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Korean *Hallyu* in Trade Policy

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Summary: In early 2012, Korea undertook two major trade initiatives with China and Turkey that are likely to trigger new dynamics in the world trading system frozen by the Doha failure. These initiatives reveal a worrisome "policy decoupling" between Korea and the United States and the EU, which have been unable to take similar moves despite being in much worse economic shape than Korea. Compared with Korea's preferential trade agreements (PTAs), PTAs with the EU and the United States have produced limited market access. The key Korean lesson for the EU and the United States is that Seoul conceives trade policy — be it Doha or PTAs — first and foremost as a component of a pro-growth domestic agenda, not as a quasi-autonomous policy with only rhetorical references to growth and jobs.

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In the last decade, Korean singers, dancers, and actors have swamped East Asian stages and theaters. Most prominent among these is superstar Rain (Bi in Korean) who rapidly rose, with Confucian humility, from the poor streets of Seoul to the Time 100 list of most influential persons in the world. Astounded Chinese observers have given the name "Korean *Hallyu*" (Korean wave) to this phenomenon.

There has also been a Korean Hallyu in trade policy in recent years. Two months after the official recognition of a "Comatose Doha" round of multilateral trade negotiations, Korea undertook two major trade initiatives that are likely to trigger new dynamics in the world trading system frozen by the Doha failure. In January 2012, Korea proposed opening talks with China on a preferential trade agreement (PTA). And in February, Korea offered to restart similar talks on a PTA with Turkey.

These Korean initiatives are not novel. They are the continuation by Seoul of a carefully designed policy implemented since the mid-2000s to sign PTAs with large, relatively open, and well-regulated economies. These initiatives have proven quite successful. By 2010, just 11 PTAs gave Korean firms free access to 57 percent of the world's GDP. The two proposed PTAs with China and Turkey would add another 10 percent of world GDP to that total, meaning that Korean firms will enjoy a level of market access close to what the Doha Round would likely have given them if it had been completed.

These initiatives reveal a worrisome "policy decoupling" between Korea (and a few other developed and emerging economies) and the United States and the EU, which have been unable to take similar moves despite being in much worse economic shape than Korea. Seoul remains firm in seeking trade liberalization — be it via Doha or PTAs — as an indispensable engine for domestic growth. Brussels and Washington should be deeply concerned by such a policy decoupling because Korea's initiatives have the capacity to be game-changers in Asia and Africa.

The Korea-China PTA

In both Europe and the United States, the Korea-China PTA is seen first and foremost as a political initiative. Seoul needs Beijing's support for stabilizing a dangerously volatile North Korea after the death of Kim Jong Il and his son's hasty succession. Nonetheless, the economic consequences of this PTA are equally huge.

First, Korea's initiative opens a helpful door for China, which has been isolated in trade matters after the Doha failure. The U.S.-sponsored Trans-Pacific Partnership (TPP) initiative leaves no room for China because Beijing will never be able to sign the anticipated TPP provisions on labor laws or state-owned enterprises. Moreover, the EU has still to make up its mind on what to do with China. Japan enjoys the luxury of two trade-expanding alternatives — joining TPP and a PTA with the EU — rendering a trade initiative with China less urgent. Finally, no developing country is ready to sign a substantial PTA with China — fear of the Chinese industrial powerhouse is simply too great. But clearly, a Korea-China PTA would be a game-changer, forcing all these countries to reassess their current trade strategy vis-à-vis China.

Second, a Korea-China PTA is Korea's response to another key game-changer in East Asia: the China-Taiwan Economic Cooperation Framework Agreement (ECFA) that gives Taiwanese firms substantial preferences when entering Chinese markets. Korea hopes that the PTA with China will put its firms on par with those of its arch-competitor, Taiwan. How difficult and/or how shallow the Korea-China deal might be is a wide open question — as indeed it is for the ECFA. But moving (or moving first) may be a huge advantage when dealing with the mammoth Chinese economy and China's complex national and regional economic policy decision-making processes.

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The Korea-Turkey PTA

In 2010, Korea and Turkey started talks on a PTA, but Turkey wanted to focus only on tariff issues and lost interest. In sharp contrast with Korea's PTA-driven economic vision of the world, Turkey has seen PTAs as

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foreign policy instruments for (re)establishing regional influence. If one excludes the customs union with the EU, Turkey has signed 18 PTAs, all of them with Middle Eastern or Central Asian neighbors, often parts of the former Ottoman Empire.

Turkey's approach has encountered severe limitations. The markets opened to Turkish firms by these PTAs are small: the GDP of all Turkey's PTA partners represent less than 6 percent of world GDP — less than one-tenth of Korea's result. Turkey's partners are economies that are highly protected and badly regulated, and therefore not particularly promising in terms of growth prospects. Last but not least, the political benefits of these PTAs have been undermined by the Arab Spring revolutions that have overturned several of the regimes with which Turkey had signed PTAs.

Thus, a Korea-Turkey PTA would also be a game-changer. Ankara has long been stymied by Brussels in its efforts to join the European Union. A trade deal with Seoul would demonstrate that Turkey has alternative economic partners in the global economy. Moreover, a Korea-Turkey PTA would help Turkey to shift from a trade policy driven by Ottoman nostalgia to a policy looking for the largest and fastest-growing markets in the world. For the Korean side, it is an additional opening to EU, Middle Eastern, and Central Asian markets.

Lessons for the United States and the EU

Compared with Korea's PTAs, PTAs with the EU and the United States have produced limited market access. The EU's 32 PTAs have opened only 17 percent of the world's GDP to EU firms, while the United States' 15 agreements have opened only 13 percent of world GDP to U.S. companies.

Why such paltry results? Most U.S. PTAs have been driven by foreign policy concerns, as exemplified by the failed initiative to create a Free Trade Area of the Americas and then the successful but economically irrelevant PTAs with Morocco, Oman, and Bahrain in the wake of the 9/11 attacks, in an effort to show that Washington could have strong relations with Muslim countries. Despite their names, these deals don't qualify as trade policy. In fact, the most meaningful trade policy would have been strong U.S. support for a successful conclusion of the Doha Round. But Washington had a hard time choosing between its international leadership in trade matters (which favored a compromise at the WTO) and its domestic trade hawks ready to kill the Doha Round if not "ambitious" enough.

Brussels' trade policy was ambiguous. It hoped to get both a successful conclusion of the Doha Round and extra benefits from PTAs. In the process, it overestimated its true negotiating leverage with respect to its potential PTA partners. As a result, the EU chose the wrong PTA partners. Since 2006, the EU has tried to conclude PTAs with partners (Argentina, Brazil, India, Russia) that will become truly large economies only in the 2030s, that still have deep-rooted protectionist instincts, and that are among the most regulated economies in the world. Such a choice was driven by the hope to get big preferences for EU firms in these future large markets. This hope can only lead to bitter disillusionment. As soon as the EU PTA partners realize the huge rents that EU firms will gain from the strong market access preferences these nations have granted to the EU, these nations will conclude PTAs with other countries, eroding EU preferences and leaving EU firms with severe adjustment problems.

The EU chose the wrong PTA partners.

Paradoxically, the current U.S. and EU PTA policies have led to similar partners — too small and/or too badly regulated to have any chance of boosting European and U.S. growth in the current economic crisis. As a result, top U.S. and EU decision-makers (presidents and prime ministers) are not interested in supporting such PTAs, which then tend to be captured by narrow vested interests fighting for years before getting final ratification of modest deals.

Learning from the Korean Hallyu

The key Korean lesson for the EU and the United States (and indeed for any country) is that Seoul conceives trade policy — be it Doha or PTAs — first and foremost as a component of a pro-growth domestic agenda, not as a quasi-autonomous policy with only rhetorical references to growth and jobs.

If PTAs are the only option left to the EU and the United States for the time being, the Korean Hallyu suggests that they need to fulfill three conditions:

- Open big markets. The bigger the prospective trade partner's economy, the greater the opportunity for U.S. and European firms to expand the scale of their operations and the scope and variety of the products they can sell.
- Favor well-regulated partners. The better-regulated the partner is, the more the country in question will be induced to improve its own regulations. Modern economies are regulated by norms in goods and by market regulations in services. The quality of these regulations decides whether a country has a thriving and successful economy or a sluggish and declining one. Better regulations are powerful instruments to change the relative prices of goods and services, hence to increase consumer welfare, in modern economies where services represent 70 percent of GDP.
- Look for timely results. Negotiating a PTA with a partner that may be a large economy in two decades is not suitable for the United States and the EU, both of which are debt-ridden regions with an urgent need

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to boost growth now. Timing is key in choosing PTA partners.

Combining these three criteria suggests that the EU and the United States should concentrate their negotiating efforts on concluding a small number of deals as soon as possible, in addition to the recently concluded ones with Korea: a PTA with each other, EU bilateral deals with Japan and Taiwan, and a U.S. deal with Japan through the Trans-Pacific Partnership.

Back to the WTO

By doing so, the EU and the United States will inevitably amplify two costs of the emerging web of PTAs. First, such a web will inevitably generate discriminatory treatment among the economies linked by these PTAs simply because there is no negotiating process guaranteeing that concessions granted to one PTA partner will be granted to other PTA partners. These costs are likely to flourish in all the issues more complex than tariff matters.

Second, such a web of PTAs tends to leave aside many developing countries — those that are too small, too badly regulated, and/or with growth prospects too distant to be attractive. This stratification is certainly not a desirable one for world growth, development, or peace.

This conclusion shifts attention back to the WTO forum, which remains the only and/or best place to solve these problems. In particular, the WTO emerges as by far the best forum for small developing countries — a lesson they would do well to remember.

About the Author

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