

THE KOREAN - U.S. RELATIONSHIP: ITS CURRENT CONDITION AND FUTURE PROSPECTS¹

by

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I want to thank the Institute for Global Economics for the invitation to speak to you this morning. The Institute is one of Korea's leading centers of research and analysis on international economic issues. It is an important resource as the Korean government and private sector tackle the challenges of adapting to a globalizing international economy.

This morning, virtually on the eve of the year 2000, I would like to take stock of the Korean-US relationship, its current condition and future prospects. As I have stated many times in the past, no bilateral relationship is more important to the United States than our relationship with Korea. I venture that the same can be said from Korea's perspective. However, relationships cannot be taken for granted. They require tending. They must be nurtured and sustained over time. We must continually examine their foundations, checking to assure that these are built on common interests, that they reflect shared values, and that they further our respective interests.

Let me begin with the economic aspect of our relationship. The United States has a major stake in the health of the Korean economy. Not only is Korea one of our major trading partners, but Korea's economic strength is also key to the effectiveness and strength of our security alliance. The current outlook for the economy is dramatically improved in comparison to the end of 1998. Korea has made a truly impressive recovery from the financial and economic crisis that struck in late 1997.

Economic growth is galloping ahead and will likely reach 9-to-10 percent for this year, compared with an almost 6 percent contraction in 1998.

Inflation this year is less than 1 percent, compared with 7.5 percent in 1998.

Foreign reserves are about \$70 billion, compared with less than \$10 billion in early 1998, and are anticipated to reach \$100 billion in 2000.

Korea's current account surplus surged to \$40 billion in 1998 and probably will exceed \$23 billion in 1999, following a deficit of \$8 billion in 1997.

The Korean stock market is up over 75 percent this year.

The Korean won has strengthened to 1150 or less per dollar compared with close to 2000 per dollar early in 1998.

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Moody's is currently reviewing Korean sovereign bonds for a possible upgrade, after restoring their investment-grade rating earlier this year.

Clearly, Koreans deserve enormous credit for the remarkable turnaround of the national economy. The Government has put in place important measures of financial and corporate reform. Korean workers and companies have made major sacrifices, and the world's admiration for the strength of the Korean work ethic has reached new highs. The Korean recovery is also an outstanding example of the importance of effective international cooperation. With the leadership of the International Monetary Fund and the strong support of the United States, Japan and other industrialized countries, Korean commitment to reform and restructuring was linked to emergency financial assistance and the rescheduling of short-term foreign debt. Absent this international effort, I suspect your recovery would have come later and perhaps been much less robust.

The economic policies pursued over the past two years have in many ways transformed the Korean economy. It is now far more open, more transparent, more market-based, and more competitive internationally. The benefits to Korea of these changes are clear: employment is rising; consumer spending and investment have increased; exports are growing strongly; the stock market is approaching record levels; and foreign direct investment is flowing into the country. Indeed, foreign direct investment committed to Korea over the past two years almost equals the accumulated total of the preceding 36 years.

Confidence is growing, and that is good. But I think President Kim was right when he said a few months ago that "this is not the time to uncork the champagne." This is no time for complacency. The evolving global economy provides great benefits, but it also heightens vulnerability. International competition for markets and capital is relentless. If a country does not keep up with rising international standards of transparency, efficiency, and competitiveness, it risks punishment in the global marketplace. Also, it is important to note that Korea, particularly this year, has benefited from a generally benign international environment. Interest rates have been relatively low, economic growth in many of your major markets, including the United States, has been strong, and commodity prices have generally been stable. While we all hope these conditions continue, it would be a mistake not to be prepared for a more difficult set of circumstances.

The Korean Government is clearly correct, therefore, when it stresses that reform and restructuring are not yet complete and that further effort is needed. The international financial community shares that judgment and will continue to watch Korea's performance closely over the coming months and years.

In the area of financial reform Korea has clearly made great strides. Many insolvent financial institutions have been closed, a new, consolidated institution for prudential supervision has been created, and standards have been strengthened. Substantial public funds have been committed to the purchase of non-performing loans and bank recapitalization, and the Government has said it is prepared to provide further funds if necessary. Given the widespread belief that earlier estimates of non-performing loans in the banking system may have been too low

--a belief that has been strengthened by the Daewoo crisis -- this commitment to provide more funding if necessary is critical to international and domestic confidence.

One result of the use of public funds to recapitalize the banks has been the *de facto* nationalization of much of the banking industry; the Government now owns 90 percent of four of Korea's five largest banks. This was an unavoidable consequence of the need to prevent the complete collapse of the banking sector. However, it raises significant questions as to how and when the Government will divest itself from the banks and restore private ownership. Clearly, it would not be healthy for the Government to continue to own the banks for an extended period. In addition to offering domestic investors the opportunity to acquire shares in the ownership of restructured banks, foreign direct investment can be part of the privatization process. A majority interest in one of Korea's largest banks, Korea First Bank, is being sold to American investors. There has also been considerable foreign equity investment in other commercial banks. Foreign participation in the banking sector has the advantage of stimulating competition and efficiency through the introduction of modern practices of credit analysis and risk assessment.

In recent months, the Daewoo crisis has underlined the essential need to continue corporate restructuring. The Government has acted decisively in response to the Daewoo crisis, recognizing that the unprecedented size of the Daewoo default posed a systemic threat to the entire economy. Thus far, the Government's effort has focused on the financial restructuring of Daewoo's major affiliate companies. Korea's taxpayers, who already own most of the banks, will soon own much of Daewoo as banks swap debt for Daewoo equity. However, financial restructuring alone will not be sufficient to restore the Daewoo affiliates to profitability. Major operational restructuring will also be necessary, and Daewoo affiliates must be subjected to market-based discipline. Korea's international audience will be watching closely to see whether non-viable firms are liquidated in an orderly fashion and not allowed to continue consuming scarce capital. Those that can be restructured and made profitable can then be sold to new owners. Korean banks do not have a long-term interest in owning equity in non-financial enterprises.

The lessons of Daewoo should be obvious to all Korean corporations. Delay in restructuring can bring disastrous consequences. While much has been done, further progress in debt reduction, greater corporate transparency, and improved corporate governance are clearly crucial.

Daewoo's troubles have also focused attention on another problem area – the investment trust companies. Some ITCs invested heavily in Daewoo paper, now worth a fraction of its face value. The ITCs have been allowed to act like banks because they promise their clients a given rate of return on investments. In fact, they are more like mutual funds because they hold assets of fluctuating value like Daewoo bonds. Whenever investors believe the ITCs may be unable to pay their promised rate of return, they rush to withdraw their money, making the ITC's cash problems even worse.

The Government has committed to the eventual solution of the ITC problem by requiring these institutions to mark their assets to market value on a daily basis. These new marks to market requirements should be imposed on all ITCs as soon as it is feasible. When the value of ITC assets is transparent, ITCs will no longer face recurring crises of confidence.

The current problems of the ITCs also threaten Korea's efforts to develop a corporate bond market and reduce the traditional heavy dependence of Korean corporations on bank credit as a source of finance. The Government's moves to stabilize the bond market and prevent a run on ITCs were perhaps necessary given the severity of the Daewoo crisis. Yet, requiring banks to act as buyers of last resort in the bond market can only be a short-term expedient and acts against Korea's long-term interest in promoting the development of a robust, transparent bond market. As soon as possible, bond markets should be allowed to reflect actual supply and demand.

Korea is one of the world's great trading nations. The United States and Korea do nearly \$50 billion in two-way trade and Korea is our eighth largest trading partner. We have made substantial progress over the past two years in managing our bilateral trading relationship. For example, we concluded an agreement on autos over a year ago and are now making progress on other matters such as pharmaceuticals. Our disputes on some matters, such as agricultural trade, we have agreed to submit to the WTO.

We both have a great stake in the continued liberalization of world markets and, thus, in the success of the WTO. Although ministers were not able to agree on the launch of a new trade round in Seattle, a successful WTO round undoubtedly will bring greater prosperity and economic opportunity to Korea, which has thrived under an open global trading regime. We already broadly agree with the Korean government on many issues - for instance, transparency in government procurement, duty-free status for electronic commerce, and expanding the Information Technology Agreement. The U.S. Government also looks forward to engaging Korea and others in frank discussions on issues where our positions differ, such as agriculture and anti-dumping. We want to find a workable consensus to move the new WTO round forward.

I would like to turn now to the other critical dimension of our relationship - security. The Korean - U.S. security alliance has long been at the core of our relationship. Our combined military strength has successfully deterred North Korean aggression for nearly a half century. The alliance and our defense partnership are solid, as demonstrated by the recent Security Consultative Meeting in Washington between Defense Minister Cho Sung Tae and Secretary William Cohen.

Yet, our two countries are agreed that it would be a mistake to rely on deterrence alone to assure stability on the Korean peninsula. We believe the time is ripe to pursue a broad diplomatic effort to bring greater security to the peninsula and the region. The Republic of Korea and the United States, together with Japan, are offering North Korea an opportunity for comprehensive engagement. Our offer is based on the judgment that the North's military threats are real and we

must continue to deter them. It is also based on the judgment that we have an opportunity, indeed an obligation, to try to peacefully resolve our differences by non-military means. What we are saying to North Korea is that it, too, has a stake in stability and peace and that we are prepared to take steps with them to reduce threats to peace.

North Korea confronts a major dilemma: it must change to survive, but the regime apparently fears that change could bring the seeds of its own demise. North Korea's autarkic economic system has essentially failed. By all standards of measurement, the North's economic condition is dramatically worse than it was just a few years ago, and the decline continues. Major changes in policy would be required to turn around the North Korean economy, but policy change would also have to be accompanied by an infusion of outside resources. As a practical matter, the bulk of those outside resources would probably have to come from South Korea.

President Kim Dae-jung has made it clear that Korea will pursue peace and stability in the peninsula through dialogue and practical cooperation with the North. To support those aims, the United States, the Republic of Korea, and Japan have joined to try to find ways to help North Korea solve its dilemmas. I'd like to restate the principles that guide American thinking on this topic:

SHARED INTERESTS. While the United States has vital interests in Korea and Northeast Asia, the Korean people have even more at stake. Accordingly, U.S. interests are best advanced by coordinating our policies with those of the Republic of Korea.

TRANSPARENCY. Given the long-standing situation of "not war, but not peace" on the Korean Peninsula and North Korea's opaqueness, the United States and the Republic of Korea must be as transparent and open as possible about our intentions and capabilities. We must avoid misapprehension and miscalculation.

ACCOUNTABILITY. Democratic countries with representative governments, like the United States and the Republic of Korea, are accountable to an informed citizenry. Our governments must provide our citizens as much information as possible about the policies that they carry out on their behalf.

In the end, the North cannot solve its dilemma through marginal change. The easing of American sanctions will remove certain commercial and financial roadblocks, but North Korea must take major steps of its own to significantly change its economic condition.

Yet, the North cannot, and will not, change overnight. We will continue to take steps beneficial to North Korea commensurate with North Korea's accommodations to our concerns. This is a basic tenet of the Agreed Framework, President Kim Dae-jung's policy, the recent U.S. steps on sanctions easing, and Japan's recent overtures toward the North.

We are aware that North Korea would like to drive wedges between the United States, Korea, and Japan. It would prefer to normalize U.S.-North Korean relations at the expense of the Republic of Korea. I can forthrightly say to this audience that such a scenario cannot happen. We seek to move toward a more normal relationship with North Korea, while addressing concerns about the North's missiles and development of weapons of mass destruction through negotiations with the North and close coordination on policy goals with the Republic of Korea. However, the United States cannot have a genuinely normal relationship with North Korea until South and North fundamentally resolve the conflict between them.

In conclusion, our two nations surely will continue to cooperate closely on economic and security matters. Our thinking on mutual concerns is similar due to our shared values. The most important of those values is our support for democracy and all that flows from deep-rooted democratic values: an open economy, competition, transparency, accountability, and a sense of fair play. Korea and the United States will face many challenges together in the new millennium, but there is no challenge we cannot overcome if we remain true to our basic values.

Q & A Session

Q: I don't think laymen on the street fully understand what happened in the WTO negotiations in Seattle: what is going to happen and what is the mechanism of the trade negotiation. All they know is that the WTO negotiation is somehow connected to opening of rice and other markets and maybe, have a distant memory of the Uruguay Rounds. The media has been reporting many negative things and many believe that the WTO negotiation in Seattle is a failure. How do you see the next rounds of the WTO proceed in the forthcoming years?

A: It is a very broad and difficult question in part because the events of Seattle are still very recent and we have not had much time to digest the consequences of what occurred there. The processes of global trade negotiations have always been complicated. You recall how long it took to complete the Uruguay Round and how many times it appeared that the Round was bound to fail. The creation of the WTO as a new international institution was in itself, a considerable achievement. As a part of that, we have had a tremendous expansion of the number of countries involved in global trade negotiations. I am not sure that we have yet found a process or a procedure for involving all of those countries in negotiations of interest to them in an appropriate fashion. Thus, some countries developed a feeling that all the important decisions are being taken by a small group in the back room.

Also, we are, to some extent, a victim of our own success. As we have brought down conventional tariffs over the past several years, we are now left with trade issues that are much more complicated: agricultural subsidies and trade in services. Development of technologies, such as e-commerce, also poses new challenges to trade negotiations.

Seattle was not intended to produce negotiated results; it was intended to produce an overall agenda for subsequent negotiations. And until that agenda is fixed, it is very difficult to have negotiations on specific problems because countries insist on being able to identify possible trade-offs between one set of issues and another set of issues.

Also, these trade issues, in general, have become much more sensitive in domestic politics in most countries because trade has now expanded to the point at which it is a major component of domestic economic activity in virtually every country. Even for the U.S., our exports have risen as a percent of our GDP, from around 8 percent to now, 12 percent. As for Korea, exports account for almost 25 percent of the Korean GDP. So these issues of trade are no longer abstract subjects for academics and government officials, they have real importance to average citizens in our countries and therefor, have acquired great political significance.

At Seattle, we found in the end that we simply could not reach an agreement on agenda for a new round. But that is far from being the end of the exercise. Trade is far too important to all of our economies for us to risk what might happen with the loss of momentum toward greater liberalization. Thus, efforts will continue in Geneva and elsewhere beginning in the New Year. There will have to be another ministerial meeting at some point, though it is rather difficult to predict when that might be. However, I am confident that despite elections and despite the events in Seattle, we have not seen the last of a new global trade round.

Q: In the margin of the Manila Summit, a meeting of Japan, China and Korea has taken place. The trilateral summit has been qualified to be a historic step towards the beginning of the Northeastern Asian cooperation. What is your assessment?

A: First, it seems to me that it is to the great advantage of the U.S. to see a process of improving relations among the countries of Northeast Asia: we can only be net winners from that improvement. We have important and vital security relations with both Japan and Korea. We are attempting to develop a very engaging relationship with China. I think the more that these countries talk among themselves and to us, the better off for all of us. I think we look forward to seeing further development of these kinds of relationships. I think it is probably somewhat premature to talk about new institutions: building of new institutions, as we have seen in Western Europe and in North America, takes a long time. But in the meantime, increased dialogue is, clearly, an essential element.

Q: In the past, Senior U.S. officials have referred to the desirability of maintaining military presence on the Korean Peninsula after reunification. Could you comment on specific reasons for maintaining U.S. military presence in a post-reunification scenario? The PRC has recently underlined that the presence of U.S. troops on the peninsula should be negotiated at an appropriate time. Can you explain the reasons for ROK and PRC's behaviors?

A: I can address this question with a growing confidence that it will not be a problem that I would have to deal with while I am the ambassador in Korea. So, for me personally and in many ways for my government, this is a hypothetical question. It is very difficult to predict at this point in

time, the conditions and circumstances that might prevail at whatever time in the future Korea is reunified. But let me say that in my personal view, U.S. will continue to have important, vital national interests in Northeast Asia after the reunification of the Korean Peninsula. How we address those interests at this unknown time in the future, of course, will be a subject of closest consultation and discussion with our major and traditional allies in the region. Again, in my personal opinion, it would be useful to have some sort of U.S. security presence in the region. The most important point is that our interests here are permanent and will continue. Therefore, there will be a requirement for continued U.S. engagement in the region. The form of that engagement will depend upon on the circumstances of the time and the desires and the wishes of our traditional partners in the region.

Q: *Koreans are concerned about the talks between the North Korea and the United States, which ended recently without progress in Berlin. Could you tell us when the proposed high-level talks between the two countries will resume and what will be the agenda?*

A: I don't think too much should be read into the fact that there was no dramatic announcement after the last meeting in Berlin. This dialogue between North Korea and the U.S. has been going on for some time and we expect it to go on in the future. Not every meeting is going to produce dramatic results. My understanding is that we expect this process will continue to move forward. Obviously, we cannot predict nor control the pace or speed at which it moves forward because it is as dependent on North Korea as it is on the U.S. But in the meantime, our contact with North Korea continues through regular channels and we look forward to the process that was outlined in William Perry's report.

Q: *In your opinion, when do you see the reunification of Korea? When do you think diplomatic normalization for the U.S. and North Korea would be possible?*

A: Those are both questions to which, unfortunately, I am unable to give precise answers. Clearly, the question of when Korea will be reunified is, understandably, the subject of intense interest to virtually every Korean. Frankly, I am less concerned with *when* than *how*. For a long time, the U.S. has and continues to strongly support the peaceful reunification of the Korean Peninsula. That is why we strongly support President Kim Dae-Jung's efforts at engagement between South and North Korea. The immediate objective of this policy is to reduce tensions and bring about greater stability, security and predictability to the Korean Peninsula. What I would stress is that the U.S. has no ambivalence about its desire ultimately to see the Korean Peninsula unified. But I can't even give you an approximate estimate of when that might happen.

The U.S. and North Korea have taken some first steps down what I would expect to be a very difficult and long road. And as you all know from reading the Perry report, the process is based upon tight reciprocity: the U.S. takes actions commensurate with the degree to which North Korea satisfies our concerns in the security area, particular with regards to missiles and weapons of mass destruction. For our part, we have been prepared for several years to establish liaison offices in Pyongyang and vice versa. However, the North has so far been hesitant about moving forward. Perhaps that will change in the future and we remain prepared to move ahead on it. I think it is an obligation for South Korea to prepare for unknowable events that seem inevitable in

the long term. In particular, I think this is a very powerful argument for the need for Korea to develop a world-class financial system through reform and restructuring. When reunification occurs, Korea will need enormous amounts of capital, much of which will have to come from abroad. The foreign capital will come only if Korea has a modern transparent system of capital markets, which give foreign lenders and investors confidence.

Q: *Korea is in the process of overcoming the currency crisis. What role did the U.S. play in this process?*

A: As I said in my remarks, overcoming this crisis has been due primarily to the efforts of the Korean government and the Korean people. I don't think that others should try to take credit for Korea's success. However, Korea did act within a framework of international cooperation, which I think was very important. The IMF, the World Bank, the Asian Development Bank, the efforts of the United States, Japan, and the European Union were all designed to support Korea's recovery and reinforce Korea's commitments to reform and restructuring by tying money to follow through on those commitments. I think it has worked. But, international institutions and governments should recognize the enormous effort that has been made by Korea. I think Korea should have a sense of quiet satisfaction that Korea has come as far as it has, but Koreans should also have a sense of quiet determination to continue to push for reform and restructuring, without which all the previous efforts might render useless.