

# US Trade Policy After the 2004 Election \*

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Since today is election day in the US, I believe that, of all the talks I have ever given, this talk may have the shortest life span.

I want to stress that though I spent time in the Clinton Administration, I am not involved in any way with the Kerry campaign. This is a talk that is given strictly from the perspective of a scholar who has studied trade policy for many years. In government, I had the fortune—or misfortune—to watch trade policy being made in real life. Watching it be made is to recognize that it is a very imperfect process, in any country. It is certainly an imperfect process in the US.

## **The bottom line on the elections**

I do not know who will win the US presidential election. I get some basic information from my colleagues who specialise in this area. They do not know who will win, either. It is truly a remarkably close election. We do know there will not be a radical change in control of the US Congress, both the Senate and the House of Representatives. There is a small chance the Republicans may lose control of the Senate, but they certainly will not lose control of the House of Representatives. They will probably control the Senate. So if there is a President Kerry, he will be dealing with a Republican Congress: a Republican majority in both the upper and lower houses of Congress. That means there will be an element of stability in trade policy.

It is also probably the case that the Senate will remain closely divided. If there is a second term for President Bush, he will deal with a Senate where—because of the structure of the Senate and the powers given to the minority party—there will have to be compromises on trade policy as the president and the two parties move forward.

There will also be a new Chair to the Senate Commerce Committee, no matter who is elected. That will most likely be Senator Ted Stevens from Alaska for the Republicans. Senator Stevens is not a person who spends a lot of time talking about general principles of trade policy. But he is a person who takes special care for his state of Alaska. Therefore, you may predict that, if you find yourself with a US-Korea free trade agreement, there will be special preference acts for Alaska in the agreement.

The next president will have some room for innovation on trade policy, but he will also operate under many constraints. It is possible that the next president, whoever he may be, will get the Doha Round of World Trade Organisation (WTO) trade negotiations approved in the US. But it will not be easy for that president to greatly expand on the current US offer. Some modifications will be possible, but there will be no wild expansion. There are many reasons why the president will be more attracted to bilateral

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free trade agreements. There are also reasons why we should watch very carefully the long-term relationship between security and trade policy.

We finished the Uruguay Round in 1994. That round did many spectacular innovative things in regard to trade in services, intellectual property, investment measures and a whole variety of other areas. It was such a big agreement we could have spent another ten years working out the meaning of what we agreed on in 1994. The add-on agreements, such as the one on telecommunications basic services in 1997, are also complex.

One problem for the Doha round, at least in the US, is that the Uruguay Round was such a big success. The Doha round did not make the same type of attractive innovations easily available. That poses a practical problem in US politics. Nonetheless, the Doha round has now achieved a negotiating format for agriculture and subsidies, and it seems to be workable. It also has one new attractive issue, trade facilitation.

Both Presidents Clinton and Bush worked toward free trade. Both Democrats and Republicans have consistently supported free trade agreements. Most of these efforts have been at the bilateral level, but they have also included WTO agreements. The critical issue these days is that the president received trade promotion authority—so-called “fast track” authority—back in 2002. The president will have to go back to Congress for approval in 2005. That will be a very important moment in legislative history. The authorization for “fast track” authority, or trade promotion authority, is the key trade negotiating power the president wants, whether it be Bush or Kerry.

### **Presidents negotiate because standing pat is dangerous**

Step back for a moment and look at the big picture for the US, or for any major economic power. Why would a US president want to keep negotiating new trade agreements? Trade obligations are not legal contracts in the traditional sense. It is not as if two companies signed a legal contract and that there are law courts to enforce the articles. There is a WTO complaint process. There is a WTO sanctions process. But, above all, when you are dealing with major economic powers there is no international agreement that can totally bind them to behave in the way in which they promised.

That trade obligations are, above all, political commitments to cooperate in making markets work together. You can write down specific obligations in a trade agreement. But it is good faith and the political commitment to make agreements work that are the true secret to open trade and open markets. Trade sanctions are an imperfect tool of enforcement. They are not overwhelmingly powerful and they tend to cause ill will. They hurt the political relationship. Sanctions are a tool you do not want to use very often.

The result is that every trade relationship in the long term is an exercise in political leadership and cooperation. In the US, certainly, it is true that the president, in order to be engaged, has to be able to show that he is doing something new and interesting. If you want the president to commit his time and political energy to a project, you have to

give him a prize. He has to be able to produce a result. There has to be something he can hold up to the public to show that he is doing something new and interesting.

That is one of the reasons why presidents have increasingly liked bilateral free trade agreements. You can write home and say, “Look! I got a free trade agreement this week.” With who? With Jordan. How big is our trade with Jordan? It is only worth a small sum. But it is a new agreement, and the president can put it on his website. There is a need for constant political success stories. Bilateral agreements provide such stories much more easily than do the very long, complicated and much more uncertain multilateral trade process.

#### **Four rationales for bilateral and regional free trade agreements**

As my colleague, Prof. Richard Feinberg, points out, bilateral agreements are politically attractive because there are some pretty good stories you can tell about the way in which they are important to US interests. First, they help to open markets for US companies. They keep pace with other countries’ free trade agreements. For example, Japan’s free trade agreement with Mexico or the discussed trade agreement between Korea and Japan, if it ever happens.

In line with this, when you look at the structure of the US’s bilateral agreements you see that the balance of concessions normally favours the US. The other country tends to make more market-opening concessions than does the US. Why? The US market is more valuable to the other country. That then becomes a good story for the US president. He can say, “You see? I got this bilateral agreement with all these extra concessions beyond what we gave the other side.” That is good politics.

A second reason a president can argue for bilateral or regional agreements is the logic of competitive liberalisation. The president can say, “We are using these small agreements to make global changes.” This was the strategy President Reagan’s trade team used brilliantly in the Uruguay Round. One of the major reasons for NAFTA was to convince Europe it had to negotiate fully at the Uruguay Round. That is a prime example of the way in which a regional agreement can drive a global agenda. It makes good politics. In this case, it also made for good global trade policy.

A third reason why these agreements are attractive is that they strengthen strategic US partnerships. This is certainly true for a US president looking toward East Asia in the long term. One of the most important reasons why a president might decide to undertake a free trade agreement with Korea would be to emphasize the strategic relationship with Korea in the long term. Emphasizing the strategic relationship goes beyond the trade relationship.

Finally, trade agreements are a classic tool used by countries like the US to try to support domestic market reforms in other countries, or at least those domestic market reforms in other countries that we like and support as a matter of principle. Again, advancing reforms in other countries makes for good politics back in Washington, DC.

There is one final point to make about bilateral agreements which helps explain why they are so popular, whether you are a Republican or a Democrat. One of the overriding characteristics of bilateral agreements, from the view of the US, is that the other country asks for them. Other countries approach the US and make the serious proposal and the serious request to initiate negotiations.

That means the US president and the White House can put that request into a particular Washington, DC, political process. That process is called the trade advisory process. It brings together all the major constituents: companies, labour unions, environmental groups, etc. All these groups sit on the trade advisory panels. The request goes into these advisory groups. They discuss the request for negotiations. By the time these advisory groups are done discussing the request for negotiations, the president has a pretty good idea whether a bilateral agreement with the country in question would be a political winner or loser. The president then knows whether to say, “Yes,” or, “No,” to the bilateral agreement because he can gauge whether or not in the future it would likely be a political success. So this is a very attractive process when compared to the very complex, global multilateral negotiations.

All trade agreements are more attractive in Washington, DC, if they tackle or make gains on big new issues or if they somehow radically resolve old issues that are important in Washington, DC. One problem with the Doha round is that the issue of agriculture is important but the area of curbing export subsidies does not get the same level of political attention or “thrill” in Washington, DC. There are not many dramatic new issues on the Doha round agenda.

Regardless of the politics of trade policy in the US, there are some basic economic limits that will influence either a Bush or a Kerry trade policy. I want to focus on three in particular: the role of foreign direct investment (FDI); the role of China; and the sustainability of the US current account deficit.

### **Foreign direct investments and financial flows**

The US has a huge stock of foreign direct investment through its multinational corporations. It is worth well over USD 1 trillion. Over 33% of this is in the APEC region.

The economics of calculating the relationship between foreign direct investment by multinationals and trade flows is not precise. Our accounting tools are not precise. But it is fair to say that at least 50% of all US trade flows in and out of the US are within the internal channels of multinational corporations. For example, IBM Japan would trade with IBM US, or Sony Japan would trade with Sony US. These are not open market exchanges. The estimates go as high as 66% or more, but we have some significant uncertainty in our accounting tools.

Most US trade today is tied to a very elaborate system of global production and distribution networks by multinational corporations. Those global production and distribution networks are essential to US competitiveness, both at home and overseas.

As a result, there is no US president who can easily undo those networks. That means you cannot easily undo or restrict open trade for the US. That is a fundamental limit on US trade policy.

Hand in hand with that, the accumulation of the US deficit over time leading to dollars sitting in the hands of foreign governments is another constraint on the US. We know, for example, that the options for the US in negotiating with China are somewhat constrained by the fact that China holds such a large amount of US Treasury bills. That is a constraint on US negotiations and international trade policy.

In the long term, these constraints are going to become even more substantial. Today, the European union's currency—the euro—is essentially becoming a substitute for the dollar in some parts of world trade. Somewhere down the line, even without a political or economic union of Asia, financial markets may invent an “Asian euro.” This would be a virtual Asian currency backed by a bundle of traded Korean, Taiwanese, Japanese and Chinese currencies. Your governments will not formally agree to this, but the financial markets will invent it. That, too, will change the nature of trade dynamics and constrain the options of the US.

### **The trade deficit is not politically neutral**

For all these reasons, the US's basic economics make it hard for the US to retreat from a free trade policy. At the same time, the huge US trade deficit and current accounts deficit, which are now running at about USD 500 billion per year, is a political problem and it is an economic problem. It is equivalent to about 5% of our gross domestic product. That level may not be easily sustainable over time. That level is higher than the US current accounts deficit when the US was an industrializing country in the 19<sup>th</sup> century. It is truly at a large level.

That deficit is not, in a sense, politically neutral in its distribution. If you look at the numbers, almost USD 100 billion of the deficit is with the European Union. The European Union is an area where the US has had a number of political disputes. But fundamentally, in the politics of Washington, DC, you do not find a fear that Europe is about to supersede the US as an economic superpower. The politics of this deficit tend to be a little constrained. They are not as politically potent as you might expect by the size of the deficit. There will be selective fights, such as those about Boeing and Airbus or about steel. But the big efforts will be to work out common ground rules, such as in the Doha round, on restraints on subsidies and export credits over the long term.

The second big area of the US deficit is with Canada and Mexico. The deficit stands at USD 40 billion with Mexico and USD 54 billion with Canada. That is almost USD 100 billion. That is a lot of money, but it is almost entirely because North America—that is, the US, Canada and Mexico—is now a single production area. To undo the trade deficit would be to take down those production networks which cover North America. That is not going to happen.

Because of these constraints, political minds tend to focus on very specific local issues that are tied to the close geographic proximity of Canada and Mexico to the US. Subsidies, particularly timber subsidies in Canada, are an issue. This leads to disputes with the very politically sensitive US forest industry. Another issue is labour. Mexican labour wages have an impact on the employment of US “blue collar” workers. Third, environmental issues tend to come up within North America. The environment is prominent and politically sensitive.

That leaves the deficits in Asia. The two largest, by far, are with China—at almost USD 125 billion—and with Japan—about USD 67 billion. Those dwarf the deficit with Korea, which is only about USD 12 billion. Both for Kerry and for Bush, the deficit with China will be the most politically difficult deficit to manage. In the long term, Washington, DC, sees China as a potential economic rival of major dimensions. That makes its deficit all the more politically sensitive.

### **Some differences between Bush and Kerry**

What do we know about their differences? I do not know who would be the US trade representative if John Kerry were elected president. Nobody in Washington, DC, knows either. But we do know a fair amount about the Kerry economic team that would manage domestic economic policy. If you look at the content of that team, you can ask who they are. It is the Bill Clinton team. There has been a slight re-shuffling of who goes where, but it looks like the same crowd of people.

We know something about that team. We know they are free traders in policy who are willing to be very tough on particular trade tactics if it is politically necessary. But fundamentally, it’s a free trade team. People like Robert Rubin are adamant in their belief in free trade as their preferred policy.

It is fair to say that both Bush and Kerry are free traders who will compromise when necessary on politically sensitive industries on a temporary basis. That makes them like most countries’ political leaders. They would both support gradual reductions in export subsidies and credits. They would both use a mixture of regional, bilateral and global strategies.

Where are the differences? Senator Kerry has called for a 120-day review of all trade policy and commitments at the beginning of his administration. I do not think that would lead to a dramatic reversal in US trade policy. I do not think, in particular, the issues of labour, the environment and outsourcing will lead to a dramatic turnaround in US trade policy. I do think there are some uncertainties with structural adjustment issues, like the currency revaluation and the effect of other issues, like health care, on trade policy. There are some less obvious differences on energy policy.

### **The Kerry approach to trade and structural adjustment**

It seems to me Senator Kerry is telling us a few things. First, he will continue free trade policies, but that, as a Democrat with a strong union constituency, he is going to have to

take a look at some areas of trade policy where the unions are particularly sensitive. That means Senator Kerry will take a look at the possibility of selected enforcement actions where he thinks unionized industries face a particular problem. The political issue that will come first, just because of politics, may well be in the automobile industry. But I remind you that in 1992, despite all the upset over the US-Japan confrontation over automobiles, by 1994 it looked like business as usual, except that at the end of the day US parts supply companies had somewhat greater access to the Japanese market. This is not going to be the end of free trade, but you may see some selective actions.

Secondly, you may see a Kerry Administration explore within the WTO rules the options for “buy US” programs by the US government for certain goods. I do not think a Kerry Administration would actually get itself into a position where it violates WTO rules, though. Of course, like the Bush Administration, it would use temporary adjustment programs, much as the Bush Administration did with steel.

On the more structural side, there are some issues at which it is worth looking. The macroeconomic policy of Kerry would differ from that of Bush because of the greater emphasis on budget deficit reduction. That would affect the options for a currency revaluation. No one knows the precise number by which the dollar has to be adjusted in order to bring down the current account deficit. Our projections and models in this area have been very unreliable in the past. If you walk around Washington, DC, to the economic think tanks, a common number you might hear is a 25% to 30% adjustment in the value of the dollar. I do not think you should take that as any particular firm forecast. Politically, this is a very difficult matter. There are those matters of large US dollar holdings out there, particularly in East Asia.

If Secretary Rubin is important in a Kerry policy team, you must remember he was a very strong believer in managing financial markets with financial discipline, and then worrying about other matters second. That may change the way such an administration would approach dollar revaluation. Whether it be Bush or Kerry, though, I think the dollar value will be re-valued through some process of negotiation with our chief trading partners.

Secondly, I would like to point to another possible feature of a potential Kerry Administration. There would be an effort to deal with the politics of trade adjustment in the long term. Any Democrat president is going to need to deal with the fact that his voters are especially from working trade union companies. The question is, what does a president do for the painful adjustment of union workers as we continue to globalize the US economy?

Let me offer two thoughts about options for a Kerry Administration. I do not offer these thoughts as predictions, rather they suggest how they will think about their options. First, the US has many worker assistance programs for its unemployed workers. We have workers who were laid off due to “trade stress”. We put them into worker training programs for three months or six months. We give them unemployment benefits. But for all these efforts, these programs are not extremely effective. If you and I were in

those programs, we would not be too confident that we were going to come out with a good job at the end. This creates a political problem. A Kerry Administration would need to look for a new “big thought” about worker adjustment.

Let me offer an example of an outrageous thought. In the world of corporate restructuring, when we want to change how a company is organized, we buy the company and essentially pay the company to restructure. These buyouts are a very important part of the corporate scene in the US. What if we did labour market buyouts? There are estimates that “protecting” a job in the steel industry in the US costs the US economy USD 20 million per year for every job we “protect”. What if we gave the workers, instead, a USD 1 million financial annuity to buy their job? We would not give them three months or six months of unemployment insurance and a job training program, but USD 1 million in a financial savings program as a lifetime warranty.

That would be a net savings to the US economy of USD 19 million. It gets the worker into a world in which he or she would have financial security. Again, I’m not saying this is the proposal a Kerry Administration would have. What I am suggesting to you is that a Democrat president may explore some radical new policies for labour adjustment in order to make the politics of trade more manageable.

Another potential Kerry approach to trade and structural adjustment involves the national health care policy. It is my belief that a Kerry Administration would be committed to reforming US health care financing. In doing that, a Kerry Administration may make that an opportunity to make it a contribution to trade policy.

In particular, writing the details of a health care program may well become a way to take the cost of financing health care off the books of highly unionized industries. In other words, if you looked today at the cost structures of General Motors or Ford, you would find that a significant part of the company’s costs are the costs of health care.

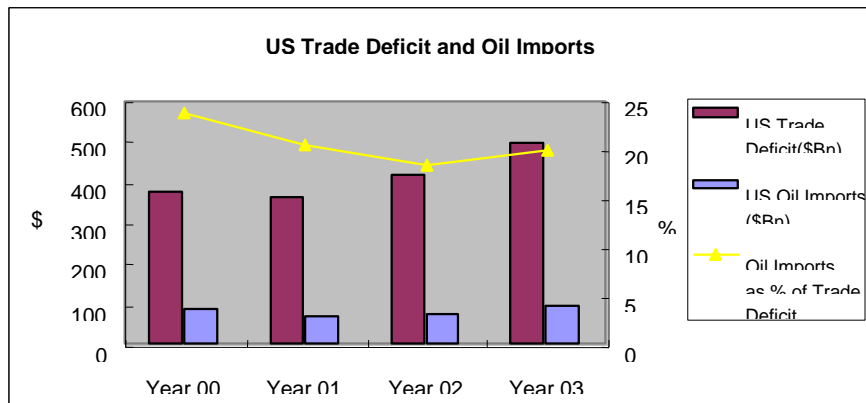
If there were to be a new national health care initiative from a Kerry Administration, why not design it so as to take the financial costs of health care off the books of General Motors and Ford and move them onto the US government roster? Doing that and changing the companies’ cost structure would make them more competitive and make it easier for them to deal with other types of adjustments.

Finally, I want to talk about the way in which energy policy could be another way to deal with the current account deficit. Figure 1 below shows the US trade deficit in oil imports. Since 2000, in an average year US oil imports account for roughly 20% of the US trade deficit.

If a Kerry Administration were to try to show that it was bringing the current account deficit under control while not radically changing trade policy or financial policy, one place to look for lowering the deficit is the reduction of oil imports into the US. It would be very popular politically, and there would be some options a Kerry Administration might explore in this area.



Figure 1.  
US trade deficit and oil imports



### Outsourcing: a modest new proposal

Outsourcing is a non-issue. Senator Kerry has spoken a lot about the “outsourcing” of US jobs. We know, in fact, that recession and growth in productivity are the main reasons for job losses in the US. In fact, the senator, despite his rhetoric about “outsourcing”, has a fairly modest proposal to deal with one issue in the tax code that encourages outsourcing and which many economists find to be not good tax policy.

The Kerry proposal is, essentially, to lower US corporate taxes and to change the way in which US firms bring profits from overseas locations, like Korea, back to the US. In doing that, the senator is “ending the subsidy” for outsourcing jobs, but not radically changing the picture of US overseas production.

### Labour rights: 2004 AFL-CIO petition on China backed by Kerry

Senator Kerry has supported a petition by the American Federation of Labour—Congress of Industrial Organisations (AFL-CIO) to review China’s restriction on labour rights. There is an elaborate theory in this petition that the lack of labour rights in China leads to lower wages in China, and that those lower wages are what cost US workers their jobs. I have no doubt the senator will support the petition and that it will go to the WTO.

The economic link between labour rights and wage levels is very, very complicated and uncertain. It’s not the sort of argument that tends to survive in a WTO panel. So even if the petition is brought, I doubt it would succeed. Senator Kerry would then still be left with the basic issues of China and labour rights.

### Labour and environmental rights and “the tool kit”

The Bush and Kerry approaches are not that different on labour and environmental issues. Both will emphasise labour rights, and countries enforcing their international labour obligations to organisations like the International Labour Organisation (ILO).

Both candidates will emphasise *ad hoc* environmental deals to deal with particular environmental issues as they come up in negotiations. I do think a Kerry Administration would be more aggressive about this than a Bush Administration. But the basic approach, as a policy approach, would not be radically different. Only the execution would be sharper and more aggressive in a Kerry Administration.

### **The agenda for Doha—The politics of the round**

There is room for a Doha agreement. Both a Kerry Administration and a Bush Administration are capable of ratifying a Doha agreement. Unless the European Union radically changes its offer at the Doha round, a major improvement in the US offer will not be readily available. There is room for improvement in the US offer. As a trade negotiator in part of my past, I can say that there is no trade negotiator who does not keep something in his or her back pocket for the final round of negotiations. That offer which was our “final” offer is not our best offer. Somewhere within the US offer there is a little bit of leeway. I’m not sure if there is a lot of leeway, but there is some negotiating leverage.

### **The new long-term challenge: Security & Trade**

This issue will be very important to the US and all other countries’ trading policies in the long-term. We have not adequately begun to address this issue. There are new linkages between security and trade policy due to the US’s war on terrorism.

I am supposed to be an expert in the area of communications and information technology. Every day I have many new e-mails promoting or talking about projects for monitoring and control technologies for anti-terrorist purposes. The easiest examples are the ones out there already. There’s something called an APEC Supply Chain Security Initiative and another one called the US Container Security Regime.

The US has basically said that all traded goods coming into the US are going to be subject to security screening. It may not be that every container is inspected. But every container will be subject to a secure electronic chain of evidence. From the moment a manufactured good leaves the production line, until the time it arrives on a US store shelf, there will have to be an secure electronic database that shows every step of its handling and every procedure involved in that. That is where we are heading.

There is a similar trend in the field of food. I believe—and this is just a personal prediction—that in 25 years, if Korea wants to, say, ship rice to the US, there will be a requirement for biological monitoring sensors in the rice fields of Korea to insure that there has been no bio-terrorist attack on Korean rice destined for the US market. The rice will then have to be tracked as it is shipped to the US.

The information and monitoring technology is coming. The creation of this “information security infrastructure (or ISI),” which will cover all parts of global commerce, will cost us our global society hundreds of billions of dollars in new capital

investment. It will create a massive new infrastructure to track and monitor global commerce.

There is only one of two possible outcomes that will come from this. One outcome might be that in building this security information infrastructure, we build a brand new tool for global efficiency. It could facilitate trade. It could improve our ability to monitor the environment. The same sensors that monitor the rice fields can monitor air pollution. This new infrastructure could become a wonderful new tool for global society. On the other hand, that tool could easily become an indirect barrier to global trade in a very powerful way. Nobody is yet thinking about this threat in the right way, since we do not yet understand the magnitude of this infrastructure and its potential.

The second area important in the long-term is the dual use of biological technology. During my career, I have lived through the wondrous miracle of the information and communications technology revolutions. These drove the growth of the economies of the world. Over the next 50 years, the biological sciences are going to be a similar engine for growth and transformation across the world. These will be extraordinarily powerful.

But those biological sciences also create security problems. Today, you read about the threat of biological terrorism, of some terrible disease that could kill thousands and thousands. All of those threats are from biologically—that is, genetically—modified germs and diseases. Genetically enhanced small pox is one example. Today in the world, there are only about 25 or 50 laboratories that can do this terrible dangerous work. Most of them are closely controlled by governments.

The biological science revolution means that 25 years from now there will be hundreds of laboratories. All the issues we have faced keeping control of nuclear materials with the spread of the nuclear power industry will be nothing when compared to this issue.

We must find the right answer early. First, security is critical. Second, if we do not find the right answer, we may cripple the growth of the biological sciences industries. That is unacceptable for the future of the world. Those industries can provide wonders of health and wonders of growth in all our economies.

We must find the right solution. It will be through the imperfect tools of trade policy and an agreement about public health standards that we will find those tools. Those are the sorts of challenges that—beyond any dispute about steel today or rice tomorrow—will be the things that really drive the future of our world and what we leave for our children.

### **Questions & Answers**

**Q** You mentioned that if Mr. Rubin ends up advising a Democrat president, he would be managing the financial markets first. The problem with that is that the tremendous economic progress we have witnessed is a result of the breakdown of a fixed exchange

rate system, as established under the Bretton-Woods agreement. As a result of the implementations of flexible exchange rates, the world economies are doing well. In short, market forces have triumphed. But Mr. Rubin believes in a strong dollar and controlled engagements. How do you view this?

**A** I do not think anyone in Washington, DC, thinks a fixed exchange rate system would work. But, it's a fact that China fixes its exchange rate against the dollar, and so do some of the other key players, like Hong Kong. I would not be surprised if Rubin, or others like him, want to negotiate about their currency management policies. In other words, China's unilateral policy will be a topic of discussion. I think it will lead to a dollar readjustment. But I do not know if it would be a 10% or a 20% adjustment. I certainly don't think we'll see the end of floating rates. In the big picture, floating rates, whether managed or not, will still be there.

**Q** Korea and the US have been negotiating a bilateral investment treaty for some time. Success has been largely held back by Jack Valenti, head of the Motion Picture Association of America (MPAA). He strongly objects to Korea's movie industry practices. He insists Korea eliminate or strongly reduce its screen quota. Until that is done, he threatens to kill any issue brought to Capitol Hill. Administration officials feel that, since it will be killed in the houses of Congress, they have better things to do. So Korea gets the lowest priority in terms of free trade agreements (FTAs). This is an issue both sides insist is not an issue. This is not an economic issue. This is an emotional issue by some insistent people who are very firmly entrenched. Can we have some political initiative, by wise people, who could move beyond this and implement an FTA?

**A** No one, especially not a school dean, has ever won an argument with Jack Valenti in Washington, DC. That's just a reality. But he has retired, as you know, so that bodes well for the future.

The MPAA is part of a bigger discussion that will go on in Washington, DC, and within the industry itself over the next few years. What is the long-term self interest of the industry? The movie industry takes the not-so-unreasonable view that it is money out of its pocket every time they fail to take advantage of these market-opening opportunities. It's foolish for it not to press as hard as it can. If I were in its shoes, I'm not sure I would take a different view.

The long-term challenge for the industry is that we are about to see a true revolution in communication networks. It will allow the manipulation and use of digital content in a whole new way. The MPAA is going to have to think about its real interest in this rapidly-coming world. It will have to think about trade rights, licensing agreements and charging arrangements. This extends to intellectual property agreements, too. There are signs the industry is thinking through this a whole lot more, as it will have to do over the next two years. It is very hard to get around the MPAA. It has enormous political visibility. But the industry itself may change its views in some ways.

Politicians deal with a world which has a short attention span. The movie industry has the tremendous advantage that, when it is yelling, it gets media attention. This makes it tremendously powerful beyond what you would imagine simply based on its sheer dollar size.

**Q** The topic of a Korea-US FTA has been under discussion for about ten years. For most of that period, the US took the position that the US itself was not really keen on this FTA. Then, just over the past few months, we now hear Mr. Zoellick and others from the Bush Administration showing very active pursuit of an FTA with our country. How do you explain this change in attitude in terms of trade policy politics in Washington, DC?

**A** I do not fully pretend to know all of Ambassador Zoellick's reasoning. But I do think there is at least one thing that is moving the US position. The growth of bilateral free trade agreements around East Asia has caught attention in Washington, DC. There are a growing number of US companies that are worried that the US has to be competitive in this area. Ambassador Zoellick is trying to show that, even as he is trying to make Doha into a success, he is also doing everything necessary to protect US bilateral interests. To negotiate at Doha he has to show he is also being aggressive bilaterally. Korea is, obviously, also a potential big story for him if he could make it work.

The broader point I would make about both Bush and Kerry is that we all know both administrations are going to face, with Korea, a very difficult set of decisions, choices and problems in regard to North Korea. We should not underestimate that, as we go forward together with the challenge of North Korea, that may have an impact on trade policy. This is not a prediction. This is just a point I want to make.

It may be that someday the White House and South Korea are dealing with terrifically difficult problems. Not next year, and not the year after, but somewhere down the line, the two presidents will tell each other for our two societies to show we are truly together in dealing with our common security, we need a free trade agreement.

Why did the US support the North American Free Trade Agreement (NAFTA) with Mexico? It really was not because of the money. It was because it was intolerable in the long-term for the US to have Mexico fail as an economy. This was not an acceptable security situation for the US. We had to commit ourselves to opening the US market in order to allow the Mexican economy to restructure. Obviously, Korea-US is a different economic relationship. But security does matter sometimes in these economic relationships. We should not ignore that.

**Q** There is another reason why the US is pursuing an FTA at this time. The free trade area of the Americas has fallen by the wayside, and China is growing rapidly. Wouldn't that explain the US's interest in an FTA with Korea?

**A** I totally agree these points you make are right. A bigger point, though—if we don't think one or two years but if we think long-term—is that there is no US trade policy that

in the long-term is not going to be focused on the fact that the future growth of US trade and investment is in the Pacific, in the areas of Asia and the Americas. By one mean or another—whether WTO, bilateral, regional or some other type of agreement—the US government is going to have to create really deep stable arrangements to integrate these markets.

We're going to see the growth of more bilateral agreements in Asia with the major trading powers in the long-term. But whether it's today or four years from now is a matter of political opportunity and political negotiations.

**Q** How can we prevent or alleviate trade friction and confrontations and promote trade cooperation between the US and Korea? What would be the most effective way to do so?

**A** We are promoting a lot of trade. Frankly speaking, Korea will face some additional choices in the future. There is still a tendency by the government here to want to orchestrate certain areas of the economy using some of the tools of industrial policy. That is going to be politically hard to do within a deep trading relationship with the US. I note that to you in the spirit of candor.

**Q** The two biggest US issues are the twin deficits. Work adjustment or national health care are domestic things. But a revaluation of the US dollar, whether naturally or made by political leaders, would affect the whole world. The speed and range of the revaluation would matter very much.

**A** First of all, the issue of a currency revaluation is always a delicate problem. There was the "Nixon shock" in 1971 when the US unilaterally went off the gold standard and the fixed exchange rate system. The US moved to a floating rate. Holdings of US dollars around the world limit the US's ability to do anything quite so dramatic or unilateral in the future.

It is going to end up being much more of a process of consultation, trying to find an understanding about the range of possible US action. It will also be a matter of trying, in particular, to get China's exchange rate policy modified. We are already seeing this today in APEC and, more importantly, in the G7. G7 discussions are entirely focused on this subject. There is going to be some change. There will be an element of negotiation to it. But no US president is going to entirely give up the ability to set that decision on his own. There will be some element of discretion for the president, even in negotiations.

**Q** You mentioned that the US could peg to a bundle of Asian currencies. Do you have in mind, in the long-term, some sort of Asian common currency area?

**A** I do not see a future Asian currency. Politically, that would require long-term deep political action on the part of Asian governments. I am skeptical even Europe is the right model.

When I talk to traders in the financial market, they talk more and more about the size of assets available in the open capital markets. It is so great, traders may be able to create the equivalent of a European currency unit out of Asian currencies without the governments ever publicly agreeing to a currency link. Such a currency would not be a full substitute to a euro or a dollar. Central banks coordination would not be there. But for a lot of purposes, it would be an acceptable substitute. You have to ask the financial currency traders if this is feasible. That is what they come and talk to me about, though. I think it's pretty extraordinary.

**Q** Especially since you are the dean of the school of Pacific studies, I would like to ask you about trade in this region. Once upon a time, that is, under President Clinton's first term, the US was very actively in pursuit of APEC. The Bogor goals were strongly championed by President Clinton himself. But over time, US interest has dwindled. During the second Clinton Administration, Mr Clinton was more intent on a free trade area of the Americas than economic cooperation at the APEC level. More lately under Mr Bush, the US has generally been using these APEC fora for counter-terrorist policy initiatives and other perceived security issues.

How do you assess the intensity of US government interest in APEC as a body for economic cooperation? Will the US be renewing its interest in pursuit of the Bogor goals? The APEC Business Advisory Council will submit a proposal to APEC economic leaders when they meet in Chile next month for a free trade area of the Pacific. That is a modified version of the Bogor goals. How will the US react?

**A** I think the US would be very interested in a true free agreement for the Asia-Pacific that had a meaningful ability to get more than the easiest, lowest-common-denominator agreement. In other words, the problem that APEC ran into during the Clinton Administration was that it was not seen as capable of coming to hard decisions about the toughest issues. It was a consensus system, with the Bogor goals to be achieved by 2010 for the more advanced countries and by 2020 for the less advanced countries. A likely outcome would be a pretty low level of common agreement at the end. If the free trade area for the Pacific could really tackle some of the remaining hard problems, you would see huge interest in Washington, DC.

My colleague Professor Richard Feinburg was the principal person on the National Security Council pushing the free trade area of the Americas. He took advantage of the fact that he was able to make the argument in Washington, DC, that you couldn't make all these commitments to Asia—which is how APEC was viewed—without making an effort in the Americas. It was an easy way of arguing for the importance of the Americas. But I don't think anyone in Washington, DC, thinks a free trade area of the Americas is as important, in the long-term, as the Asian trading relationship.

**Q** The US has for many years been very aloof, to say the least, about FTAs, largely because US policy has been to promote free trade through the WTO and a multilateral system rather than bilateral agreements. Theoretically, that is a very correct approach. Arguably, the US changed its policy stance after being frustrated with progress at the

WTO, particularly with the Cancun failure. The US has now mostly moved on to bilateral FTAs. The US now has something like 166 FTAs registered or in progress, and this is expanding every minute.

FTAs were originally allowed by GATT with strict provisions. If those provisions were strictly kept, it would not be so bad. But now, just about all FTAs are in violation of these. Hence, Professor Jagdish Bhagwati perpetually worries about a “spaghetti bowl” effect complicating world trade. It is a reality and it is getting worse.

The US could take the initiative to enforce some discipline throughout the entire world. FTAs are not the preferential agreement, and should keep within the original GATT provisions. That is the only way substantial world trade could go. What are your thoughts on this?

**A** My short answer is yes. It is an imperfect world, and so people pursue bilateral agreements.

**Q** The Bush Administration, particularly Ambassador Zoellick, has continuously pursued a multi-track trade policy, focusing both on multilateral and regional agreements. If Kerry’s team wins, would that change? How would this affect a Korea-US FTA?

**A** I do not think a Kerry team would back away from the Doha round. Such a move would not be politically acceptable. It would not be seen as economically prudent. There will not be a retreat from that.

Beyond the minimum that is required to make Doha work, both Bush and Kerry will be tempted to put more of their time into bilateral and regional agreements, rather than the WTO agreement. They will not let the WTO process fail, but the regional agreements will be more important.

In all candor, if there is a serious effort to push forward a Korea-US FTA, you would see a Kerry team be pretty aggressive on issues like the automotive parts industry, the unions and high-technology. There will be less about motion pictures and more about the remaining areas of communications and information technology, and some about new areas in biotech. I believe a Kerry Administration would consider those to be growth industries for the US.

Also, in the long-term, a free trade constituency within the Democrat party has to include a very enthusiastic high-technology component. The Democrat vote nowadays is the traditional labour vote and the college-educated, professional research class. If the high-technology industries are not part of a Democrat trade constituency, it is hard for a Democrat president to run a good trade policy.