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THE KOREAN ECONOMY IN CONGRESSIONAL PERSPECTIVE

A STUDY

PREPARED FOR THE USE OF THE

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

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LETTER OF TRANSMITTAL

SEPTEMBER 18, 1986.

Hon. DAVID R. OBEY,
Chairman, Joint Economic Committee, Congress of the United States, Washington, DC.

DEAR MR. CHAIRMAN: I am pleased to transmit a study on "The Korean Economy in Congressional Perspective." The author is Dr. John Starrels, staff economist. Also, the author wishes to thank Carole Geagley who typed the study.

The study focuses attention on Korea's growing competitiveness and analyzes this development with respect to United States-Korean trade ties. It concludes that both Seoul and Washington need to develop longer range approaches for addressing their bilateral trade problems.

Sincerely,

JAMES ABDNOR,
Vice Chairman, Joint Economic Committee.

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PART I

Among developing countries, the Republic of Korea (ROK) stands out as a spectacular example of how market principles can be effectively employed to promote rapid modernization. Those modernization prospects have, if anything, been significantly improved recently by what Korean analysts call the "three blessings": a national currency (won) that continues to depreciate in line with both the dollar and Japanese yen, drops in oil prices, and lower interest rates. The result? International Monetary Fund (IMF) estimates that Korea's gross national product will expand by as much as 9 percent in 1986, along with projected surpluses in both the ROK's trade and current accounts.

Still, these buoyant prospects need to be seen within a larger environment of continued challenge that confronts Korea's economy. On the domestic front, growing numbers of Koreans are dissatisfied with their modest standard of living. In comparison with their more affluent Western counterparts, average Koreans put in substantially more hours to obtain many common goods and services which even today remain in scarce supply. As in most other developing societies, labor rights and occupational safety rules are noted by their absence. In light of the North Korean threat, defense costs are willingly shouldered by a vast majority of South Koreans. But those costs—6 percent of GNP—still impose a drag on the economy.

On the international front, the ROK also confronts major challenges. The ROK's external debt of $47 billion (more than 50 percent of gross national product as of September 1986) is one of the highest in the world even though its debt service is being managed with little difficulty. A more formidable obstacle confronting Korea involves that country's trade posture, explains the World Bank:

> With imports from LDC's threatening to make the existence of many traditional industries, which are important sources of employment, even more precarious, the attraction of free trade is being overshadowed by political and economic concerns supporting protectionism. The orderly marketing arrangements, quota restrictions, and voluntary restraints that have become so obtrusive in trade relations, may be here for some time and these could depress the high import elasticities for particular products. The very magnitude of Korea's exports and the importance of a small number of items such as clothing, footwear, consumer appliances, steel products, and transport equipment also now militate against high export growth in the future.[1]

EDITOR'S NOTE.—Unless otherwise stated, "Korea" solely applies to southern part of the country.

[1] "Korea: Development in a Global Context,' Washington, DC, December 1984, pp. xi-xii.

This potential danger is most pronounced in Korea's trade with its largest overseas market, the United States, which absorbs close to 40 percent of Korea's exports. Traditionally, the United States has played a decisive role in supporting Korea's modernization. Between 1950 and 1975, for instance, the United States provided its fledgling ally with some $13 billion in military and economic assistance. Washington has also extended valuable trade benefits to Korea, notably the Generalized System of Preferences (GSP's).

But America's benign view of Korea is now being replaced with a more skeptical attitude toward the trade practices of its long-time ally. In substantial measure, this is due to the recent deterioration of our merchandise balance with this Asian country which has, in turn, helped trigger a series of bilateral trade disagreements between Seoul (Korea's capital) and Washington. U.S. trade and corporate leaders are beginning to criticize the way Korea does business with this country by drawing unflattering comparisons between the ROK and Japan. In Washington, the air is accordingly thick with calls for retaliation against Seoul even while the two governments endeavor to compose their outstanding commercial differences.

The Congress plays a significant role across a range of military, political, and economic matters involving the United States and Korea. Members of Congress regularly travel to the ROK in order to exchange views with their Korean counterparts. The eruption of trade tensions between the two countries is being given special attention in both Houses. It is hoped that this Joint Economic Committee study—the result of an 8-day congressional staff trip to Korea this past April—will provide an appropriate foundation for informed discussion of U.S. trade policy toward the ROK. To facilitate this task, the narrative is divided into two overlapping sections involving (1) an overview of the Korean economy; followed by (2) an analysis of United States-Korean trade problems.

THE KOREAN CHALLENGE

Over the past quarter century, the Republic of Korea has emerged as the second most dynamic Asian economy after Japan. It has been a dramatic transition. Explains Anne O. Krueger, an expert on Korean development.

> (Korea) * * * in the 1950's was regarded as one of the most hopeless cases in terms of development prospects of any country in the world. * * *. The idea that Korea could become one of the most affluent countries in Asia was simply not in the cards.[2]

Times have changed. Since 1960, Korea's per capita income has quadrupled. Living standards have improved. Powered by huge productivity jumps in the manufacturing sector, wages increased by an average rate of 10 percent between 1961 and 1978, with the share of population under the poverty level dropping from about 40 percent in the mid-1960's to 15 percent by the mid-1970's. According to

[2] The Wall Street Journal, May 20, 1986.

the IMF, "Korea has * * * made admirable progress in meeting basic needs.[3]

The longer term implications of South Korea's rise are spelled out by "Business Week":

> * * * South Korea has made enormous strides. Its highly educated population, driven by the Confucian work ethic, has grown to 41 million, nearly as large as several major European nations. Its gross national output of $81 billion is already larger than that of half the members of the Organization for Economic Cooperation and Development * * *. Korea's raw industrial muscle has pushed it ahead of such OECD members as Austria, Belgium, Greece, and Norway—and it is closing in on Sweden.[4]

What factors account for such success? Collective effort, for one thing. The typical Korean employee puts in an average of 55 hours a week at wages considerably below those paid in Western Europe, the United States, and Japan. Korean workers are also more flexible than their Western counterparts. For example, it is considered normal for one parent to accept lucrative employment in outlying reaches of the country while the other elects to stay in the major cities where schooling opportunities are considered more favorable for children.

Korea's successful transition into a modern economy is also the result of effective political leadership. Recent turmoil in South Korea has not undermined the foundation of mass support for those aspects of corporate-government practices, which over the years have helped create a stable environment for innovation and growth through policies designed to stimulate long-term investments in human capital (education and training), high rates of saving, the acquisition of labor-saving technology from the West and—most important—the promotion of export-led growth.

South Korea's domestic expansion has been powered by exports. The peak was reached between 1962 and 1978, when the ROK increased those sales by nearly 40 percent; after which export growth declined to an annual rate of 13 to 16 percent during the recessionary period of 1979–84. In dollar terms, this 22-year period registered a corresponding jump in export sales, moving from $32 million in 1962 to approximately $26 billion for 1984.

Korea's export drive is sustained by foreign customers who are increasingly receptive to high-quality, low-priced ROK goods. The initial impetus behind Korea's successful export drive, however, derives from two indigenous sources: export promotion and technological adaptation.

Export promotion.—Korea's long-term competitiveness has traditionally depended on the success of its ambitious export program. Indeed, during the mid-1960's, export promotion took on the aura of a mystique. One analyst explains:

> Exporters * * * received government honors, prizes, and varied bureaucratic privileges; the Blue House [equivalent

[3] Aghevli, Bijan B. and Marquez-Ruarte, Jorge. "A Case of Successful Adjustment: Korea's Experience During 1980–84," International Monetary Fund, Washington, DC, August 1985, p. 3.
[4] Business Week, Dec. 23, 1985, p. 39.

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to our White House] is said to have had an "export situation room" that kept daily track of the export performance of the larger companies relative to preassigned targets. The incentives for exporting were so great that Korean companies would sometimes buy export orders from each other at a premium in order to meet their export targets.[5]

The Government's role in such activities today is not so pronounced. But Korea's passion for export promotion remains undiminished.

Technology acquisition.—The second key to the ROK's foreign commercial success is to be found in Korea's uncanny ability to adapt Western and indigenous technological know-how to the demands of the global market. This point is driven home by Larry Westphal, a former World Bank analyst:

> It is well known that Korea's growth has been led by its export drive. But less well known is the significant consequence that this has had for the pattern of technology acquisition. Technologies have been acquired, assimilated, and developed primarily with a view toward exporting based on international cost competitiveness rather than with a view toward simply satisfying local demands. Until recently, the question has rarely been what the local economy would demand; the important issue has been what the world's consumers would seek from Korea.[6]

Like other advanced developing countries, the initial thrust of Korea's export drive began in the mid to late 1950's with the production and export of low-technology, high-volume goods such as clothing and textiles. Then in the early 1970's, the focus shifted to the "heavy and chemical industry," including petrochemicals, metals, and heavy machinery. It was also during the 1970's that Korea, in an effort to pay for expensive petroleum imports, began to make substantial inroads into Middle Eastern markets through exports of civil engineering, shipping, and nursing services. By 1981, South Korean contractors were generating nearly 14 billion dollars' worth of business in the region. OPEC's declining oil revenues have since forced these countries to cut back on purchases of Korean services. By 1985, new orders had accordingly dropped to $4.7 billion. But the ROK's market position in the Middle East remains strong. Korea is focusing the bulk of its present export efforts on the production of competitively priced, ever-more sophisticated capital goods and high-tech products such as automobiles, consumer electronics, and information-processing equipment.

What about imports? They are also substantial, and reflect Korea's heavy dependence on three major items: Raw materials, energy products (Asia and the Middle East), and manufactured goods (Japan and the United States). Korea's trade account is virtually balanced between high volumes of exports, whose earnings are then used to pay for equally large amounts of imports. By 1985,

[5] Petri, Peter A. Testimony before the Special Subcommittee on U.S.-Pacific Rim Trade, Committee on Energy and Commerce, U.S. House of Representatives, Aug. 11, 1986.

[6] "Korea's Technological Development," Korea's Economy, Korea Economic Institute, Washington, DC, May 1986, p. 21.

for example, from a total merchandise trade turnover of nearly $53 billion, virtually half consisted of imports.

For outside observers, two countries provide especially significant points of comparison with South Korea: North Korea and Japan.

North Korea

Since the division of the peninsula in 1945, North and South Korea have followed radically different modernization strategies. Pyongyang, capital of Communist North Korea, has embraced a highly centralized, inward-looking, planned society. Defying market logic, the official ideology of "Juche" emphasizes self-reliance in the production of articles, from clothing to industrial goods. Where Seoul relies on trade as a catalyst to growth, Pyongyang embraces autarchy.

Even by Soviet-bloc standards, North Korea's economy is considered to be rigid and in need of reform. Japanese analysts estimate that the country is at least two decades behind the South in technology development. As long ago as the early 1970's, North Korea's leaders recognized this fact when they went some $2 billion into debt to Western banks in order to purchase manufactured goods and technology from Western European firms. Pyongyang soon defaulted, however.

South Korea has clearly outperformed its Northern rival. Explains Korean specialist, Chong-Sik Lee, Professor of Political Science, University of Pennsylvania: "North Korea needs to change its economic policy particularly because of the fast pace of growth in the South Korea economy. North Korea's industry has been estimated to have grown at a 7 percent annual rate between 1977 and 1983, and one could call it respectable, but South Korea has far outdistanced North Korea in terms of technological level and the overall scale of economy." [7]

Japan

Illuminating contrasts can also be drawn between South Korea and Japan. There are significant parallels between these two Asian economies. Both countries, for example, have established a comparative advantage in many product areas in competition with the United States, Canada, and Western Europe. For Japan and South Korea, this feat has been accomplished through the same means, i.e., a shrewd use of highly motivated, low-paid workers, and aggressive entrepreneurship which has been placed under the guidance of a strong, mercantilist-oriented state. Other similarities include: limited natural resources, an abundant capital stock, heavy specialization in manufacturing, and a strong dependence on the lucrative U.S. market as an outlet for high-quality consumer and industrial goods.

But the disparities between these economies are, if anything, larger. Compared with Japan, South Korea is poor, with a per capita income of $2,000 versus $10,000 for its more affluent neighbor. Korea's gross national product is but 6 percent of Japan's.

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[7] Testimony before the Subcommittee on Asian and Pacific Affairs of the House Foreign Affairs Committee, Mar. 20, 1984.

Moreover, while South Korea remains a net borrower, Japan has become the world's largest net exporter of capital, as reflected in its large current account surpluses. The ROK, by way of contrast, has yet to run a current account surplus, although it may finally do so this year.

South Korea's and Japan's trade postures also differ. Peter A. Petri of Brandeis University explains:

> The Korean economy is nearly three times as open to world trade as Japan's: exports and imports each amount to approximately 37 percent of GNP, as compared to approximately 15 and 12 percent, respectively, for Japan. Korean policies have encouraged a high degree of internationalization by letting imports in relatively freely if they are to be used in the country's large export sector. * * * Korea imports more manufacturers than raw materials; indeed, Korea runs a $3 billion trade deficit with Japan where many of the components required for Korean manufacturers are made.[8]

But the most significant contrast dividing Korea from Japan involves their bilateral trade relations. Despite traditional Korean animosities toward Japan—a legacy of Tokyo's punitive occupation of the country between 1910 and 1945—the ROK's economic dependence on its larger Asian neighbor remains pronounced. Between 1965 and 1985, Korea's cumulative trade deficit with Japan came to $33 billion.

The United States is not the only country dissatisfied with Japanese trade practices. Korea also has axes to grind. The average Japanese duty on Korean imports is about 10 percent, versus an overall average tariff rate of 3 percent. Koreans also express bitterness over Japan's unwillingness to transfer key technologies to its less-developed neighbor. South Korea, then, clearly has good reasons for reducing its dependence on Japan.

Last March, the Chun government accordingly announced an import substitution program, designed to encourage a number of Korean companies to turn away from Japan by manufacturing goods locally. An even bolder initiative has been unveiled by Korea's Trade Ministry. The Ministry's idea is an offshoot of the American "reciprocity" idea: with future Japanese imports to the ROK made dependent on Tokyo's willingness to import more Korean goods. This is a provocative idea. But if Japan chose to retaliate against Korea, Seoul might end up being the ultimate loser. Nor would such an inward-looking strategy accord well with the Korean Government's campaign to upgrade the ROK's diplomatic status.

A more realistic opportunity for Seoul to improve its competitive position toward Japan is to be found in the 50-percent plus appreciation of the yen vis-a-vis the Korean won. This development, which began in September 1985, has already yielded Korean firms significant price advantages over their Japanese counterparts across a range of consumer goods, including subcompact autos, per-

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[8] Petri, Ibid.

sonal computers, videocassette recorders, compact refrigerators, microwave ovens, and floppy disks.

Faced with U.S. pressures to reduce Korea's surplus with this country, the ideal solution for Seoul would be to cut back Japanese imports and replace them with American goods. But reality dictates otherwise. Despite Seoul's displeasure with Tokyo, Japan continues to be Korea's primary source of technology. Since 1962, Japanese companies have provided 55 percent of all foreign technology introduced into the country. Japan, for example, supplies up to 40 percent of the components which go into Korean VCR's. One such arrangement involves the transfer of these items from Japan Victor Co. and Sony Corp. to Samsung Electronics Co., Goldstar Co., and Daewoo Electronics Co. The result, a whopping 61 percent of Korea's $8.7 billion worth of parts and machinery imports in 1985 came directly from its large Asian neighbor.

Ironically enough, Japan, not the United States, presently derives the major benefit from Korea's import liberalization program. Explains Mark Michelson, Director of North Asia for Business International Asia/Pacific, Ltd.:

> Imports of the 31 items liberalized in January 1984, largely due to pressure from the U.S. Government, totaled $49.85 million in 1984, with Japan accounting for 43.9 percent of the total and the United States accounting for only 16 percent.[9]

[9] Michelson, Mark. The Asian Wall Street Journal, May 19, 1986.

PART II

UNITED STATES-KOREAN TRADE TENSIONS

Korean's economic rise places the United States in a dilemma. As a guarantor of Korean sovereignty, the United States has ample reason to celebrate the triumph of an experiment in Asian capitalism which the United States played such a substantial role in helping bring about. As with West Germany and Japan, however, the ROK's very success no less strengthens U.S. fears that yet another recipient of American generosity is on the verge of overtaking us on the trade front.

To be sure, trade conflict between Washington and Seoul is hardly new. From 1960 through 1982, 13 significant commercial disputes broke out between the two countries. Yet, in two respects, the recent upsurge in bilateral trade tensions constitutes a break with the past.

First, in contrast with earlier periods, when the United States played a tutelary role, the Seoul-Washington relationship is more equal today, with each partner bargaining with the other to obtain maximum trade benefits. Case in point, Seoul's willingness to back the United States in convening a new multilateral trade round in exchange for continued tariff relief under the Generalized System of Preferences.

Second, the stakes involved have also become more substantial for both countries, as reflected in the steady growth of two-way trade, moving from $12 billion in 1982 to nearly $17 billion in 1985. About one-third of South Korea's exports go to the United States. But Korea has also become a key export market for U.S. firms. In areas where the United States enjoys a comparative advantage—as in information technology and insurance—Korea's probusiness climate offers American firms lucrative investment and export opportunities. Overall, South Korea constitutes the second largest market in Asia, and the seventh largest export market for U.S. goods.

The commercial atmosphere surrounding United States-Korean relations remains healthy. The political atmosphere remains tense. This is so despite settlement of two publicized "unfair trade practices" cases (so-called 301's) filed in September 1985 involving U.S. demands for access to Korea's insurance market and better protection for U.S. intellectual property rights.

Despite Korea's burgeoning trade surpluses with the United States, and an expanding U.S. market share for its products, officials in Seoul continue to worry about the spread of protectionism in the United States which they sometimes see as uniquely directed against them. Why? Part of the answer derives from Korea's traditional position as a poor dependent of the United States.

But Seoul's trade concerns are not entirely the result of residual dependency feelings. Korean leaders have some reason to believe that political pressure in Washington to rapidly cut the overall U.S. trade deficit might inevitably lead to retaliatory actions against the ROK. A number of its leading exports, including steel and textiles, are already subject to U.S. import quotas.

Consider the situation in steel where the United States has forced Korea to negotiate a 5-year (October 1, 1984 to September 30, 1989) bilateral agreement limiting exports of this commodity. A Congressional Research Service report explains:

> The agreement limits Korea's penetration of the finished steel market in the United States to a 1.9 percent share and U.S. imports of semifinished steel from South Korea to 50,000 tons. The United States concluded these agreements because of the American steel industry's concerns with the rapid growth of competition from foreign steel producers.[1]

Korea boasts one of the world's more modern steel industries.

The United States has also initiated a series of highly publicized actions involving Korean firms. Several years ago, for example, employees of Daewoo Corp. were indicted on charges of fraudulent trade practices aimed at undercutting the prescribed "trigger price" set by the United States for steel imports. Subsidy and dumping actions against the Koreans have also increased. A recent case in point, Korean photo albums, on which the Commerce Department imposed a 64.8 percent antidumping duty. Both the Korean Government and opposition denounced this action, purporting to see in it an example of how American trade laws can be arbitrarily applied against the most marginal and exposed small businesses. Charges Hee Jin Kim, General Manager of the Korean Traders Association in Washington:

> In the past several years, Korea has been assessed more antidumping duties than any other developing country except Taiwan. U.S. petitioners have also won several countervailing duty cases against Korean exporters. These duties have been levied against products ranging from steel to color televisions.[2]

How does the United States view the issue? Differently. Korea's growing presence in the U.S. market is seen as a new, unwelcome source of concern for U.S. firms who already face determined competition from Western Europe and Japan. And from textiles and shoes, to automobiles and semiconductor products, the Korean import challenge is growing. U.S. imports of these various items have nearly doubled between 1981 and 1985, moving from $5.5 billion to $10.7 billion. For the first half of 1986, the U.S. trade deficit with Korea was 75 percent greater (at $3.26 billion), versus a comparable period in 1985.

At a time when South Korea is selling larger volumes of goods in the United States, American exports to the ROK have virtually

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[1] Congressional Research Service, "Economic Changes in the Asian Pacific Rim," August 1986.
[2] KTA Address, Washington, DC, Apr 18, 1986

stagnated. For the 1981–85 period, Korean imports of U.S. goods expanded by a paltry $700 million, moving from $5 billion to $5.7 billion. Says the National Journal:

> While (Korea's) dependence on sales to the United States is growing, (it is) diversifying the sources of (its) imports. In 1975, 30 percent of Korean exports went to the United States; in 1985, the United States bought 38 percent. In 1975, Korea bought 26 percent of its imports from the United States, but a decade later, it purchased only 22 percent of such goods and services from the United States.[3]

Meanwhile, the United States continues to demand greater market access in Korea for American goods. To its credit, Seoul has initiated a broad import liberalization program. Between 1979 and 1983, for example, the ROK reduced the ratio of foreign products that can be imported without prior official approval from 54 percent to over 80 percent in 1983. Projected ratios for 1986–88 are 90.6 percent and 95 percent, respectively. Moreover, a 1984 law greatly improves foreign access to direct investment in Korea. These moves have been complemented by more recent bilateral agreements to allow sales of American cigarettes in Korea, and potentially far-reaching arrangements for the protection of U.S. intellectual property and the marketing of insurance.

These Korean actions have been welcomed by the United States. But Washington continues to press for additional concessions. U.S. negotiators, for example, are pushing for further reductions in Korean tariffs. For good reason. Despite Korea's commitment to carry forward a program of such cuts through 1988, Assistant U.S. Trade Representative Peter F. Allgeier points out that even when the present round is completed 2 years hence, "more than 80 percent of Korea's tariff categories will (continue to) have duties in the range of 20 to 50 percent."

Washington also wants changes in Korea's import licensing procedures which, in effect, make the import of a good dependent on the approval of a relevant governmental or private sector agency. U.S. auto parts, for instance, can only be imported if there is a recommendation to do so by the Korean Automotive Industries Association. Thus, a major U.S. negotiating goal has been to significantly expand the list of products which qualify for "Automatic Approval" (AA). AA status means that a given import automatically enters the Korean market, effectively short circuiting the time-consuming, licensing process. In response to U.S. prodding, the Koreans have expanded the number of items which qualify for AA status, including corn, glassware, certain machine tools, loudspeakers, and various auto parts. U.S. trade officials have recently praised Seoul for taking these additional steps. Far from letting Seoul rest on its laurels, however, Washington is now calling for similar import liberalization measures governing computers, construction equipment, sporting goods, and agricultural equipment.

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[3] National Journal, Apr. 5, 1986, p. 815.

Conclusion

Resolving United States-Korean Conflict: A Longer Term Perspective

The time has come for the United States and South Korea to reexamine their trade relationship. Failure to do so will inevitably result in a further weakening of trust between these allies. Rather than continue on the present course—a combination of self-righteous finger pointing, followed by intense, sector-specific negotiations—the interests of both parties will be better served if Washington and Seoul broaden their negotiating perspectives to accord with the larger realities surrounding United States-Korean trade.

Up to now, trade negotiations between Seoul and Washington have been designed to achieve short-term political ends: specifically, to forestall protectionist actions against Korea in the United States in exchange for Korean promises to quicken the pace of market liberalization at home. Progress on both fronts has been achieved. While Korean officials remain wary about future congressional intentions toward their country, the U.S. market remains open to Korean goods. This July's joint agreement, involving Korean commitment to provide better protection of U.S. intellectual property rights and improved access to the local insurance market for American firms, likewise reflects the Administration's success in impressing upon Korea that trade must be a two-way street.

What now? Despite a recent cooling in the rhetoric between the two countries, Seoul and Washington need to resolve two key issues if they wish to establish a more mature and stable trade relationship.

1. *The GSP.*—Korea's growing trade surplus with the United States has encouraged the United States to call for major revisions in our traditional commercial relations with the ROK. The most far reaching of these proposed changes involves Korea's future membership in the Generalized System of Preferences.

Launched in 1976, the GSP was designed to foster trade-driven growth in developing markets by extending duty-free treatment to approximately 3,000 products from 140 developing countries and territories. Under section 502 of the Trade Act of 1974, the President determines a recipient's eligibility based on these considerations: the nation's level of economic development; its eligibility status in other industrialized countries' tariff preference programs; and the extent to which the LDC (lesser developed country) grants U.S. exporters equitable and reasonable access to its markets. In addition, a provision of the Trade and Tariff Act of 1984 requires recipient countries to adhere to internationally accepted labor rights standards.

Since the program's inception a decade ago, the value of imports receiving GSP treatment has risen from $3.2 billion to $13.3 billion in 1985. This growth is largely attributable to just five advanced developing countries (Brazil, Hong Kong, Mexico, South Korea, and Taiwan), who between them constitute nearly 65 percent of all GSP preferences. Korea's share comes to about 14 percent.

In view of America's substantial trade imbalances with GSP recipients, the program has come under increased scrutiny by Congress. Outright scrapping of the GSP would create more political conflict with these nations than the imagined benefits would justify. Mindful of congressional dissatisfaction with the way GSP has operated in the past, however, the Administration has initiated a less contentious "means test" which would be used to "graduate" certain countries out of the system—those, such as Korea, which reach an advanced level of development, and whose goods are considered to be competitive with equivalent U.S. products. At the same time, the Administration continues to use GSP to bargain for complementary trade benefits from these same countries.

Not surprisingly, Seoul wants to retain its GSP status, while Washington wants to revise it. But over the long term, the odds are good that Congress will force the Administration to progressively cut back on Korea's GSP benefits. The trick is to bring about this change in a manner which does not explicitly single out Korea for what nationalist groups at home might consider humiliating treatment. Such actions in turn could easily force the Chun government to retaliate against the United States. One means of achieving this end would be for the United States to "multilateralize" the graduation issue by calling for simultaneous negotiations with the five major GSP recipients. It's worth a try.

2. *Bilateral diplomacy.*—Recent U.S. breakthroughs in negotiating new market access arrangements in Korea will not bring an end to bilateral conflict. The stakes are too high on both sides. But this should not prevent them from establishing an interim consensus, designed to limit the spread of commercial disagreement into the political and strategic spheres.

A necessary jumping-off point is a more forthright U.S. acknowledgment of Seoul's substantial trade liberalization efforts to date. Confronted with a projected $6 billion merchandise deficit with Korea this year, Washington has ample justification to continue pressing for market access in South Korea. But the Chun government is already encountering strong opposition at home for the concessions it has made to the United States. Seoul recognizes that it must continue to negotiate with Washington on removing existing obstacles to free trade between the two countries. But the job of selling Korea's market opening package to a skeptical domestic public will be made easier if the United States properly credits South Korea for the substantial progress it has already made.

In a similar vein, Seoul should abandon the position that every U.S. trade undertaking against South Korea constitutes an assault against a reliable friend. Confronted with this charge recently, one U.S. official quipped: "What it all boils down to is that Korea is moving into the big leagues." In fact, while Korea has become the object of a growing number of U.S. trade actions, the ROK's market position in this country has never been stronger.

On a broader canvas, Seoul and Washington need to devise indirect ways to reduce the U.S. trade deficit with Korea. Opening markets in third countries provides one means of doing so, beginning with Japan with whom Korea ran a merchandise deficit of $3 billion in 1985. The U.S. deficit with Korea has many causes. But one unexplored cause is to be found in the diversion of large volumes of Korean goods from Japan's heavily protected marketplace to the more open one provided by the United States. Even if Japan were to suddenly liberalize its import regime, Korea's existing export drive in the United States would continue. But over the longer term, such a step by Japan would help create an alternative market for Korean goods. This in turn might make it easier for Seoul and Washington to restore equilibrium in their bilateral, merchandise trade account.

A final priority for Seoul and Washington involves the next, multilateral trade round. From the beginning, of course, the initiative behind the new round has come from Washington. But South Korea has also played an important role in selling the idea to a largely hostile Third World. For this, Seoul deserves a full share of credit—and another powerful dose of encouragement by the United States to take even more responsibility for the revitalization of a global trade system upon whose fortunes both United States and Korean trade prospects ultimately depend.

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