Korea and the TPP: The Inevitable Partnership

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Marcus Noland: Good afternoon. My name is Marcus Noland. I am the Executive Vice President and Director of Studies here at the Peterson Institute for International Economics. And it’s my honor and pleasure to welcome you all to this luncheon on the release of our newest policy brief – Korea and the TPP: The Inevitable Partnership by Peterson senior fellow Jeff Schott.

Jeff has been with the Institute since 1983. He is the author of numerous studies of trade policy, economic integration in the Americas and Asia and economic sanctions. He has led the Institute’s research in the area of bilateral and regional free trade agreements, including his 2001 study, free trade agreement, free trade between Korea and the United States, which laid the groundwork for the KORUS FTA.

Since January 2003, he has been a member of the Trade and Environment Policy Advisory Committee of the US government. He is also a member of the State Department’s Advisory Committee on International Economic Policy and chairs its sanction sub-committee. In this piece that we are releasing today, in the spirit of looking over the horizon, Jeff argues that Korea will need to join the Transpacific Partnership, TPP, sooner or later, but now faces additional costs because it chose not to ask to join before the basic outlines of the trade agreement were struck. I described this as looking over the horizon because, of course, we don’t actually have a TPP deal for Korea to join yet.

In addition, we’re delighted to be joined this afternoon by President Lee Il Houng, of the Korean Institute for International Economic Policy, or KIEP, whose institution graciously provided financial support for this research and who will offer some comments on Jeff’s work.

KIEP is a publicly supported institution and government officials are notoriously tightlipped about discussing future contingencies. So we are doubly delighted that President Lee has agreed to give some remarks on a hypothetical on top of a hypothetical. He is well qualified. Dr. Lee has been president of KIEP since 2013. In addition to this, he concurrently held the position of Ambassador for International Cooperation and G20
Jeffrey Schott: Thank you, Marc, and welcome everyone. We are missing some of our regular crowd today. Many are down in Atlanta for what is expected to be or is hoped to be the endgame negotiations of the Transpacific Partnership Trade agreement. We’ll see what happens later this week. But in any event, as Marc said, this is a bit future forecasting. But looking at where countries’ legitimate interests lie, and clearly the Transpacific Partnership is important for both the United States and Korea. The TPP has been the main event, really, in the world trading system for the past five years and consequently the central focus of US trade policy. That’s why; I think, it’s important to go over this, look at why TPP is important and what it means in terms of US-Korea relations.

Now, why is it important? Because it’s a big deal and we’ve said this on many occasions in this room. But the TPP should greatly expand opportunities for both trade and investment and indeed if you think about trade agreements over the past few years, they’re really about providing a better environment for conducting business and international investment. They’re really investment facilitation agreements among 12 countries that currently account for about 40% of global GDP and over a quarter of global exports.

But importantly as part of this framework of rights and obligations that will encourage both trade and investment, it is developing a new rulebook for trade, including new disciplines on state-owned enterprises, on labor practices and on trade-related environmental practices. Indeed, the environmental chapter is a groundbreaking charter that goes well beyond what has been done in previous trade accords.

It’s also designed importantly, as every US trade agreement is, to reinforce economic and strategic ties among the partner countries, and so very important in the Asia Pacific region. And it serves to establish many useful precedents for broader multilateral and Asia Pacific trade accords. Indeed the TPP is seen as the preferred pathway to the APEC goal of
establishing a free trade area of the Asia Pacific and indeed, we’ll see how that evolves in the future if and when TPP enters into force and attracts additional members.

In short, the TPP is important not only for its current 12 members but also for other major trading nations like Korea and China. Our new report, which I have compiled with the very valuable assistance if Cathleen Cimino-Isaacs and Euijin Jung, focuses on Korea’s prospective participation with a word about China at the end.

So, where do the talks stand right now? This is probably what everybody wants to hear and since we’re already well into the football season, let me use a football analogy. We’re well inside the red zone. Indeed, probably the negotiators are at the five-yard line and they’re gearing up to cross the goal line. Those last couple of yards are always the toughest and in trade negotiations, the items that are left at the final stages are always the ones that are the most politically sensitive. Even if they are not the most economically important, they’re the most politically sensitive and can provide a real constraint on closing the deal.

We almost had that deal in Maui last July, but trade ministers were blocked in part because of differences on rules of origin for autos and auto parts. But they’ve been working intensively since then and are now engaged in what is hoped is intensive talks on the remaining key sticking points. And I’ve just summarized them here – intellectual property rights with regard to pharmaceuticals and terms of patent linkage and data exclusivity for biologics. That’s always been a very important issue and one of great concern for many constituencies in the TPP countries. Rules of origin for autos and auto parts, which have attracted a lot of attention and led to negations among the NAFTA countries and Japan last week and already still engaged this week.

And agricultural market access for dairy, rice and sugar, which require significant changes and practices and access to the Japanese market, but also to the market of North American countries. And indeed, it’s only fair to say that the outcome of the TPP in this area will be constrained by US reluctance to substantially reduce its own trade protectionism in these products.

Now if my forecast is right and the TPP is finalized later this week, President Obama will then be required to give Congress 90 days’ notice before formally entering into the pact. During that period, the entire agreement, including the schedules with all of the cuts and requirements in goods and services will be published on the USTR website so everyone can read it here and abroad. And that will give members of Congress who are concerned, political constituencies who are concerned, the actual
factual detail of what is in the agreement so they don’t have to guess or build worst-case scenarios. They’ll be able to see and evaluate and the Peterson Institute will also evaluate that full text and produce in rather short order a reader’s guide and assessment of the TPP that hopefully will be out well before the end of this year.

With that timetable and the requirements of Trade Promotion Authority, the TPP could be signed early in 2016 and then Congress could act probably in the time period in the spring of next year and before the summer. So there is an optimism and a window of opportunity to move on TPP but it requires first the negotiators to get moving.

Now, why do I say inevitable partnership? Korea is not participating in the TPP, though it has had a number of opportunities to do so since it announced its interest in possibly participating back in November of 2013. I think the window is now basically closed for Korea to join, to become the 13th member, but given the importance of its trade relations with all of the countries in the Asia Pacific region, I think it’s well recognized here and in Korea that Korea will need to be a party to this agreement sooner or later. And it’s not a question of whether Korea will join but when it will join. And indeed that has been the issue, I think, in the Korean political debate for the past several years.

That said, the cost of entry in the TPP in terms of liberalization commitments will probably be higher in the future than it would have been if Korea had entered the talks as an original signatory. And so that’s some of the things that I want to discuss today why Korea has stayed on the sidelines and what is needed in moving forward.

Why has Korea been cautious? Despite many recommendations from the Korean business community, despite analysis from the Peterson Institute, many meetings that we’ve had, even speeches by former Korean trade ministers here at this podium expressing interest in the TPP. I’ll crystallize it in three points.

First, negotiation fatigue. Korea had very intensive negotiations with the Unites States and the European Union on very comprehensive free trade agreements – agreements that are very comparable in many respects to the TPP. Korea may have been tired, but it did not retire from the FTA negotiating business and indeed it continued negotiations with China, Australia, Canada and others. And so it had still a very active negotiating agenda.

I think probably the argument was give priority to negotiations with China, which seemed like a good idea, but because of political reasons ended up being substandard because of the political desire to finish the
agreement before the negotiations were ready. We’ll be doing further analysis on this, but the Korea-China free trade agreement really did not meet expectations in terms of its coverage and so did not, in economic terms, justify the priority that was given to it. That may sound a little harsh because trade negotiations have both political and economic objectives and certainly the political objectives for Korea in working with China were of very high priority.

The second point is frictions with Japan. Korea and Japan started their own bilateral FTA negotiations in 2003 and they were suspended a year later and it’s been difficult to get them restarted ever since. The same problems that stalled that negotiation would likely resurface in the TPP talks so that certainly was a constraint thinking about dealing with Japan.

But at the same time Korea’s also dealing with Japan in the context of trilateral negotiations of Japan, Korea, China trade accord that is ongoing, proceeding relatively slowly but ongoing. And Korea signed a CJK trilateral investment pact back in May of 2012. So, there are frictions but there are ways of doing business as well.

And third, there were concerns about reopening sensitive political issues of the KORUS negotiations, especially with regard to the exemption that Korea got from the liberalization for rice and reopening the debate in Korea on investor state dispute settlement procedures.

Now, that said, TPP still is very important for Korea. If you look at this chart, the TPP countries taken together account for about one-third of total Korean merchandise trade. So, you can see it’s a very big component of Korea’s economic interest in the region. China as the individual country is the largest trading partner. But if you look at the trading profile of Korea, really the TPP deserves a lot of priority. I could go into a lot more detail on this but time is short and we want to make sure we have time for a lot of questions for both me and Dr. Lee.

Why is the TPP important for Korea? One-third of its trade for sure but Korea already has a lot of trade agreements with many of the TPP countries. That’s the standard argument that’s made, but trade agreements aren’t alike. And indeed they vary dramatically in quality in terms of their scope of coverage and the depth of the liberalization required. As I said, the Korea-China agreement, not a TPP member, but is one that has extensive exceptions for the automobile industry and for many agricultural products so to do many of Korea’s FTAs, particularly those that were negotiated a decade or so ago. That’s not a criticism for Korea.

Negotiators learn by doing. And Carla, I’m sorry to say, but if you look at the NAFTA, that was the state of the art in 1993 when you concluded it.
But the world economy has changed quite dramatically and it needs substantial updating, upgrading. And indeed that’s one of the advantages of the TPP. It will take the existing relationships that have been growing strongly over the years under existing trade agreements and improve them, reinforce them. And that’s a great advantage for Korea especially since many of its FTAs are less comprehensive than the TPP and contain many more exceptions.

Second, as it will for all TPP members, the agreement would align trading rules across all of the trading partners. So it’s one thing to have a bilateral agreement with ten different countries, it’s another thing to have an agreement that comprises all of those countries and establishes a common set of rules. It makes it much more effective to do business. It lowers transaction cost and strengthens the linkages of firms in global and regional value chains.

And third, as it will for the Unites States, the TPP would yield effectively for Korea a free trade agreement with Japan – very important in economic terms, also political terms, and would compensate for difficulties that have been going on the past 12 years.

What are the consequences of the delayed entry? Basically, the first point is that the delay in TPP participation, the fact that Korea was not one of the original negotiators means that Korea will have less leverage in negotiating terms of its accession to the TPP in the future.

The Japan problem won’t go away. Japan will still require a market access deal that is sufficient before it will accept Korea as a member of the club. Indeed, one could – it’s hypothetical – but one could imagine the scenario if Korea had joined the TPP negotiations that it could have worked with Japan in some areas to deal with sensitive issues like rice. But that’s water under the bridge. And so looking forward, that will still be an issue in terms of dealing with Japan.

Korea will also have to meet the TPP rules and reforms largely set by the United States and Japan in politically sensitive areas like autos. So, instead of helping to craft the rules in this sector, Korea will be a rule taker, not a rule maker. And it will have less leverage in avoiding additional agricultural liberalization especially if Japan increases its rice quota. It seems likely that that will occur even if it’s a relatively small increased quota. Press reports have been talking about an extra 100,000 metric tons that Japan would commit in the TPP. If Korea was asked to do the same, that’s the equivalent of about 2.5% of Korean production and Korean consumption. But it is quite different than what Korea got in the KORUS FTA in terms of a total exemption from reform commitments.
The second area of consequences of delaying entry deals with more on the rule-making side. The KORUS FTA implementation would receive close scrutiny by Congress before the TPP accession talks could begin. I mean, one has already heard this in the Congress with regard to KORUS, but if there are lingering concerns about implementation of KORUS obligations, then that will be a break on congressional support for adding new members to the TPP club.

I think Korean and US officials have been working very closely and there’s been a lot of progress in these areas, including changes in Korean regulations on the outsourcing of financial data, a major concern for the Unites States over the past few years. But I put this up as just a warning that one has to be vigilant and make sure that the obligations of the current agreement, comprehensive agreement, are being faithfully undertaken.

In the TPP accession negotiations, Korean negotiators could face demands to broaden Korean reforms beyond those covered by KORUS because in some areas the TPP will be KORUS-plus. And those areas are the obligations, disciplines on state-owned enterprises, some of the new provisions on labor and the environment. I think in most of these respects, it won’t be major political challenges for Korea, but it will require some additional thought and planning.

And finally, provisions on currency policies. This was added as a priority negotiating objective of the Unites States in the Trade Promotion Authority and addition legislation that’s likely to be passed. Trade legislation likely to be passed by Congress in the coming month or so could also require that US officials look a potential partner’s exchange rate policies before passing judgment on whether to move forward with negotiations. This could focus attention on Korean exchange rate policies.

There was mention of Korea in the last treasury report in April of this year. It noted Korea’s large and growing current account surplus. It did not cite Korea as a currency manipulator but it did recommend that Korea refrain from currency intervention except in the instance of disorderly markets so something that members of Congress and both parties will be looking at.

And there is some concern if one looks at the trajectory of Korea’s current account balance that is has been steadily growing and this is not a determinant of inappropriate currency policies. But it does raise warning signals that one has to say, “Why is Korea running such a large and growing current account surplus?” And lower all prices is only a small part of the reason why the surplus has gone up in the past year or so.
So, finally let me turn to the TPP timetable and considerations for Korea’s entry. I think it’s generally acknowledged that given Korea’s adherence to comprehensive trade agreements with the United States and the European Union that Korea would be at the top of the queue of potential new TPP members once the agreement enters into force. But that’s the key point.

At this point with the negotiations nearing completion, it’s hard to conceive of a scenario that Korea could get in under the wire. And it either will have to wait until the agreement enters into force possibly in 2017, but it could be longer depending on first how quickly the Congress acts and other countries and the formula that is set out in the TPP to determine when the overall agreement can enter into force.

I think the final provisions will also spell out the procedures for acceding, for new members joining the agreement. It’s likely to be very similar to the precedence of the World Trade Organization. But what is unclear is whether TPP members would accept new participants individually or if there was a group of countries seeking to join whether there would be a group negotiation of a second tranche of membership. That’s unclear and I’m not sure it’s been given full thought by the participating countries. It’s clearly important for Korea because it wants to be first in line and also first in. And if you negotiate with a group of countries, then obviously you’re losing some flexibility in terms of timing and content of the negotiation.

I think Korea is well positioned to move quickly, but there is a wild card and that wild card is, what if China asked to join? That may seem like a highly speculative question today. It may seem less so two or three years from now, but certainly that would raise concerns. It certainly would be a benefit for Korea in terms of its strengthening and strong relationship with China. But it would change the dynamics of the accession process. I think this is an issue that deserves more attention in the future and so I’ll only raise this as a speculation at this point.

So, in sum, I think what we can say is that there is a good prospect for TPP to conclude. There’s no sure thing in trade negotiations but it’s likely that TPP will be signed early next year and then hopefully the Congress, after a lot of effort – because nothing is easy in the Congress – will pass implementing legislation. That will open the door for future participation by Korea in a way that helps strengthen and reinforce our already strong economic relationship. Thank you very much.

Il Houng Lee: I’d like to thank Marcus for the kind introduction, but I need to emphasize one word here. I was the former – I am the former ambassador for International Cooperation. So, the point I’m trying to make here is whatever I say does not represent the Korean government. Okay, now I
feel much more relieved. So, on other points, I basically agree with most of the points made by Jeff, although I have slightly different takes on some of the issues.

Particularly one point that I’d like to make a point is that from my point of view I never considered capacity constraints to be the major reason why we didn’t sort of jump into TPP and even considering that it was a matter of choice between TPP and China-Korea FTA, was something very new to me. But it sounds plausible from an outsider’s point of view. But from where I was looking at these things, it actually never came to a point. And you can actually argue that the Korea-China FTA is not really high standard from a TPP point of view, for example. But from our point of view it’s tailored to each country’s needs, it’s substantial. And given that our trade with China is substantive in volume, it is a very meaningful FTA, which will have fairly substantial impact on our trade pattern.

With this forward, let me start with my formal comments. I’ll make few comments on Korea and TPP in general and then sort of provide you a little bit of background on the facts relating to KORUS FTA. Starting with Korea and TPP, Korea, in my view needs to join TPP. I’m not sure whether the internal consensus is as straight as Jeff makes it out to be. It’s not a matter of if, but when, but certainly my perspective is that we should join TPP. Whether we missed the boat, I’m not quite sure because the main reason is even until now, I don’t think there’s general consensus that the benefit of joining TPP is huge to Korea. I have a slight different take again.

I think that the real benefit of Korea joining TPP is not coming from the usual trade volumes or the trade deals, but it’s more on adopting international standards that can actually help Korea reduce inefficiencies, pockets of inefficiencies still existing in our economy. So in that regard, my comment essentially is assuming not knowing the real content of the TPP at this stage. Assuming that the TPP is more or less a multilateralized KORUS FTA plus, I think there are certainly benefits to be gained by joining it.

Except for the political advantages or considerations, the geopolitical reasons as you all know, also beneficial for the TPP groups to have Korea joining them because we are actively interested in pursuing or joining the initiative under One Belt, One Road although we are not 100% sure what it actually entails at this stage. We have an FTA with China already. So, certainly if we become a member of TPP, we’ll provide a gateway to Asia through these channels and also the discussion at the outset, although it’s not quite clear at this stage how fast that will make progress, there will be advantages definitely for TPP members if Korea joins the league.
On why Korea needs to join the TPP, I already elaborated the main points. We certainly would benefit from the external pressures in opening up some of the sectors, especially in the services sector. And currently my understanding is the Korean government is also very interested in streamlining the services sector. And our institution has signed an agreement with OECD on coming up with some standard in the services area that, you know, countries can actually adopt to which we hopefully can become a new source or part of the new source of economic growth in the next few decades.

Challenges within Korea joining TPP as I elaborated at the beginning, we still have a large number of people uncertain of the benefits coming from joining the TPP. We’ve ran some model simulations and so on and the economic benefits according to the traditional payroll CGE models and so on do not really generate the substantive gains that would convince people to sacrifice some of the things that they have to if one joins a mega FTA. So there is still some work to be done within Korea to convince everybody else. But as I said, I personally think that the real benefit is not from the traditional trade FTAs.

On other things there are also concerns that if we start discussing about negotiating TPP in seriousness might rekindle old memories and flare up some political discontent in Korea. And most of you are familiar with what kind of issues we had actually faced during negotiations of the KORUS. So, we’re still discussing under the WTO the rice issue, rice quota issue, so I don’t have any comments to make on that because that’s still an ongoing discussion. Because I can’t really see what I actually have on the screen, I’ll just say from my memory. The KORUS FTA, let me, rather than talking through my points, let me just go straight to some of the charts that I have prepared.

In terms of the currency issue of the KORUS FTA or going forward that would be related to TPP, we have a problem here because if you look at bilateral trade balances or current account balances with some major trading partners, Europe, the EU for example, the United States, China, Japan and so on, it’s all over the place. In other words, if you compare the exchange rate movements, Korean won versus whatever bilateral currencies they have and our current account balances with the bilateral balances, the exchange rate had some impact in the 2000s definitely.

It’s quite clear if you’re on regression, you really get some evidence, concrete evidence. But since the global financial crisis, there isn’t really any concrete evidence and I personally am a bit lost as to what role the exchange rate plays because it’s all over the place. With one country where currencies are appreciating, the balance goes the opposite direction and so on. I brought you a few examples of this. We’re going to go
through these details but that’s one concern that we have. And this currency issue certainly is not an issue that we can just simply say, “Okay, we will appreciate or we will depreciate and that’s the end of the story.” It’s no longer that simple anymore.

A second point is that I was personally surprised when I actually looked at Korea’s investment to other countries, our trading partner countries. And the United States is our largest destination. On your left hand side, which I can’t really see, that’s the committed number and on your right hand side, that’s the actual number. The United States on both accounts are the largest recipients of FTA. So if you want to invest, it’s not necessarily beneficial for you to have a depreciative exchange rate.

And also GVCs now, it’s all over the place. The yen, the Korean won relationship, there’s a lot of discussion on that. But one evidence seems to indicate that the reason we still do not have any significant notable impact on our bilateral trade balances because we import a lot of raw materials for Japan which is beneficial if the yen depreciates.

On the other hand, of course our direct competition in the United States on automobile, we will be hit certainly. So, if you take them all into consideration, it’s not quite clear where things are heading. But the point that I wanted to make here is that United States is the largest recipient country of our FTA and certainly I don’t think that Korea is pursuing an exchange rate policy just to be able to export a few more items to the United States. That is no longer the fact.

And then we ran various tests on what is actually contributing to our recent growth in counter account surplus. And terms of trade has played a big role on both sides actually in the last couple of years, but also has domestic demand and a few other factors. Real effective exchange rate did contribute also. I’m not saying that the exchange rates is no longer relevant, it is still. But the importance that it used to take has diminished substantially.

Just to make further comments on the domestic demand side, the main reason comes from sluggish domestic demand. That’s why the three-year program the government announced in late 2013 had one of the main pillars rebalancing to domestic demands as one of its objective because in order to revive economic growth, fine, I mean, it’s still 2.5% to 3% growth. It’s a decent growth for our economy but in order to regain some momentum, we need to rekindle our domestic demand and that remains a challenge as you can see in these charts.

And also I was very surprised to find that our exports to the United States in terms of US GDP are still very small. The Congress may actually
complain about our currency and the growing current account surplus, but if you look at the chart our total experts to the US is less than 0.4% of US GDP and so is US export to Korea. It’s less than 4% of our GDP.

In other words, there is huge scope for increasing trade, bilateral trade and US investment to Korea is very low. The largest recipient in Asia is actually Australia and Singapore and then followed by China and Japan. And Korea is just less than one-fifth of all these countries. So that made me wonder, given our strong military alliance, you know, why is US not investing in Korea? I don’t know. I haven’t really studied this in depth.

And then if you decompose the export components or the import components from both direction, you’ll see that it’s highly skewed towards transportation and equipment. What are the other products? I mean, do we have problems selling each other’s goods in each other’s market? If so, why? Certainly, I don’t think the exchange rate is an issue. I think the general problem in terms of products that we produce in each of our countries, trying to sell it in each other’s markets.

Anyway, but there is hope because following the FTA, the KORUS FTA, there is a huge increase in agricultural export from the US to Korea. Beef livestock, as you can see, increased by 123%, that’s a huge increase. It has a small base, but still it’s a huge increase. Agricultural product as well. Services area is also increasing. And some of the numbers that you actually see is falling because the whole company is actually relocating to Korea because of the opening of the services sector. So there’s good progress.

But I hope that bilateral relations between United States and Korea, be it within the TPP or not, I hope will grow and not limited to just transportation and equipment, but expand to all areas of our production. And the US investment in particular will start to grow also in Korea. Given that you have military presence in Korea should provide your companies also some assurance that it’s safe to invest in Korea. We look forward to a greater economic relationship between bilateral countries. Thank you.

Marcus Noland: Well, thank you very much. I think we had two excellent presentations. What I’m going to do is, as the moderator, I am going to assert the privilege to ask the first two questions and then I will direct one to Jeff and then one to President Lee. And I will ask them both at the same time and ask Jeff to answer first, thus giving our guest more time to think about his answer.

So, one of the things Jeff mentioned was the possibility of China joining the TPP. President Lee is no longer a government official as he explained
but I think what we might want to say to him is that after the experiences here last week, what you might want to do is go back to Seoul and suggest to your government that you persuade Vatican City to join TPP. Despite the fact the Pope came out against TPP, if Korea was going in with the Vatican City, you’d probably pass the Congress with only one dissenting vote.

So, for Jeff. It really was an eventful week last week. One of the things that occurred was the Speaker of the House, John Boehner announced his resignation effective the end of next month. Now you told us that we’re on the five-yard line although you didn’t tell us whether it was first and five or fourth and five goal to go. But my question to you is, does Speaker Boehner’s resignation have any impact on the prognosis of passing TPP legislation in the Congress should the negotiators actually reach a deal, whether they do it down in Atlanta or at the APEC meetings in November?

And my question for President Lees is one of the issues that Jeff discusses in the policy brief is the exchange rate issue. And Korea is – I don’t want to call it a small open economy, it’s a large economy – but it’s a very open economy. Trade accounts for more than 100% of GDP. And it is closely linked to Japan for reasons that we don’t have to go through here. Japan is pursuing an unconventional monetary policy of quantitative easing, which although this is not the primary purpose of the policy, is having the effect of depreciating the yen against the won as you showed in one of your charts.

And so my question to you would be given this situation and Korea’s need to manage its exchange rate, what is Korean exchange rate policy and how would you respond to the concerns of the US Treasury articulated in Jeff’s paper? But now back to Jeff. Does speaker Boehner’s resignation have any impact on the likelihood of passing TPP?

Jeffrey Schott: Well, I’m glad you put it that way. I would say it probably doesn’t have an impact on concluding the deal. But the leadership in the congress is crucial for getting through a very important hurdle in the implementation process and that is constructing the implementing legislation itself. That’s something that has an indefinite time period.

So, the only way that the TPP can be voted on expeditiously in the Congress next year is if the Congress and the administration work very closely together and craft this implementing legislation. Once that is done, then the President submits it to congress and the TPP fast track clock starts. But it doesn’t start until there is an agreement on the implementing legislation. And as we saw in the KORUS precedent that can take many
years if there isn’t commitment from both the Congress and the
administration to work together.

So, how the successor to Speaker Boehner will work with his or her
counterpart in the Senate and with President Obama is uncertain. But that
will be the key variable I think in determining how smoothly TPP moves
toward ratification in the Congress.

Il Houng Lee: I think there are two issues here. One is, is Korea actually managing the
exchange to the extent that it influences current account balance in such a
way that it deserves to be sort of commented by Treasury. That’s one
issue. The other issue is more fundamental. Do small open economies
under the current global liquidity environment deserve a reconsideration
of the total monetary framework that it [inaudible 00:50:16]? And on the
first point, as I was trying to show in my chart, Korea has not actually
managed the exchange extensively since the global financial crises. Before
then it did. It’s very clear. You can test it in any way you want.

There have been two occasions where the current account was—two
quarters since the global financial crisis where the current account balance
was affected by the real exchange rate. On both occasions, it was actually
the one depreciating against the dollar. But it was not because of the
intervention but because the dollar was strengthening globally. So under
the circumstances, it’s not quite clear whether Korea deserves to be
criticized or being pointed out by the treasury that we are managing the
exchange rate. So that’s the short answer for the first point

The second point is, as you all know, for a small open economy,
especially if your currency is not monetary policy versus exchange rate
policy, there’s no difference. Essentially one is the other. In this respect, I
think we need to rethink fundamentally how to actually go about in
managing exchange/monetary policy in countries like Korea. It’s not
limited to Korea, but I think it’s a general more fundamental question that
we need to deal with. Let me just stop here for now.

Marcus Noland: Great. So we have a microphone in the center of the room and we have a
roving mic over here. So please when you ask your question, identify
yourself. Yes, a man who needs no identification, Dr. C. Fred Bergsten.

Fred Bergsten: Hi, Fred Bergsten here at the Institute. A two-part question for President
Lee. As Jeff mentioned, not only Korea but a number of countries will be
looking to join TPP as soon as it comes into effect. We already know the
Philippines, Thailand, probably Indonesia, certainly Taiwan if you can get
over the political hurdles, a number of countries will be wanting to join at
the same time Korea joins. So that means Korea will be running into
something of a logjam of applications to join Korea. What’s your thought
about that? Do you want to work with those other countries? Would you like to form kind of a coalition? How will it affect you own negotiating strategy? Have you thought about that complication in you accession proposal?

And second question and related to that, Korea as you mentioned is also participating in the RCEP negotiation and as Jeff mentioned, this whole thing might at some point fold into a broader free trade area of the Asia Pacific. Korea has been a leader in trade policy strategy over the last decade. You’ve negotiated FTAs in every direction. What’s you strategy for relating TPP and RCEP and that broader long-term APEC goal which the Chinese have pursued in their chairmanship of APEC last year toward a comprehensive free trade area of the Asia Pacific? How do you relate the logjam to the broader ideas and what is your architectural strategy?

Il Houng Lee: I was expecting a question on the exchange rate, but I was slightly disappointed with these questions. But on the TPP, the strategy, I personally haven’t really thought about it. I’m sure the government has. I’m pretty sure because it’s something that has been ongoing for a long time and I’m not even familiar to what extent forming a coalition is beneficial to the extent that all the rules have been already preset. So unless you create a coalition big enough that can influence the rest of the existing TPP members, I don’t see the benefit of having to negotiate.

Jeff Schott: And that’s where China…

Il Houng Lee: Exactly. I think China is actually the only country big enough to actually make a difference. But I don’t know whether China will join as a second group. I did speak to the Chinese but you probably have also, so that’s the simple answer to your first question.

The second is I have my own sort of personal view on how things might actually unfold in Asia and that is, I think the RCEP, AP FTA will take some time before they can actually come to something concrete. I think what might actually happen in Asia is it may become a powerless structure – the powerless structure being one, being the TPP and the other being the One Belt, One Road.

I don’t see the One Belt One Road as anything else other than a materialized, a new version, new generation FTA. It’s focused on hardware but software will probably come along. But what kind of software we can discuss. The real software for economic integration I think will have to be provided by TPP. It’s an international standard. It’s setting the rules and so on. It’s something that TPP can actually contribute significantly to Asia, whatever form of integration it actually might adopt.
But during that process, the One Belt, One Road, if it is successful will certainly lay the foundation for the hardware where the software, the TPP, can be imposed at the end of say the next decade or so. Maybe we will see a joint TPP/One Belt, One Road package that might actually provide a new impetus for growth in Asia.

Marcus Noland: More questions, please.

Ben Hancock: Hi, I’m Ben Hancock from Inside US Trade. Thanks very much for this presentation. I had a question for President Lee. You said that there wasn’t as much of a consensus about joining TPP. That was your own feeling within the Korean government as maybe has been presented by Mr. Schott here. I wonder if you can tell us why you feel that way. There have been some different accounts about how the industry itself feels about it. Some of the old tensions had to do with the agricultural constituency. That seems like it may not be the only reason. The auto industry obviously with Japan’s involvement seems to have some concerns. And secondly you said the benefits weren’t so much the normal benefits of trade agreements but you saw it in a different light. I wonder if you could expand upon that a little bit more. And Jeff I was hoping to ask you, you said that –

Marcus Noland: Hang on, hang on, hang on.

Ben Hancock: Sorry.

Marcus Noland: This room is named for Fred Bergsten so he gets to ask two questions. Everybody else gets one and you’ve gotten two so let’s wait on the third one, okay?

Il Houng Lee: Okay, on your question, I did point out that it is not the Korean government that is undecided. I don’t know whether they have decided or not. What I was referring to was the people that I usually talk to, other government think tanks, academia, and former government officials who may actually have had some interest in these areas and so on. And we ourselves being the main government think tank responsible for making all the assessments for FTAs have ran some tentative assimilations, trying to get a sense of you know what the benefits are and so on. But because we have already bilateral FTAs with most of the TPP members, that’s one.

Second, the TPP, while my understanding is that it actually is a very high standard FTA, in terms of the conventional or the traditional benefit it can actually generate, which our current quantitative models are capable of only. It doesn’t actually provide much because our tariffs, non-tariff barriers are quite low anyway. So it was in that respect that I was making these comments. But as I said, the real benefit, which I’m looking forward to is the adoption of the software ahead of the Asia in AWE in terms of the
international standards and the rules that will hopefully eliminate the pockets of inefficiencies we still have in our system.

Jeffrey Schott: Indeed, I fully agree with Dr. Lee. When you’ve looked back at what the previous projections of CGE models have been for what could come out of a trade agreement, they’ve almost always underestimated the actual gains that accrue. And I think that a lot of that is because a lot more goes on in terms of the dynamics of integration and encouraging investment that spur higher levels if growth and employment than projected by the current level of analysis from those models.

Marcus Noland: Sir.

Irving Williamson: Irving Williamson, US International Trade Commission. So Lee, you mentioned the possible benefits for Korea and TPP was, I think in the area of services trade and I didn’t understand what you were getting at as to why those [inaudible 01:00:41] was your focus on? And I might also get to just a point about the dynamic effects and whether or not services is one area where you would see that.

Il Houng Lee: I was not limiting my comments only to services and trade. I was. I was referring to services in general. Yeah, because the aspect, okay. There are many restrictions in services, and also according to the OECD database, as you may be familiar with, they have done analysis on G20 countries. A lot of restrictions still, in many, even in most – well, OECD is mainly for, not mainly, but only advanced economies, but advanced economies who have lots of restrictions in the services areas. And hopefully by providing or imposing some multilateral structure through the TPP, some of the standards can be adopted more quickly than otherwise. And that was what I was referring to.

And as I mentioned also, we have begun joint work with the OECD trying to figure out how best we can actually open up the services sector itself. And we are also doing some work on how we can actually relate it to potential joining of the TPP and gain a greater impetus on these areas.

Marcus Noland: Don Kirk. You can just walk up there before I recognize you or make a line just to -

Don Kirk: My name is Don Kirk. I’m a journalist. There seems to be some sort of an assumption here that TPP is going to sail straight through early next year and that KORUS has been a success. And yet a lot of people think that KORUS has not been a success. Some people thinks it’s been a failure because of a widening trade gap and also because of failure on the part of Korea really to open up as promised. I wonder if, you know, obviously you all feel much more optimistic. I wonder how you counter that view
that TPP might encounter severe problems in Congress because of the problems with KORUS and what you say to, to the criticism that KORUS has not worked out? Thank you.

Jeffrey Schott: Well, we don’t have time to give you a full explanation on why all the things that you’re hearing are wrong, but they are. First point, you say something that I agree with. Nothing that goes through Congress is going to go through Congress easily. So, there are going to be people, members who will be opposed to TPP, are opposed today. They will be opposed after they actually read the agreement and it has, you know, more to do with their particular politics and constituencies that they represent. But I think a strong majority in the Congress represent interests that will greatly benefit from the TPP and there should be with extensive majority of the republican caucus, an overall strong majority in the Congress to support TPP.

But that means that their not voting on TPP; they’re voting on the implementing legislation. And so what I said before on the importance of the Senate leadership and the President getting together and crafting a bill that ensures that it takes into account the concerns of the majority of members of Congress. That’s very important. So that if there’s an area where they’re concerned about increased competition, maybe there’s a domestic policy that can be tweaked to ensure that there is more balance or support. Those are the types of things that I think will end up going into implementing legislation as they have in the past.

Marcus Noland: I’m glad that Don asked that question because in my head, the next question I was going to ask in case there was a lull was that, I was struck by the fact that we were asking President Lee about South Korean public opinion about a prospective deal in which the marginal gains were not particularly evident because of the preexistence of these existing FTAs. I would just observe that I have a secondary affiliation with the East-West Center in Honolulu. The entire Hawaiian congressional delegation has come out against TPP and I find that when I’m in Hawaii, anybody who’s sort of pro-TPP is a—the default position is that you’re against TPP and if you explain that, no, actually it might be a good idea, you’re sort of off trying to destroy the environmental club baby seals or something. So, I think there is a political issue here in the United States as well as in Korea and it’s an issue that we’re going to have to confront soon if Jeff is right.

Gary Hufbauer: Thanks. Well, just following up on your comment Marc, I wanted to ask Dr. Lee whether the common view amongst the opponents in the US that TPP really just enriches corporations and all the gains, in fact more than a 100% of the gains go to the top 1% is echoed in Korea or were there other
quite different political objections in Korea to joining TPP or trade agreements in general.

Il Houng Lee: The 1% is a very interesting question. I have to think about that. But the concerns that we have once negotiation of TPP begins is that it would rekindle some of the old issue that we have hopefully had left behind. And the first one is agricultural products, how much would we have to open up more. Rice certainly is a very politically sensitive issue. If you press the wrong button it will just end everything. Then also we had some concern on investment treaties. If you open up the investment too much, is there a concern that in case there’s dispute that this may become subject to international arbitration? In which case in some sectors, there’s a general perception that the US has the upper hand if it comes to international arbitration. So there is some concern in this regard.

And also there is some general, very small minority, but very vocal group in Korea that is just anti-US. We don’t know why but that sentiment is still there, a very small minority but very vocal and they make up stories and we don’t know with what stories they would come up next so.

Marcus Noland: Yes, please.

Speaker: [Inaudible 01:08:25]. I have a question for Jeff. I’m wondering what impacts of the Canadian elections this month will have on the TPP negotiations especially for the direct talks and also the laws of warranty in the warehouse industry. Thank you.

Marcus Noland: Could you repeat that?

Speaker: Yeah. The Canadian elections this month, what are the impacts of the …

Jeffrey Schott: The Canadian election?

Speaker: Yeah.

Jeffrey Schott: Okay. Well, my impression, and I spent some time in Vancouver last weekend, was that the Canadian government actually wants to get the deal done before the election and they are committed to doing a deal. I think they understand, like with NAFTA, that the TPP is an agreement that they have to be in, that overall they’ll benefit greatly. Dairy farmers may not be happy, but beef and pork producers will benefit very, very well and they are the ones that are supporting the Prime Minister. The dairy farmers are not supporting the Prime Minister and won’t in any event. So that’s one area where I think politics actually works in favor of the current government moving quickly to have a handshake on a deal. And I think that’s their strategy and they recognize that it will have some pressure on
them in the discussions on autos and auto parts but I think that’s an issue
that they’re confident they can find a good compromise.

Marcus Noland: All right. Having had me shut up Ben Hancock, Fred Bergsten gets the
final question.

Fred Bergsten: The third question in this room, so a quick one to Dr. Lee, a follow-up to
Gary Hufbauer. You stressed that Koreans say, “Well, TPP doesn’t add
much to what we already have.” You already have an FTA with the United
States, with China. There’s one big difference – Japan. One component of
an extended TPP for you would be a free trade agreement with Japan,
which as Jeff pointed out, you’ve been trying to negotiate for 12 years.
Not successful.

My question is whether that is really the big hang up in Korea about
joining TPP? My impression is that Korea has always worried a lot about
moving to free trade with Japan. Your chart showed a big Korean trade
deficit with Japan. That’s structural, it’s been there for a long time. My
impression is many Koreans fear that would be much worse if you went to
free trade with Japan. Is that really at the heart of a lot of the concern in
Korea about joining the TPP?

Il Houng Lee: I think you have a point that there’s still some people in Korea that’s
concerned about Korea-Japan FTA because of this reason. We have very
similar products. We will be competing on very similar products, not only
bilaterally but at the global level. So there is concern that if we have
bilateral FTA with Japan, Japanese products, particularly machinery, since
those will swamp the markets in Korea. But that concern is actually now a
minority, which I can tell you.

There is more sort of a call for, you know— we have sheltered or tried to
shelter our products for the last 30 years. For how much longer and will it
make any difference anymore? That sentiment is actually much bigger
now. So certainly, that concern was there but that was not a make-or-break
issue for us being hesitant at some point whether to join TPP or not.

And if I may add, one of the reason that we were concerned with Japan
FTA was when we have to negotiate, we will have to negotiate a trade
card in terms in our tariff whereas Japan has to work on their NTBs
against us because their tariffs are already very low. And our concern was,
how do we actually monitor implementation? That’s probably a similar
concern that the US had with Korea and now that Japan has joined TPP,
we are hopeful that maybe the US has dealt with this issue for us.

Marcus Noland: President Lee, would you like to make any final remarks before we close?
Il Houng Lee: I’d just like to make just one last point that Jeff has already mentioned and that is the outcome of KORUS FTA has been much more successful than is generally perceived and as I was trying to show in some of the actual hard data, there has been progress. But the problem has been that the global economy went through some many different things in the last five, six years. There are so many noises and it’s very difficult to see clearly the benefit.

For example in our FTA with the EU, trade deficit widened substantially in the last couple of years and there’s a lot of calls within Korea of accusing the government of having made the wrong agreement with the EU. So we ran various tests and then when we controlled for different things that’s happening around the globe, for example the global trade slow down and so on, we came out with the result that the net benefit was very strong. I mean, our export, once you control for these noises grew substantially vis-à-vis the EU and so on.

Same thing applies vis-à-vis the US also and Korea. It’s just that in the EU, we have to justify why we have huge growing deficit. With the US, we have to justify we have a huge growing surplus. But it’s not because of the exchange rate or because the agreements were done wrongly but it’s just because there are so many other things that’s happening at the same place at the same time.

Marcus Noland: Jeff, any final words?

Jeffrey Schott: I fully agree with that and I think it was well said.

Marcus Noland: Well, I think our discussion has demonstrated that the United States and Korea have a very fruitful relationship and the Peterson Institute has a very fruitful relationship with KIEP, which we hope and expect to continue. So please join me in thanking President Lee and our senior fellow Jeff Schott with a round of applause. And I declare this meeting adjourned. Thank you.