property protection, investment restrictions, and transportation services. It also improves importantly on many of the draft agreements negotiated in the Uruguay Round, particularly with regard to intellectual property, sanitary and phytosanitary standards and investment issues.

The NAFTA is a reciprocal free trade agreement, really the first of its kind between a developed and a developing country. The NAFTA provides for the phased elimination of all tariffs between the United States and Mexico, and most non-tariff barriers over a period of about ten years, though in a few select cases where there is particular import sensitivity the liberalization schedule is extended for fifteen years. In addition, the NAFTA extends the innovative dispute settlement mechanism of the Canada-U.S. free trade agreement to Mexico; it contains precedent setting rights and obligations on services and investment; and it takes an important first step in addressing cross border environmental issues.

The NAFTA negotiations were completed last year and the agreement was signed on December 17, 1992. The ratification of the agreement is now proceeding in the three countries. In the United States there is strong opposition from labor and environmental groups. I think much of their concerns have been generated by long-standing problems in the U.S. economy relating to labor adjustment, and to concerns about pollution control and abatement. In other words, they are basically focusing on problems that exist in the U.S. economy, indeed existed before the NAFTA, and would exist even if the NAFTA was not enacted. But the NAFTA has

created a political platform for these interest groups to pursue a broader national debate of these long-standing problems of labor adjustment and environmental control. They see the NAFTA as a way to push their concerns on the national agenda, and they have used that podium very overtly to focus the NAFTA ratification debate in the United States on these two issues.

I think President Clinton has adopted a very good strategy to deal with ratification of the NAFTA. First, he has announced that he will accept the agreement as negotiated and seek its ratification rather than try to fine tune or renegotiate the terms that were worked out between the three countries last year. Second, he has proposed to negotiate additional agreements to supplement the rights and obligations of the three countries, particularly in the areas of labor and environment, and to promote greater cooperation by the three countries in those areas. Those side agreements will likely include the establishment of trilateral commissions to monitor labor and environmental conditions in the three countries, and new provisions to help encourage the compliance with national laws and regulations on labor conditions, worker rights, and environmental control. The third element of the Clinton strategy is basically to use these supplemental agreements as lightning rods to divert criticism from the NAFTA agreement itself to the new side agreements. I think much of the debate in Congress will focus on whether the side agreements alleviate many of the concerns in the Congress about labor adjustment and environmental controls.

All three countries see the Clinton strategy as a positive way of dealing with the NAFTA critics in the United States, as opposed to trying to weaken the existing agreement by deleting some provisions or adding new provisions that allow

for increased protectionism to deal with labor problems. I think this is a positive step forward and strengthens the area of cooperation between the three countries. It is important to mention these agreements for Korea and for other countries, because these additional rights and obligations are likely to set precedents for trade agreements that the United States will seek to negotiate with other countries in the future both in the GATT and bilaterally, and so it is worth looking at the NAFTA both as a model and providing precedents for future trade negotiations by the United States.

Before I turn to that final subject, however, I would like to raise the issue of what impact, if any, the NAFTA will have on the bilateral trade of the United States and Korea. My brief introduction on the NAFTA perhaps does not dramatically state the case as well as it should. I believe in most cases NAFTA preferences will not have a significant impact on foreign suppliers to the U.S. market. There is a simple reason: existing barriers to the U.S. market are already relatively low. Moreover, Mexico already enjoys extensive preferences both under the GSP and under various in-bond duty drawback programs that have essentially opened the U.S. market through unilateral preferences and concessions to Mexican suppliers.

Even in import sensitive sectors such as textiles and apparel, the average tariff that a Mexican exporter faces on his shipments to the United States is only in the range of about 6 to 8%, much lower than the MFN tariffs faced by other suppliers. And the U.S. import quotas applied to Mexican textiles and apparel, and steel, have been greatly expanded over the past few years; indeed, for most products, the quotas have been enlarged so much that they don't bite. There are a few notable exceptions on a few apparel products

and on a few steel products, but by and large most of the U.S. controls on Mexican goods really are not binding.

The major exception is in the area of agriculture. Here the NAFTA provides very significant and precedent setting reforms between the United States and Mexico, including the elimination of trade barriers in the most sensitive sectors over a fifteen year period.

Because Mexico already enjoys relatively unfettered access to the U.S. market, the scope for potential new trade diversion is quite limited. That does not mean to say that the existing preferences under GSP and the in-bond duty processing programs don't discriminate against foreign suppliers -- in other words, some trade diversion already exists, but the additional discrimination implied by the NAFTA should be quite limited.

However, I need to add an important qualification to that last statement, because the NAFTA includes industry specific rules of origin that may pose problems for Korea and other Pacific Basin countries in a few specific sectors. The NAFTA contains 193 pages on rules of origin; almost 10% of the entire agreement is the chapter on rules of origin. This is a clear indication that the issue has enjoyed a very prolonged political massage, and the interpretation of these rules of origin will remain susceptible to political manipulation in the future. I think this problem is most important in the area of textiles and to a lesser extent in the auto industry, where the origin rules are much more restrictive than comparable rules in the U.S.-Canada free trade agreement. And perhaps even more important, the NAFTA rules of origin provide an unfortunate precedent that may be emulated in future trade agreements, not only by the United States but by the European Community and others. Instead of going into the details on how these rules will be applied, I will be

happy to answer questions -- but I should note that this is an area where one should be alert to the potential impact on U.S.-Korea trade.

The NAFTA, as I said, has been regarded as a model for future trade pacts that the United States may seek to negotiate in the future. I think it might be more accurate to say that it sets the core agenda for those future trade negotiations. Indeed, the future agenda will likely include an even more extensive array of non-trade issues, since the U.S. Congress will probably insist as a condition for the renewal of fast-track authority that the U.S. negotiators address an increasingly broad array of non-trade issues (such as environment, democratic rule, human rights enforcement, and worker's rights) as objectives that the United States needs to attain in a trade negotiation. So trade negotiations are going to become much more messy than they have been in the past. And they have already been quite messy affairs from time to time!

There are two ways the United States could enter into new agreements: one would be to negotiate separate free trade agreements between itself and other countries around the world; the other way is by enlarging the NAFTA itself. The NAFTA does include an accession clause, modeled after the GATT provisions, and membership is open to any country. There is no geographic limitation on this membership; the only requirement set out in the agreement itself is that the prospective new member be accepted by all three members, so there is a one country veto of any new member. However, the agreement does not spell out the procedures and conditions for applying, nor does it set out the criteria that a new member would have to meet to join the club.

It does not necessarily follow that the existing rules would be the sole basis for membership of new countries. Indeed,

the negotiation of a protocol of accession may include additional obligations with regard to many of the non-trade issues I just mentioned -- but that remains to be worked out once the NAFTA enters into force hopefully next year.

The NAFTA members left open the prospect for enlargement on a global basis, because they did not want to send a signal that the three countries were seeking to build a fortress either in North America or in the Western Hemisphere; that is why there are no geographic limitations on membership. But some time will be needed to sort out the details of how the NAFTA will operate and then how it will be opened to new members -- after the agreement enters into force.

CONCLUSION

Let me conclude with a few comments that tie the NAFTA and the Uruguay Round together. I do not regard the NAFTA as a shift in U.S. policy away from its central focus on multilateralism. Indeed, as the economies of North America restructure and grow in response to domestic economic reforms and the NAFTA commitments, I believe a successful outcome to the GATT negotiations becomes even more important for one simple reason: the NAFTA will help promote greater efficiency and productivity in North American industries, and thus contribute to the improvement in our global competitiveness. In that regard, however, the domestic economic reforms and the budget reforms that President Clinton has put before the Congress play a much more important role than the NAFTA. But the two initiatives should work hand in glove to help improve the competitiveness of U.S. industry.

Expanding foreign trade has been, and will continue to be,

an important factor in U.S. economic growth. Indeed, if one looks back at U.S. growth over the last 5-6 years, a significant share of that growth has been provided by net export expansion up until the past year. Given the slow growth in industrial economies around the world, the United States will have to redouble its efforts to compete more effectively in global markets. It can not do that simply by trading more with its neighbors; it needs a broader base. Mexico accounts for only about 7% of total U.S. trade, so while it is important, the U.S. presence in global markets is much more important. For that reason I see the objectives of the NAFTA and the Uruguay Round as complementary and mutually reinforcing -- and the same logic holds for Korea in both its dealings in the Uruguay Round and in pursuing regional and bilateral arrangements in the region.

With a successful Uruguay Round, I think the NAFTA will continue to be outward-oriented; then the United States can prosper and continue to pursue both regional and bilateral arrangements under the GATT umbrella -- which will continue to be outward-oriented, trade promoting and be beneficial for U.S.-Korea economic relations.

But what happens if the Uruguay Round breaks down? It's not inconceivable, given the political obstacles and the uncertainty whether the political initiatives will be taken in Europe and the United States to push the needed compromises. I remain relatively optimistic that the GATT talks will conclude successfully. But if they do not, I think that confidence in the multilateral process will be greatly undercut and new approaches will be sought to resolve longstanding trade problems.

In that event, the focus of U.S. trade policy would turn westward toward the Pacific Basin, where our major trading interests lie, and an attempt would be made to try to rework

the GATT disciplines in the regional context. There would be heightened interest in building a Pacific Basin trading arrangement, drawing on the nascent efforts of the Asian Pacific Economic Cooperation initiative, which would seek to replicate and perhaps extend GATT disciplines for regional trade.

The APEC has really come into its own, and there is already a great deal of interest in elaborating those arrangements. A new Eminent Persons Group has been established and has just had its first meeting to try to offer recommendations on how the APEC initiative can move forward. I think the work of this group can provide a strong foundation for regional cooperation, and provide a very useful framework for U.S.-Korea economic relations. On its own, such an outcome makes sense for the United States considering that the Pacific Basin accounts for more than one third of U.S. trade. But I think such an arrangement makes even more sense with a successful outcome in the GATT talks, so that regional cooperation can expand under the umbrella of a strong and vibrant multilateral trading system.

And so for the future of U.S.-Korea economic relations, I think the first order of business is to work together to promote a successful conclusion to the Uruguay Round. Then we should look how we can build on the GATT results to promote GATT-plus type arrangements, both in the region under the APEC and bilaterally, to ensure the continuation of strong, healthy relations between our two countries. Thank you very much.

*The following is open discussion
for Jeffrey J. Schott's lecture.*

Q : Mr. Soo Duk Chang (Director, Bain InterConsulting)

I spent over ten years practicing in Los Angeles, California and now I have returned to Korea to live. I am currently the executive director of the International Business Center Institute which is located nearby. I have been watching the developments surrounding NAFTA for several years and there is one fundamental question that has puzzled me and I have been unable to resolve as of yet. Taking the position of the U.S., it has two objectives to achieve, multilateral trade negotiations and regional affiliations. Now these two themes might seem a little inconsistent with each other. You suggest they may be complementary, but to the people who don't really understand the way they complement each other it invokes possible misconceptions. I would like to know how you either justify or reconcile these seemingly different concepts. Is it not risky or at least awkward to present these two different ideas and suggest we will either take this or that, but if we succeed in the former, namely multilateral negotiations, we will also succeed in the later, but if we don't succeed in the former we will suffer? How might you reconcile these seemingly different issues?

A : Dr. Schott

Well, I don't regard them as inconsistent. The point that I was trying to make was that the approach for the United States in the regional area is part of a competitiveness strategy. But take a step back and ask the question why is the United States interested in these trade agreements in the region? We already have substantial trade with Canada and Mexico, the trade is relatively unfettered, we are not

making many commitments beyond what we already do. What essentially the NAFTA is doing, except for a few peak tariffs that are being cut, is turning unilateral concessions to Mexico into contractual commitments. Otherwise there isn't much change in US policies, and remember that 85% of the output of the North American region is the United States economy. So adding Canada and Mexico to the club is only making marginal incremental additions to a trading bloc that has existed for a long time, called the United States of America.

So why should the United States pursue such agreements? Two reasons: first, it maintains pressure for continued trade liberalization and maintains a cohesive open trade constituency in the United States; second, these agreements provide building blocks or precedents for broader multilateral accords. We have already seen this in the Uruguay Round, where some of the results of the Canada-U.S. free trade agreement have educated the negotiators in the GATT in their efforts to develop new rules on services and investment. I think the NAFTA agreement will provide additional fodder for the GATT negotiators both in the Uruguay Round and in future negotiations. For example, the NAFTA provisions on investment are very substantial, go far beyond what has been achieved in the GATT, and provide useful precedents for future accords. There are other improvements as well.

But, again, for the United States the economic interests lie in a successful Uruguay Round; regional efforts can reinforce that policy both in economic terms and in political terms. One has to look at trade policy linked together with domestic economic policy; the two need to reinforce each other. In that way they will encourage or generate stronger political support in the United States for an open trade policy.

That is one reason why I am so encouraged by the actions taken so far by the Clinton administration, because they are dealing primarily with the domestic economic problems (the macroeconomic imbalances) in the United States that have generated so many of the protectionist pressures in the past. The inability to deal with the budget deficit has exacerbated trade problems, and provoked new anti-dumping actions and requests for voluntary export restraints. The best way to try to address those trade problems is to deal with the fundamental issues which are generating the protectionist policy. I think that domestic reforms, along with initiatives in the GATT, will do that.

Q : Dr. Bonho Koo (Professor, HanYang University)

You are only talking about the possibility of trade creation, but what about trade diversion (or trade destruction) -- will it undermine trade creation? Your remarks seem to have only one emphasis.

A : Dr. Schott

You raise a very important concern about trade diversion. Perhaps the crucial point to make about the potential for trade diversion is that the more one succeeds in multilateral trade liberalization, the less the preferences granted on a regional level make a difference. Indeed, the continued progress of multilateral trade reform erodes the value of those preferences, and therefore encourages further liberalization and prevents the kind of trade diversion that you are concerned about. I think for Korea, if there is a successful Uruguay Round that includes the textile reforms that have so far been negotiated, and includes additional

reductions in tariffs, then the scope of potential trade diversion will be quite limited. If the Uruguay Round fails, and nothing is put into place to try to continue the liberalization process on a regional level, then there could be more significant diversion of Korean exports in a few particular industries. So if you are concerned about trade diversion, work hard for the Uruguay Round.

The second point is that there still needs to be more multilateral analysis and review and monitoring of preferential trade agreements. In that regard, on other occasions I have proposed strengthening the GATT system to review preferential trade agreements by monitoring the potential trade diversion that might occur as the agreement is implemented. That is not being done right now in the GATT and would be a useful safeguard for the interests of non-member countries.

Q : Dr. Mahn Je Kim (Former Vice Prime Minister)

Just ten days ago I attended the APEC meeting in Singapore which addressed trade relations in this area. The impression I got from the meeting is that the trend is now changing. With the possible failure of the Uruguay Round negotiations, from Korea's point of view as a non-member of the NAFTA or AFTA, there are many concerns that the procession of regionalistic groupings will increase confusion in international trade relations. In the text book, free trade is considered the best solution and if there are going to be blocs the bigger the bloc, the better. So if NAFTA is going to be in existence it is better that NAFTA becomes bigger. So I think we have interest in two options (as mentioned by Dr. SaKong and others): one possibility would be for Korea to become a member of the NAFTA if the door is open or if this is a realistic possibility.

The second alternative could be the formation of an Asian Pacific Community initiated by the U.S. and Korea and centered around APEC. How might you comment on these two options? Is it desirable for Korea to become a member of NAFTA or should we try to make a broader Asia-Pacific community?

A : Dr. Schott

I think you have raised some very important points, and I would list the priorities this way: given Korea's broad trading interests, the first priority should be a successful conclusion to the Uruguay Round. Now that does not exclude proceeding with additional initiatives at the regional and bilateral level. Indeed, one can argue that those initiatives make even more sense with a successful Uruguay Round because then you have a broader scope for liberalization and open oriented agreements. I think the second order priority for Korea should be to work within the APEC, recognizing that almost 70% of Korea's total trade is with other members of the APEC. While Korea also has important trading relations with European countries, if Korea is concerned about going it alone on the trade front, its natural allies would be its main trading partners and that is already in the APEC system that is evolving. Third, working in the multilateral negotiations and working in APEC does not preclude also closer economic cooperation between the United States and Korea. And there I think a lot will depend on the results of the GATT negotiations and the progress in the APEC towards extending trade and investment arrangements.

Again the NAFTA does not preclude the prospect for a future free trade agreement between the United States and Korea. And indeed I think it is worth looking into that issue

again. But one thing that worries me about the discussion of free trade agreements today: it is quite similar to the discussion that took place five or six years ago. Right after the conclusion of the Canada-U.S. free trade agreement there was concern in Korea and in many other countries that the GATT talks were going to fail and the U.S. was going to drift towards protectionism. Because of that concern I convened a conference in Washington to discuss the possibilities for more free trade areas. I asked experts from many countries, including Korea, to think about what a prospective free trade agreement would look like between our two countries.

From the variety of analyses done from Asia and Latin America, I reached a very clear conclusion: the interest in a free trade agreement with the United States at that time was for defensive purposes -- not to seek further trade liberalization, but rather to secure existing market access. I regarded that as a very dangerous signal and one that would further complicate abilities to move forward in multilateral trade negotiations. Because that defensive strategy is an inward looking one; it does not promote further liberalization but creates vested interests in maintaining existing protection and keeping out non-member countries.

I am hearing the same types of concerns today about prospects for the Uruguay Round and the possibilities for new protectionism in the United States. I think that there is excessive concern on both counts, and I remain optimistic that the Uruguay Round will succeed and the United States will continue to pursue an open trade policy.

But still I think there is scope for further analysis of bilateral and regional initiatives, and work should be undertaken to see how the United States and Korea can work more closely bilaterally and in the APEC. I think the work that you are doing in the Eminent Person's Group will be

very instrumental in providing insights both for the regional relationship and for our bilateral relationship.

We also should look at what issues would need to be dealt with if there was a negotiation of a reciprocal free trade agreement, which would require the reduction of barriers in goods and services sectors, including agriculture, and would involve reforms on investment and financial services, intellectual property, and a broad array of other issues. Such an accord could perhaps be beneficial for both our countries, but we ought to understand the economic implications and the political implications of moving in that direction. I think the objective should be further study at this point on the bilateral option.

Q : Dr. Il SaKong (Chairman & CEO, IGE)

Jeff, to pursue the question, let me just ask this question: as you said in theory there is an accession clause to NAFTA, and therefore we can join the NAFTA. Now in practice, as you pointed out in your text, it is actually more complicated for other countries to join NAFTA. Now my question is what is the likelihood of Japan joining NAFTA? Because that will make the thing quite different for us, in terms of taking this strategy. Now what is the U.S. view, and your own, on the likelihood of Japan joining the NAFTA (or the U.S. asking Japan to join the NAFTA)?

A : Dr. Schott

First of all, under U.S. law the United States cannot ask any country to join or enter into a free trade agreement; the initiative has to come from other countries. So we do not have to worry about that. But I think the likelihood of a free

trade negotiation between the United States and Japan in the near future is quite remote. Our bilateral trade relationship provokes political controversy, and there remain numerous structural barriers that inhibit trade and investment between our two countries. Speaking bluntly, I think there is also an element of mistrust in the U.S. Congress about commitments to improve the openness of the U.S.-Japan trade and investment relationship. That of course is a serious problem, and it breeds reciprocal reactions in Japan which are not healthy to our bilateral relationship.

Nonetheless, there will be a very strong focus on U.S.-Japan relations because of the very large size of the trade deficit and because of specific problems, particularly in high technology industries, that are of major concern to the president and some of his key advisors. Those issues will need to be worked out, and the macroeconomic imbalances between our two countries will have to be rectified, before a serious attempt can be made at negotiating further trade accords.

This means that, in the near term, most trade talks between the United States and Japan (outside of the GATT context) will focus on sector specific issues, as well as some structural issues regarding the Keiretsu system and competition policy issues. The best way to prevent those issues from clouding the atmosphere of U.S. trade policy is to try to divert them to the GATT and to the ongoing examination of those key issues in the OECD.

A final note on the OECD. I think it would be very useful for Korea to move quickly towards membership in the OECD. I say that for purely selfish reasons: not only would it be very useful for Korea to be a full member of this important industrial country club, but I think it would be important and very useful for the OECD to be reinvigorated by the

participation of Korea and perhaps a few other industrializing countries -- and to have the benefit of Korean economists participating on the staff of the OECD. I think that would help break the lethargy that one sometimes sees in that organization. So I would wholeheartedly recommend that you give serious consideration to joining the OECD and helping it regain its vigor.

Q : Dr. Wan Soon Kim (Professor, Korea University)

Responding to your rather cautious outlook for the successful conclusion of the Uruguay Round, you have not really talked about the massive Japanese trade surplus and its negative impact on the global trading system. Reflecting on Thurow's very biting comment that "the GATT is dead", which you cite in your memo, do you still believe in the very effective and forceful GATT without something to say about Japan's growing trade surplus?

A : Dr. Schott

Well, I believe that problem will get worse before it gets better. But the solution to the trade surplus will not be found in terms of trade actions. It requires new macroeconomic stimulus in Japan, plus the important macroeconomic reforms being proposed by President Clinton in the United States, and it will take some time to resolve. But I think Japan will need to show good will in its participation in the Uruguay Round and make very important contributions to demonstrate its dedication to the multilateral trading system. I believe and expect that Japan will do that in the final stages of the negotiations, including in the area of agriculture. But one has to get to that final stage of negotiations before that

commitment can be put to the test.

Q : Dr. Kihwan Kim (Chairman, KOPEC)

I want to go back to the ordering of priorities. You said the first best priority for Korea would be to seek successful multilateral negotiations, second that Korea ought to work hard to promote cooperation in APEC, and thirdly to improve its bilateral relation with the U.S. Well I'd like to suggest a little amendment to this. I think Korea at this moment really ought to seek an entry into NAFTA. And I would make that recommendation not only for Korea but also for a country like Taiwan which has almost every qualification for becoming a full member of NAFTA (in addition to a very strong incentive). If either Korea or Taiwan joins, the other would have to join given the competitiveness of their exports in the North American market. Once these two countries joined the NAFTA, Japan would also have to think about its position in NAFTA, as Japan could not afford to remain outside of the agreement. This could then trigger other East Asia-Pacific countries to join the NAFTA, where eventually the NAFTA could in fact span the entire Asia-Pacific community. The NAFTA could then become sort of an equal to APEC (the two could fuse together). Such a formal system of Asia-Pacific cooperation would be very good in that it would put greater pressure on Europe for more free trade. I'd like to hear your comments on this alternative suggestion of priorities.

A : Dr. Schott

Well, I agree fully with your long term vision. Where we have a slight disagreement is on strategy -- or, in other words, how to get to that long term vision of an important

Asia-Pacific economic community Dr. Kim describes. I think the issue will probably be clarified in any event over the coming year, because no free trade negotiations can begin until after the NAFTA enters into force and the three member countries determine the conditions and criteria for dealing with applications for membership. During that period of time, I think we will have a clearer idea of what will come out of the GATT negotiations. If there is a successful conclusion to the GATT negotiations, I think that may change the perspective of Korea and Taiwan towards the need for an immediate negotiation of a free trade agreement with the United States. But I would not want to predetermine that decision. I think we have some time now to do a study of the implications of a potential agreement on our bilateral relationship, what it would mean for our relations with other countries in the region, and how it would contribute to the eventual achievement of stronger trade and investment ties throughout the Pacific Basin. So I agree with your long term vision, but I think one needs to think a little more about the bilateral option in light of the progress in multilateral and regional negotiations.

Q : Dr. Sung-Tae Ro (President, First Economic Research Institute)

To a Korean like me, what you said about the impact of NAFTA on Korean exports sounds quite optimistic. It might be true that Mexico has already enjoyed preferential treatment by the United States, so the additional benefits might be quite limited. But there seems to be another aspect to this question: with formal ratification of the NAFTA, the foreign capital inflow into Mexico might be accelerated. And with more foreign capital the productivity and thereby the

competitiveness of Mexican output might grow very fast. I'd like your opinion on this issue, which is a current worry for Korean businessmen.

A : Dr. Schott

Dr. Ro raises a very important point. The concern about investment diversion is probably more important than the concern about trade diversion. However, investment diversion has less to do with the NAFTA, and more to do with your own domestic economic policies in establishing a productive investment and growth climate in your own country. The NAFTA will probably not substantially accelerate the inflow of capital into Mexico. It is already quite substantial and is financing a very large current account deficit, in the order of about 6% of GDP.

The Mexican government hopes that the NAFTA will reinforce confidence in their economic reform program, which has really been the chief factor in generating those capital inflows. Mexico has undertaken a very extensive domestic economic reform program since the debt crisis, and that is the main reason why it has been able to enter into bilateral negotiations with the United States -- because it has already done much of the hard adjustment by itself. It is those domestic economic reforms that have encouraged the capital inflow, and the NAFTA would reinforce and help sustain that inflow.

For countries concerned that more capital will flow into Mexico, the target of concern should not be the NAFTA agreement, but rather whether your own economic policies create an investment climate that compares well with that of Mexico. Indeed, there is a global contest for investment resources, one could say it's a beauty contest and investors

are going to the country with the most beautiful economic policies. That's why it is very important to look at your own investment climate and assess whether there is need for further liberalization of investment rules -- so that Korea can benefit from more capital inflows, bringing in the technology needed to accelerate the pace of development of the Korean economy.

Now I can not criticize the results of Korean economic policy. As Dr. SaKong has documented in his book, Korea has done very well in the past few decades. But one always has to keep one step ahead of your competitors, and for that reason I think one has to look at the NAFTA and try to learn from the experience to improve the economic climate in Korea -- and thus minimize the potential for investment diversion.

Q : Dr. Taeho Bark (Economist, Office of the President, Republic of Korea)

Jeff, I would like to ask two questions, both of them are related to the Uruguay Round. You mentioned our extreme difficulty in promoting the final conclusion of the Uruguay Round. You also talk about some problems in France, some problems of agriculture issues, etc., but you have not mentioned U.S. problems. My first question is, do you think the U.S. has been acting or showing a great leadership in concluding the final version of the Uruguay Round? Some international organizations like the IMF (in documents I have read) have criticized the U.S. stating that it's taking a multi-track approach, while we are extensively having Uruguay Round negotiations (you started talking about NAFTA and other U.S. policy areas). I would like to hear what you think about the U.S. approach so far for the Uruguay Round. Secondly, you mentioned several prospects for the

Uruguay Round while I actually feel quite pessimistic about reaching an agreement. You mentioned that anti-dumping issues should be readdressed in the Dunkel text, and also that the U.S. has some reservations about the MTO and MFA issues (textile issues), etc. I am not saying that the Dunkel text is good, but if you want to reopen talks on these major issues, I don't think we'll be able to finish the Uruguay Round even with another three or four years. So I would like to hear your opinion.

A : Schott

I could speak for a long time on both those questions, but I won't because I know you're all very busy and have many important things to do today. But let me address them quickly but hopefully thoroughly. The first is the issue of U.S. leadership.

The U.S. has been the leader of the Uruguay Round; indeed, it has been the demandeur and leader of every GATT negotiation. Moreover, on substantive grounds, I think the U.S. has been the prime mover of all the GATT negotiations. Now one can argue with some of the negotiating tactics of the United States; I have criticized U.S. negotiators for taking a much too ideological position on agriculture for too long, and for not provoking a crisis with the European Community over some issues earlier in the negotiations so that one could reestablish the talks and move to a conclusion. But these are tactical issues that are of secondary importance.

The reason why the United States went full speed ahead with the NAFTA over the past year was because of the lull in the Uruguay Round. Julius Katz, who was the chief negotiator in both negotiations for the United States, has clearly said that if we had been actively engaged in the

Uruguay Round negotiations, he would not have had time to conclude the NAFTA talks. But the impasse on agriculture in the Uruguay Round left the opportunity to complete the NAFTA. So I don't think the NAFTA represents a sharp redirection of U.S. trade policy; rather the NAFTA took advantage of the lull in the GATT talks and was used to prod countries to rethink the importance of a successful Uruguay Round by showing that there are alternatives -- not good alternatives, but alternatives.

The second point about the renegotiation of the Dunkel text raises a more difficult issue. My point on anti-dumping was not that it should be reopened, but that it should be dropped. I think if you reopen the anti-dumping text you will only cause more problems. As was pointed out in a conference that you organized here two years ago on the Uruguay Round, there are very serious concerns about the anti-dumping text. In fact, there was a recommendation during that conference to drop anti-dumping off the agenda, which I think you strongly supported at that time. I think a focus on those issues more in terms of competition policy would be healthy, but I don't think that will be possible in this current negotiation.

As far as the other issues, I think that only minor revisions will be required in many of the texts. The bigger problem is if the textiles text is reopened, and that's why I will urge the U.S. government, and other governments that have been seeking to change the textile agreement for differing reasons, to abstain from that exercise. Although it is a highly flawed arrangement, it is much better than one that could conceivably be achieved with further negotiation in the Uruguay Round -- and reopening talks on textiles would complicate the ability to conclude the final package of agreements anytime soon. If the textile agreement is opened

up, my prognosis becomes much more pessimistic and more in line with yours. If it is held together and some of these other changes are made, then I'm relatively optimistic that an agreement can be reached this year.