

## **The Economic Policy of the Bush Administration toward Korea \***

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The topic of this lecture is economic policy towards Korea in the Bush administration. However, at this point, there is no Bush administration. This is to say, in the American system, the President makes almost 4000 government appointments and many of those appointments require confirmation by the Senate. As a consequence, after a change in government, especially from one political party to another, it literally takes months for the new administration to staff itself. Indeed, on some of the critical issues, key people have yet to be identified, much less confirmed into their offices. Therefore, we continue to be in an interregnum and there is still some uncertainty about some of these personalities and policies.

I would like to discuss three issues: first, issues relating to the international financial architecture, which are probably of declining interest in Korea as it recovers from the financial crisis of 1997/98; second, trade relations between the US and Korea; and third, issues relating to North Korea and the Korean peninsula more broadly.

In Washington, the issue of international finance has become possibly the hottest of these three issues. The IMF program in Korea was very unpopular with many Koreans. What most Koreans do not realize is that the IMF and IMF programs are also quite unpopular in two segments of the American public. The first segment is comprised of anti-globalization activists who regard the IMF, the World Bank and other such institutions as instruments of a neo-liberal world order which they oppose. They frequently appear in street demonstrations as we saw at the WTO meeting in Seattle and later at the annual World Bank/IMF joint meetings in Washington last spring. The other segment is not often seen on the streets and is comprised mostly of a group of economists who, based on notions of moral hazard, have an ideological opposition to the institutions. They believe that IMF lending practices foster an environment of moral hazard in which large international investors and their domestic counterparts in countries like Korea are able to make reckless investments because they know that if

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\* A transcription of the presentation at the Distinguished Lecture Forum on February 27, 2001.

things go badly, these international financial institutions will bail them out at the taxpayer's expense.

In 1998, at the height of the crisis, the IMF was reaching the point where it was potentially running low on funds. There had been a number of major crises and there were concerns about future crises in other large systemically important countries, particularly Brazil and Russia. There was fear that the fire department was not going to have enough water to fight the fires. The IMF board proposed an increase in the quota that each of the member governments has, which is the amount of foreign exchange that the central banks, or other equivalent institutions, from various countries make available to the IMF. In the US, there was a great deal of skepticism in certain quarters of the Congress, which would have to pass legislation authorizing this increase in the US quota, about the advisability of these IMF programs. The decision was made not to reorganize the fire department in the midst of the fire. That is to say, Congress agreed to increase the US quota to, in effect, supply more water to the fire department, but was concerned about the way the fire department was organized and how it was fighting the fires.

The reciprocal agreement that the skeptics in the US Congress extracted from the Clinton administration in 1998 was to have a congressionally appointed commission that would examine the role of the international financial institutions and make recommendations. That commission became colloquially known as the Meltzer Commission, after its Chairman, Carnegie Mellon University professor, Allan Meltzer. The Meltzer Commission was very badly split between a Republican majority and a single Democratic appointee, Professor Jeff Sachs of Harvard University who signed with the majority part of the report, and the remaining members who were all Democratic appointees who wrote a dissenting minority report. The leader of the Democratic faction was C. Fred Bergsten, the Director of the Institute for International Economics.

The majority report, signed by Meltzer, Sachs and others, if put into place, would have had a tremendous impact on the international financial institutions. With regard to the IMF, it would have greatly scaled back the size of IMF lending programs and greatly restricted countries that would be eligible in the future. For example, under the majority's recommendations in 1997, Korea would not have been eligible for an IMF program because of its credit rating. In the case of the World Bank, the transformation

would have been even greater. The Bank would have been transformed from an institution making loans for development purposes, to essentially a charitable grant-giving institution for which only the poorest countries, largely sub-Saharan African countries, would be eligible. The funding of the World Bank would go from essentially revolving funding that it has now as a Bank, to annual appropriations by national legislatures. So, under these recommendations, there would have been a big scale back of the IMF and a complete transformation of the World Bank, the Asian Development Bank and other regional multilateral development banks.

In the US, certain issues become what we call “litmus tests.” For example, for decades now in the Republican Party the stand on abortion has been the political litmus test about whether candidates were suitable for various offices. To a surprising extent, the Bush administration has become tied in knots over the international financial institutions which have become, in a sense, a litmus test for appointments on the economic policy team. The administration is split between a kind of radical, fundamentalist sect, which supports the Meltzer Commission report and advocates fundamental changes in the international financial architecture. Economic Advisor Lawrence Lindsay is often portrayed as the leader of this fundamentalist faction. The other faction is more moderate and is associated with the Treasury Secretary Paul O’Neill who would like to see some reforms, but not wholesale reordering of the institutions as the Meltzer Commission proposed.

The battleground between these factions has been sub-cabinet appointments. For example, one person who was touted for the important Under Secretary for International Affairs job was essentially vetoed because he was considered too pro-bailout. The eventual designee for that job, Professor John Taylor, is a respected, renowned economist and a world-class expert on monetary policy, although some reporters looking back through his speeches found an incident in which he had actually called for the abolition of the IMF. However, if one reads the whole context of the interview, it is clear that he was badgered into taking this position by the moderator of a panel discussion. The Assistant Secretary of the Treasury for International Affairs position, which would really be the key frontline person in a crisis of this kind, remains unfilled. Each of these factions is pushing their own candidates for this post. Some of the names that have been in the press would include Adam Lerrick, who was an assistant on the Meltzer Commission report and is considered a fundamentalist, David Malpass from Bear Stearns, who is also considered fairly radical on these issues, and Morris Goldstein

from IIE, who is thought to have much more moderate opinions on these organizations.

The Clinton administration was criticized for an inability to integrate economic and foreign policy concerns. What we have in the US today, with this skeletal staffing that exists in the administration, is a potential for another set of problems in this regard.

This is because, if one looks at the foreign policy team members, they have very traditional, political-security backgrounds. Many of the top policy makers, Secretary of State General Colin Powell being the most obvious example, come from military backgrounds. This is true especially with regard to Asia; General Powell, Richard Armitage (the deputy Secretary of State), James Kelly (designated Assistant Secretary of State for East Asia) and Torkel Paterson (designated Director for Asia at the National Security Council) all come from very traditional military backgrounds. On the other hand, the economics team is still fighting it out, but there is a likelihood that there will be some more pro-market believers in the economics camp.

It is not difficult to imagine a crisis sometime in the future involving a large, strategically important country, in which the foreign policy team, for diplomatic and military reasons, wants to be generous and help them out in the economic crisis, while the economic team is very concerned about moral hazard and wants to take a hands-off approach. At the beginning of the Asian financial crisis in 1997, the US was criticized severely for not participating in the first bailout of Thailand and the argument is that this helped the crisis spread and did enormous diplomatic damage to the US. There could be a similar or worse split between the economic and foreign policy teams in this administration, given the backgrounds of the players.

How is this relevant to Korea? Today Korea has US\$96 billion of foreign exchange reserves and it would be difficult to predict that Korea will have a financial crisis in the near future, like the crisis of 1997/98. At the same time, there are aspects of Korean economic policy that leave something to be desired. The economy has not fully recovered from the crisis, growth is slowing, there are weaknesses in the financial sector and continuing problems with corporate restructuring, so while I do not think an externally generated crisis is imminent, there are weaknesses in the internal economy that are worthy of attention.

This week Turkey has been another example of a country that can get into a financial

crisis involving both the foreign exchange and banking sectors, although it is much smaller than Thailand was. Foreign bank exposure in Turkey is much lower than it was in Thailand in 1997, but for Koreans the point is that there is still a possibility of Korea in the medium-term being adversely affected by a combination of internal developments and possible contagion from crises arising elsewhere. As a consequence, the stance of the US government towards the international financial institutions is worth considering. Even if Korea does not expect to participate in another IMF program, the behavior of the IMF in other countries, potentially including neighboring countries here in Asia that may still require IMF assistance, is of relevance to Korea.

This fighting about staffing the Treasury and what to do with the IMF and other international financial institutions are hot issues in Washington at the moment. But of course, the more traditional point of contact between the US and Korea in the economic sphere is trade.

In terms of trade, the Bush administration's first priority is going to be to get fast-track negotiating authority or as the Bush administration has termed it – "trade-promoting authority." This is because the US constitution gives the Congress the final say over regulating foreign commerce, but for basic administrative reasons, it is the executive branch of the Presidency that handles negotiations with foreign countries. Foreign countries would be reluctant to negotiate with the US, either multilaterally or bilaterally, if they thought that once they came to an agreement with the US, the Congress could amend that agreement *ex-post*. As a consequence, to pre-commit itself to sign on to any agreement negotiated by the executive, the Congress passes fast-track or trade-promoting legislation in which it agrees to vote yes or no without amendment on whatever agreement is negotiated and brought back to the Congress by the executive branch.

That authorization lapsed in 1995 and the Clinton administration was never able to get it back. Two attempts to pass fast-track legislation through the Congress failed because the Clinton administration was never able to bridge the gap between traditional proponents of trade liberalization and people concerned about linkages between trade and labor rights issues, human rights issues and environmental issues. It was never able to put a stable political coalition together on trade.

In this regard, the Bush administration has a better chance of moving forward. The

Republicans have a small majority in both houses in the Congress. At the margin, because it is a Republican President, even Republican skeptics on trade liberalization are more likely to vote with the President, or at least not oppose him in a very active way. At the same time, there is a significant block of Democratic legislators who are in favor of trade liberalization. So, in my view, the President should be able to build a stable coalition of pro-trade Democrats and the bulk of the Republican Party in the Congress in order to get fast-track legislation.

In terms of the calendar of events, the most immediate thing on the agenda is the Free Trade Area for the Americas meeting that will be held this spring in Quebec. They are aiming to have fast-track authority by the time of this Quebec meeting. It is uncertain whether they are going to get it, simply because the legislative calendar of Congress is quite full, but my belief is that they will get it in the long-term.

Beyond the regional issues, such as FTAA or activities in APEC, the administration obviously wants to restart the global talks in the WTO. The fact that this administration will be less concerned with trade and environment, trade and labor and trade and human rights linkages, should smooth the way to reaching an agreement in the WTO and should make for better bilateral relations with the Korean government. On the Korean side the key issue will be agriculture, whereas on the US side the issue will be the anti-dumping laws which are of highly dubious economic rationality and raise the ire of many of our trading partners.

With respect to bilateral relations, it is quite pleasant today to see that the bilateral relationship between the US and Korea is not afflicted with the really high-profile emotive issues that it has been in the past. Of course, the US has complaints about certain things; automobiles, procedures in public works contracts, pharmaceuticals, etc., but basically these are not the kind of core issues that have bedeviled bilateral trade relations in the past.

Given the very pro-market ideological tendency of the Bush administration and concerns about backsliding on structural reforms in Korea, in the next year or so the Bush administration will probably attempt to initiate negotiations with Korea that might be similar to the US-Japan Structural Impediments Initiative negotiations that were held under the first Bush administration in the late 1980s. In my view, this would indicate that the US trade policy-makers would like to get out of the weeds of arguing about

individual sectors and try to talk about broader structural themes. Indeed, this would have some consistency with past aspects of the US-Korea relationship, such as the Presidents' Economic Initiative and the Dialogue for Economic Cooperation.

In that regard, there is one issue that is important for Koreans to know. Towards the end of the Clinton administration, the US Treasury, under Secretary Timothy Geithner, complained about the Korea Development Bank bailout of Hyundai Electronics. This issue came up again in the confirmation hearings of US Trade Representative, Robert Zoellick. The message I give to Korea is that the US is serious about this for two reasons:

Firstly, the US is generally happy with the trade relationship with Korea. The US is happy with the structural reforms that Korea has taken on in the last three years, but it is very concerned and worried about possible backsliding in Korea, especially as the economic situation has improved. There is a legitimate economic concern about that set of issues and there is a school of thought in the US that the KDB bailout of Hyundai Electronics may be the leading edge of a greater backsliding on economic policy reform in Korea. So, it is seen as a possible harbinger of bad things to come.

Secondly, the US has a complainant-driven trade policy formation system, for basic historical and cultural reasons. So there is a tendency in US trade policy-making for the squeaky wheel to get the grease. In the US, there is a firm called Micron Technologies, which has a history of being a squeaky wheel and getting a fair amount of attention. Today Micron Technologies is the leading complainant about the situation between KDB and Hyundai. That firm is located in the state of Idaho, which is a lightly populated state in the mountain region. Micron Technologies is the largest employer in the state, accounting for nearly half of Idaho's manufacturing output. As a consequence, it is very prominent in Idaho politics and the Idaho congressional delegation, which is two Senators and two Congressmen, takes Micron Technologies very seriously. There is also a plant in the neighboring state of Utah, which has a very senior influential Republican Senator, Orrin Hatch, who brought up this issue in Zoellick's confirmation hearings.

My point is that there is a real policy basis for US concerns about this issue. At the same time, there are real domestic politics in the US that amplify those concerns. I believe that the Korean government ought to take this seriously, because it could

become a political issue (there have been talks of a WTO case, but that seems unlikely) and I am sure that President Kim is going to get a lot of questions on this when he goes to Washington next week.

Finally, I will discuss the issue of North Korea. What is going to be the Bush administration's policy toward North Korea? First of all, one must understand, for basic political reasons, every new incoming administration has to differentiate itself from the previous administration, at least rhetorically. The policy may be the same, but the words and the slogans have to be different. Therefore, we know that the rhetoric coming out of the Bush administration on North Korea will be different to the rhetoric of the Clinton administration and will be harsher. The question is, are there going to be substantive policy differences?

I think there is likely to be a great deal of continuity in US policy towards North Korea and the Korean peninsula more broadly, but this is not going to be perfect continuity. There will be differences between the Bush and the Clinton administration. I think the people coming into the Bush administration are completely unenthusiastic about building two light-water nuclear reactors in North Korea. They would say that the Agreed Framework might have made sense in 1994 when we were measuring the expected lifetime of the Kim regime in months if not weeks, but it certainly makes no sense now. I expect this administration to push harder on extension, revision and amendment of the Agreed Framework. They are not going to walk away from it, but they will want to change it. The fact that the North Koreans are asking South Korea to provide electricity, which was arguably the whole *raison d'être* of the original Agreed Framework, could even be turned into a North Korean request to renegotiate, extend or amend the Agreed Framework. So I expect to see a lot of action on that front.

Moreover, the way staffing has evolved, Secretary Rumsfeld and Deputy Secretary Wolfowitz, who are both considered relatively hard-line on North Korea, are at the Department of Defense, whereas Secretary Powell and Deputy Secretary Armitage, who are considered relatively softer on North Korea, are at State. That suggests to me the potential for bureaucratic rivalry between the Department of Defense and the Department of State, which would tend to slow the formation of policy in the US.

In summary, I think we can certainly expect harsher rhetoric from the Bush administration. I think there will be a great deal of continuity in US policy, but there



will be some differences. Issues like KEDO and the Agreed Framework are likely to be central to the policy push in that regard. Also, the fact that it will take a long time for the US to staff itself combined with the possibility of rivalry between two of the big bureaucratic players in the US, suggests that the formation or development of these new policy alternatives within the US government could be slow.

### Q&A

Q:

Firstly, I agree that every administration wants to differentiate itself from the previous administration. Do you think President Bush will move toward vertical globalization as opposed to Clinton's horizontal globalization outlook, i.e., increasing links with South America?

Secondly, the Republican-oriented Meltzer Commission would like to change the IMF's role and function. What is your view on this issue?

A:

Personally I am skeptical about the advisability of many regional trade integration schemes. I think we run the risk of creating a crazy quilt pattern of many, hard to understand, non-transparent rules among all these different FTAs, which eventually would mean a net reduction in global economic efficiency. However, I am not against all such agreements. There are certain occasions where there are justifications, often non-economic justifications, which strike me as being quite reasonable. For example, for different reasons, I think the US-Canada and the US-Mexico FTAs made sense.

Today, on the one hand, the US is continuing to pursue this multi-track strategy of wanting to negotiate in the WTO, and on the other hand, wanting to pursue these regional initiatives. I think the interest in Latin America stems from three factors. Firstly, the Latin Americans have done a lot of liberalization and they are open to negotiating these trade integration packs. Secondly, the Europeans are trying to negotiate their own agreement with Mercosur, involving Brazil, Argentina and some other Latin American countries, so the US feels under threat. Thirdly, the President was Governor of Texas, which has a long border and a lot of commercial exchange with Mexico. The President speaks Spanish and he seems to feel comfortable dealing with Latin American countries.

In terms of the Meltzer Commission, I think there are good and bad aspects. The international financial architecture was designed in 1944 for a world in which developing countries did not play a major role, there were developed economies in Japan and Western Europe that had been devastated by war, and the international financial system was characterized by ubiquitous capital controls and difficulties in moving capital. That is not the world we live in today. The IMF has essentially lost all relevance to those industrialized countries and their balance of payment problems that it was initially aimed at dealing with under a fixed exchange rate system. Instead it orientates all of its relevant work towards the so-called transitional economies and developing countries. Likewise, the World Bank has gone from being an institution that promoted economic reconstruction of these devastated economies to being a bank that tries to promote development in countries that were never developed, which is a much more difficult task. So, there has been a kind of mission creep among these institutions in that they have increasingly diffused goals and it is very difficult to measure performance.

I think the Fund has done a better job of trying to come to terms with these changes by trying to narrow its mandates in certain ways. However, in recent crises it seems to have responded in the same way as five years ago. The Bank, for a variety of reasons, seems to have had much more difficulty. So I think there is great room for reform in these institutions.

Nevertheless, I do not think the particular recommendations in the majority report of the Meltzer Commission are necessarily the right way to go. I think it is completely implausible that one could create a grant-giving institution to replace the World Bank and the Asian Development Bank and other regional development banks and then expect national legislators to fund this on an annual appropriations basis. I think the real effect of trying to do that would be a big withdrawal of concessional funding to developing countries. So, I think there is consensus that these institutions need reform, but not as much consensus that the Meltzer Commission recommendations are the way to go.

Q:

You have expressed your ideological opposition to regional integration schemes such as FTAs. I think most of us agree that regional integration is second best to the

multilateral liberalization of trade and investment. However, the proliferation of interest in these regional schemes has been mostly due to a lack of progress on the multilateral front. Considering the new administration's very pro-liberal trade commitment, how would you assess the prospect of launching a new WTO in the next one or two years?

A:

Let me make two points on this issue. Firstly, on the subject of the proliferation of proposed bilateral or multilateral regional integration schemes in Asia, I think they are an understandable reaction to what is going on in the world economy. At the same time, I would recommend some caution, because it is a second best solution. Moreover, I think that Asian countries, especially Northeast Asian countries, would have a hard time negotiating agreements that would be consistent with their WTO commitments, because of problems in the agricultural sector. I think Korea has already encountered this problem in its negotiations with Chile.

With regard to the future WTO round, I think there is plenty of blame to go around for the failure of Seattle and certainly the US is most prominent in that regard. The US came to Seattle with an entrenched negotiating position essentially demanding that the agenda consist only of items that the US could expect to win and exclude everything else. I think that was wrong. However, the US was not alone. I think that the EU and Japan acted in an unhelpful manner, particularly regarding agriculture.

Having said that, I think that a combination of forces – increasingly disturbing conflicts between the US and the EU on the trade front, the lapsing of the so-called peace clause in agriculture, among others – will give some impetus to a new round. I think with a stronger leadership in the US, it is quite possible that there could be a new round within the year.

Q:

At the G7 finance ministers meeting the US Treasury Secretary spoke as if he was supporting a weak dollar policy, then denied those remarks on the following day. So I am curious as to what kind of foreign exchange policy the US has in mind.

A:

What Treasury Secretary Paul O'Neill said at the G7 meeting was nothing unusual.

Financial markets have developed a kind of totemic relationship with certain mantras and hearing US Treasury Secretaries repeat mantras makes people feel calm and secure so they can get on with their business. So for years now we have heard this “strong dollar mantra,” but it is simply something that is chanted and not a policy. Secondly, what Paul O’Neill said was that the dollar is set in the exchange market. He was expressing a certain degree of skepticism about the efficacy of government intervention, which I think is completely non-controversial.

I think he was simply pointing out that the value of the dollar is setting the exchange markets and occasionally the US may intervene to try to make alterations, but that is not fundamentally within government control and those interventions are likely to be few and far between.

He also expressed skepticism about meetings such as the G7 finance ministers’ meeting. He said that there was a certain kind of junket component to them in that he did not need to physically travel to Italy to find out about the Italian economy. I think most people would agree that there is a lot of pageantry involved that is not particularly useful from the standpoint of economic policy. So I think his remarks were completely understandable and defensible.

Q:

Firstly, when the Asian crisis developed in 1997, Mr. Sakakibara of Japan proposed to establish an Asian monetary fund because of the unpopularity of the IMF program at the time. The main reason for this was that the AMF would have some kind of regional consideration, not the one-size-fits-all policy of the IMF. So what is your opinion on the establishment of an AMF?

Secondly, last years record high trade deficit was US\$370 billion, which is 4% of GDP. With this in mind, do you think the Bush administration will push for fast-track negotiating authority in order to make bilateral agreements with Korea, China, or other countries which have shown a big trade surplus with the US?

A:

There is a lot of understandable anger about IMF programs and there are at least two ways that an AMF could be useful. Firstly, contagion clearly has a regional component to it. So countries may be willing to put up resources if they were used for regional

purposes. In this regard, it may be that countries have a greater commitment to a regional organization than to a global organization. Secondly, the process of surveillance, which is supposed to be an important aspect of the IMF, could be more effective at the regional level, because countries feel they have more directly at stake.

Nevertheless, the problem is how to make the conditionalities of these organizations consistent. I think that was the basic concern of the US government and the IMF in 1998 when the Japanese originally proposed the idea. An AMF was seen as undercutting the IMF. Ultimately these are global financial markets, not regional financial markets, and the global institution has to take priority. The key issue is how to set up a regional financial institution of that sort without undercutting the IMF. It can probably be done, but it is a sensitive issue and it will take a lot of time.

Q:

So do you think that the new administration will be more receptive to the idea of an AMF, compared to the previous administration?

A:

No, not at all. In the US there is one group of people that is instinctively worried about any organization that does not include the US. So they would oppose the AMF if the US were not a participant. There is another group who take the principle position that an AMF would inevitably undercut the IMF and lead to a deterioration of the global institution, which is ultimately is the key so there cannot be an AMF. That is an objection on the basis of principle and there are a lot of people who hold that view. This could well be one of those issues where there would be a split in the government between the politically or diplomatically oriented people, who might want to foster Asian regional organizations or at least have the US be seen as not opposing them and the more economics oriented people who would take a much more hard line that it would be a distraction from the IMF.

So I do not think it is obvious that the US would be supportive, but we have to see exactly what the proposal is. I do not think we can talk about these things in theory, but rather they have to be seen in practice in order to be understood fully.

Regarding the trade deficit, the US has a big trade deficit, but it would take years to negotiate an agreement. Once the agreements are negotiated, the liberalizations

typically have phase-in times in the order of ten years, so trade policy in a direct economic sense is not a response to the trade deficit. Everyone in Washington understands that. In that sense, the fact that the US has a big trade deficit is not going to lead the US to have greater interest in trade negotiations.

However, there is a political sense in which there is a linkage. Surprisingly, the US has built up this huge trade deficit with very few repercussions for US trade policy. Despite the magnitude of this deficit, there have not been big cries for protection in the US. If the US macroeconomy starts to significantly weaken or go into recession and unemployment starts to rise, then the trade deficit could suddenly have much more political salience. At that point, the administration is going to be confronted with firms, unions and congressmen demanding protection, so negotiations, especially in the WTO but even maybe regionally or bilaterally, could be a very effective way of deflecting political pressure. However, this will not be because the US thinks it is literally going to affect the trade deficit, but because it will affect the policy environment and the politics in Washington.

Q:

I would like to ask about the US view on the state of the Korean economy. Regardless of the state of the Korean economy, Americans seem to say it is now OK, whether the growth rate is 9-10% or 4-5%. Does it make any difference to the US economic and trade policy toward Korea whether they see the Korean economy as good or bad? Is there any difference between the Bush administration and the Clinton administration in their view of the Korean economy? If there is a difference, does this affect trade pressure?

A:

In this US, I think the consensus is that the Korean economy is slowing for a variety of internal and external reasons. There are quite serious concerns about lingering unresolved issues in the financial sector and in corporate restructuring in Korea and the widespread popular anxiety in Korea among the public about the state of the economy does indeed have a basis to it.

However, the picture is not completely gloomy. South Korea is the most wired country in Asia. It has a higher rate of broadband Internet penetration than any other country in Asia, with the possible exception of Singapore and Hong Kong and Korean firms are

successfully penetrating the Japanese market in the IT sector. So while the story on the old economy side is gloomy, there are clearly very bright things happening in the new economy. Over the last 50 years, the area in which Korea has made the most progress in economic reform is trade policy. This is because there is a basic goal or consensus of free trade and there are international institutions to facilitate movement towards that goal. Progress in the international financial sphere has been less, because there is less intellectual consensus about the desirable characteristics of the international financial system and the institutions, like the IMF, are not as strong.

Korea has made the least progress in internal or domestic areas, because there are no international institutions to both create a goal for Korea to move towards and to create a political structure together with some political pressure for Korea to move in that direction. So the core issues today for Korea are problems in the domestic financial sector, domestic corporate governance, product markets, labor relations, etc., which are areas where Korea is on its own.

Another core issue for Korea today is where to allocate its savings. To a disturbing extent, the state continues to channel capital into projects and firms of dubious quality and there are real opportunity costs to doing that. Every won that is put into Daewoo Motors is a won that is not available for the new economy firms that are creating value-added, creating jobs and have much better long-term potential.

That then links to the issues of trade policy and policy with the US. As I indicated, I think there has been a lot of progress made on trade policy and these issues are really secondary now for both the US and Korea.

With regard to the pressure that Korea feels from the US, they are very different countries. As I mentioned earlier, one aspect of the US system is that it is a complainant-driven system. We have a system of governance that puts a high emphasis on procedural transparency, inclusiveness and access. Those are characteristics that are absolutely necessary for social stability in an immigrant country. As a result, there is a tendency for the squeaky wheel to get the grease. Firms that have particular complaints get access to policy-makers and try to convince policy makers to pursue their agendas.

This reiterates the importance for the US and Korea to work together so that trade differences can be handled in less politicized, less emotional, multilateral frameworks in

which there is not the appearance of a zero sum game, but rather a consensual way in which both countries have agreed to a certain a set of rules and procedures and are willing to abide by their outcome. For instance, the US had complaints about the airport project in Korea and felt that US firms were being unfairly denied public works contracts. The US took that to the WTO, which both the US and Korea agreed would resolve their problems, went through the procedure and lost. I think this is the direction in which trade problems should be moving, into areas where they can be resolved in non-emotional ways, where two countries have agreed beforehand to a set of rules and procedures for resolving them.

With regard to how the state of Korea's macroeconomy affects these things, that is a subject of controversy in the US. There are some people with experience as government officials dealing with Korea who suggest that, as the Korean economy gets stronger, Korea will become less interested in policy reform. There are others who say that if the economy is weak, people feel defensive and it is a bad time to make demands, so Korea is better able to give some concessions when the economy is strong. As a result, there is no clear view in Washington on that issue.

Q:

What are going to be the three main points made by President Bush to President Kim at their meeting in March?

A:

Firstly, be resolute on North Korea. I know that President Kim is going to explain to President Bush that the engagement policy is not carried out on the basis of naivety or sentimentality. I think they will find agreement there.

Secondly, I think President Bush will urge President Kim to remain resolute on the economic reform issue, which is important to the US and is an area in which we greatly admire the progress that has been made in Korea in the last three years and we hope to see it continue.

Thirdly, I would not be surprised if President Bush and President Kim find a personal connection in their religious values.