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*DISCUSSION PAPER*

# Stabilizing the U.S.-Korea Trade Agenda Under Trump and Moon

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## Introduction

The Donald J. Trump administration's unconventional approach and focus on "fair and reciprocal trade" have serious implications for the U.S.-South Korea economic relationship. Despite relative satisfaction with the status quo in the two business communities, the bilateral economic relationship has received political attention at the highest levels. This has also spilled over into the security realm. Careful management, including the cultivation of new areas of cooperation, is needed to prevent economic issues from hindering close security cooperation on North Korea policy and to put the overall relationship on more solid footing.

Since the 2006–2007 negotiation and 2011 ratification of the Korea-U.S. Free Trade Agreement (KORUS FTA), U.S.-South Korea economic cooperation has emerged as a pillar of their alliance. Other steps to expand the security relationship included cooperation on nontraditional security issues beyond the Korean Peninsula and the 2015 signing of a new U.S.-South Korea nuclear cooperation agreement. The two countries carried out this expansion under both Republican (George W. Bush) and Democratic (Barack Obama) U.S. administrations, as well as under progressive (Roh Moo-hyun) and conservative (Lee Myung-bak and Park Geun-hye) presidencies in South Korea.

South Korea, or the Republic of Korea (ROK), has actively embraced trade promotion since the mid-2000s, enabling it to expand its exports through free trade agreements with China, Southeast Asian countries, and the European Union (EU). This expansion has enhanced South Korea's value to the United States as an economic partner by broadening South Korea's economic options and enhancing international competition for a share of its markets. But ongoing U.S.-China competition has put pressure on the U.S.-ROK economic relationship. The United States and China have pushed South Korea to choose between its security guarantor and its primary economic partner.

Negotiations that resulted in revised U.S.-ROK trade arrangements, conducted under the auspices of the KORUS FTA, have temporarily lessened tension in U.S.-ROK relations. Most recently, in early 2018, at the Trump administration's insistence, the two sides agreed on relatively small modifications to the KORUS FTA and negotiated limits on South Korea's exports of aluminum and steel to the United States. The economic relationship will require further attention as South Korea addresses its vulnerability to fallout from the U.S.-China trade war and adjusts to China's growing economic power. South Korea will also have to maneuver within the new trade environment resulting from the Comprehensive and Progressive Agreement of the Trans-Pacific Partnership (CPTPP), an eleven-nation agreement finalized in 2018 that emerged from the Trans-Pacific Partnership (TPP) after Trump's January 2017 withdrawal. Although South Korea could be interested in joining the CPTPP, the recent decline in relations with Japan, a founding member of CPTPP, complicates that prospect.

Using the revised KORUS FTA as a platform for future cooperation, the United States and South Korea should work to expand their partnership to include economic cooperation in the Indo-Pacific, energy security, and plans for inter-Korean economic initiatives. They should also address unfair trading practices, the challenges aging societies face, and fourth-industrial-revolution issues.

## A Brief History of U.S.-ROK Free Trade Agreement Negotiations

The idea of a free trade agreement between the United States and South Korea dates back to the 1980s. At the time, growing trade disputes and concerns over trade diversion from the U.S.-Canada FTA led to initial South Korean interest and U.S. consideration.<sup>1</sup> The United States and South Korea, however, did not formally begin negotiations on a free trade agreement until 2006.

From the late 1980s into the early 2000s, numerous disagreements over trade and economic policies accompanied steadily increasing U.S.-South Korea trade. As part of South Korea's International Monetary Fund package during the 1997 economic crisis, the country enacted a set of sweeping market-oriented reforms that eased but did not resolve many of these tensions. The Office of the U.S. Trade Representative (USTR) and South Korea's Ministry of Trade instituted quarterly working-level trade meetings in 2001 that provided regular opportunities to further de-escalate trade tensions.

The two governments announced their intention to negotiate a comprehensive bilateral free trade agreement in February 2006. At the time, skeptics doubted that South Korea would be willing and able to make the necessary hard decisions to reform and further open its economy. The two countries held five rounds of preparatory negotiations over eighteen months, and each side examined the proposed FTA agenda chapter by chapter. Both governments therefore had reasonable confidence that they would reach a successful conclusion by the time they announced the launch of the negotiations. As a demonstration of South Korea's ability to make politically difficult choices, the United States asked for concessions in four problematic areas: automobiles, beef, pharmaceuticals, and so-called screen quotas that limited the permitted screen time for foreign films. South Korea agreed, and the negotiations kicked off.

In June 2007, the two countries signed the completed agreement in Washington, DC, just in time for it to be covered under the Trade Promotion Authority, sometimes called fast track, which meant that the U.S. Congress had to vote up or down on the agreement with no amendments. The signed agreement languished until October 2011 due to concerns in Congress over automobile market access and South Korea's continued restrictions on U.S. beef, as well as the onset of the Great Recession and the transition to the Obama administration. After the 2010 Group of Twenty (G20) Summit in Toronto, the Obama and Lee Myung-bak administrations took steps to boost U.S. access to South Korea's automobile market, such as creating a twenty-five-thousand-vehicle exemption per producer from South Korean safety standards. These moves helped expand support for the agreement in the United States, and Congress ultimately ratified the agreement, which entered into force on March 15, 2012.

### *THE EVOLVING POLITICAL ROLE OF THE KORUS FTA*

In the mid-2000s, the Bush and Roh administrations envisioned the KORUS FTA as an instrument to liberalize trade between the United States and South Korea and encourage a more open market to enhance exchanges between the two economies. They also began negotiations to restore the health of their strategic relationship, which chafed under disagreements over how to best manage relations

with North Korea and the repositioning of U.S. troops in South Korea. For South Korea, the KORUS FTA became the backbone of a network of free trade agreements that undergirded the expansion of South Korea's export capability and access to global markets. The U.S. government also recognized the growing importance of its economic relationship with South Korea, and KORUS FTA negotiations cleared away or eased the protectionist internal regulations in South Korea that hindered the expansion of bilateral trade. Within the U.S.-ROK alliance, the KORUS FTA provided an opportunity to expand bilateral cooperation beyond security and to promote the deepening of the U.S.-ROK security alliance into a more comprehensive partnership.

Even as China's economic role and influence have risen dramatically within Asia, the KORUS FTA has strengthened institutional ties between the United States and South Korea. The KORUS FTA has facilitated U.S.-ROK bilateral investment as South Korea has sought to reduce economic dependence on China and has come under greater political pressure to achieve a balanced merchandise trade relationship with the United States.

The KORUS FTA served as the benchmark and template for the United States and other Trans-Pacific Partnership members during TPP negotiations. The EU and South Korea also used the agreement as a basis for measuring the quality and scope of their efforts to negotiate that free trade agreement. In light of the U.S. decision to withdraw from the TPP at the beginning of the Trump administration, the KORUS FTA became both a target for revision and an early model for the type of revised arrangement that would pass muster with the Trump administration.

#### *THE TRUMP ADMINISTRATION AND KORUS FTA RENEGOTIATION*

The USTR argued in its 2019 Trade Policy Agenda and 2018 Annual Report that the KORUS FTA had, after six years of implementation, "failed to bring about promised benefits."<sup>2</sup> The USTR noted that the U.S. goods deficit with South Korea had increased since the KORUS FTA entered into force and cited U.S. business community concerns regarding South Korea's failure to fully implement its commitments under the agreement in areas such as automobiles, competition, customs, labor, medical devices, and pharmaceuticals. Although Trump frequently expressed concerns about the KORUS FTA and the U.S. trade deficit with South Korea during his candidacy and after his election, they were not broadly shared by the U.S. business community despite concerns over certain implementation issues.

While the expectation was that the U.S. goods deficit with South Korea would decline with the implementation of the KORUS FTA, the deficit grew from \$13.2 billion in 2011, before KORUS FTA implementation, to a high of \$28.3 billion in 2015. Despite revisions to the agreement prior to implementation reached by the Obama and Lee administrations, U.S. exports to South Korea decreased slightly, though the extent to which the KORUS FTA affected this decline is difficult to ascertain.<sup>3</sup> For example, South Korea's economic slowdown and U.S. economic growth during these years also factored into the decline. Additionally, in 2016 the U.S. International Trade Commission projected a lower level of U.S. exports to South Korea in the absence of the KORUS FTA.

The Trump administration viewed automobile trade as particularly problematic. While sales of Fords and Chryslers in South Korea increased significantly, sales levels remained relatively small.<sup>4</sup> The USTR later noted that the majority of the U.S. trade deficit with South Korea was concentrated in the automobile industry.<sup>5</sup> Additionally, U.S. automobile sales continued to trail those of European producers in South Korea.

Already predisposed against the KORUS FTA, Trump pushed for the agreement's revision after his first meeting with South Korean President Moon Jae-in in June 2017.<sup>6</sup> Later that summer, the president reportedly pushed forward a plan to announce U.S. withdrawal from the agreement.<sup>7</sup> The United States and South Korea agreed to enter into formal negotiations in the fall of 2017, and in early 2018 the North Korea issue intervened to accelerate trade talks. In his New Year's Day address, North Korea's leader Kim Jong-un expressed an interest in North Korea's participation in the 2018 Pyeongchang Winter Olympics. Given the potential opening for negotiations with North Korea, the hope to remove any strain on the U.S.-ROK alliance, and the desire to resolve negotiations as quickly as possible to restore predictability for South Korean industry, the Moon administration moved to conclude trade talks with the United States prior to the first U.S.-North Korea summit.

The 2018 KORUS FTA renegotiation focused primarily on reducing the U.S. trade deficit with South Korea by improving trade in automobiles in light of the industry's significant increase of the trade deficit. The mostly cosmetic outcomes also spanned issues relating to currency, customs, and pharmaceuticals. Most notably, South Korea agreed to double the threshold number of U.S. automobile imports that are allowed to meet U.S. (as opposed to stricter South Korean) safety standards. South Korea also accepted the United States' extending its phaseout of the 25 percent U.S. tariff on South Korean trucks until 2041. It was to have begun in 2021. The amended agreement also included South Korean recognition of U.S. standards for automotive parts as well as steps to help U.S. producers meet South Korean emissions standards.<sup>8</sup> However, no U.S. automobile company has met the original threshold number, and no South Korean automobile company was selling trucks in the United States.

To help ensure fair treatment of U.S. exports, South Korea also agreed to address long-standing complaints regarding its customs procedures and to amend its pharmaceutical reimbursement policy. However, more work can still be done to ensure fair pricing and reimbursement.

#### *OTHER TRUMP-MOON TRADE NEGOTIATIONS*

The United States and South Korea have also held further trade negotiations as part of the Trump administration's national security investigations into aluminum, automobiles, and steel. Section 232 of the Trade Expansion Act of 1962 authorizes the U.S. president to request the Department of Commerce to investigate the national security implications of certain imports.<sup>9</sup> If the investigation reveals that the imports threaten U.S. national security, the president can then choose to modify the level of imports through tariffs or by imposing quotas.

Since 2017, three Section 232 investigations have implicated South Korea. The first two, initiated in 2017 by the Commerce Department after consultations with Trump, targeted steel and aluminum imports. Concurrently with the KORUS FTA negotiations, South Korea agreed to limit steel exports to the United States to 70 percent of their average exports from 2015 to 2017. The steel quota and drop in U.S. steel imports from the Asia-Pacific hit South Korean companies particularly hard, as South Korean steel exports to the United States fell 24.8 percent by volume (and 13 percent by value), from 3.23 million tons in January to November 2017 to 2.43 million tons during the same period in 2018.<sup>10</sup> South Korean aluminum exports are less significant. South Korean total worldwide exports of aluminum amounted to only \$3.65 billion in 2018, with just \$375 million in aluminum exports to the United States.<sup>11</sup> The United States and South Korea have not reached an agreement on aluminum, and South Korean exports of aluminum to the United States have remained subject to

tariffs since May 1, 2018.<sup>12</sup> An additional sector became subject to bilateral trade anxiety in 2018, when, following later discussions with Trump, U.S. Secretary of Commerce Wilbur Ross initiated a third investigation into whether to apply Section 232 national security tariffs to U.S. automobile imports, including those from South Korea.<sup>13</sup>

Although the successful KORUS FTA revision could grant South Korea a temporary reprieve, the Trump administration will expect the modified agreement to deliver the promised benefits to U.S. businesses and workers.<sup>14</sup> South Korea has run current account surpluses since 1998, and, as its 2019 trade policy agenda made clear, the Trump administration will continue efforts to rebalance not only America's trade relationships, but also the global economy on a "fair and reciprocal" basis.<sup>15</sup> The administration's focus on trade deficit reduction will continue to feature prominently in trade talks with major partners, namely China, Germany, Japan, Mexico, and Vietnam, as well as South Korea. The administration will continue to use a broad range of trade policy tools, including tariffs, in negotiations aimed at leveling the playing field for U.S. exports.

## The Effect of KORUS FTA Renegotiations and Other Trade Factors on the Korean Economy

Given the modest changes to the renegotiated KORUS FTA, the modifications will likely have a minimal effect on South Korea's economy. Although the provisions on pharmaceutical reimbursements and customs issues will improve the agreement, the most significant economic effect will likely come from extending the phaseout of the U.S. light-truck tariff until 2041.

In this case, the economic cost comes largely from forgone gains rather than immediate losses. Although Hyundai Motor Group and SsangYong Motor could enter the U.S. market, the two companies do not currently export light trucks to the United States. The U.S. International Trade Commission estimates that, had the United States not extended the tariff and had South Korea entered the U.S. market through a combination of exports and local production, South Korea would have exported only fifty-nine thousand light trucks to the United States. South Korean companies have had minimal losses in the medium- and heavy-truck categories in the U.S. market as well.<sup>16</sup>

The Section 232 decision on automotive imports into the United States would have become a more significant issue for South Korea's economy if the Trump administration had imposed tariffs. For years, automotive products have been the largest segment of South Korea's exports to the United States. In 2018, South Korean exports of automobiles and automotive parts made up more than 24 percent of South Korea's total bilateral export of goods.<sup>17</sup> A study by the Korea Automobile Manufacturers Association suggests that if the United States imposed 25 percent tariffs on South Korean automotive exports, it would virtually end South Korea's ability to export to the United States and automotive production could drop to levels last seen in 2004.<sup>18</sup> A study by the Korea International Trade Association suggests that South Korea's economy would lose 8.6 jobs for every million dollars in lost exports.<sup>19</sup>

Although the Section 232 decision notes that adjustments made to the KORUS FTA have relieved national security concerns for the moment, it directed the Department of Commerce to monitor and address the situation as needed. The United States has not permanently exempted South Korea from future automotive tariffs under Section 232.<sup>20</sup> However, the Trump administration could have difficulty applying Section 232 to imports of South Korean automobiles. The Trade Expansion Act of 1962 requires the administration to reach a decision under Section 232 to impose tariffs within 180 days in the case of a national security emergency. The administration allowed this deadline to pass and is now constrained in its ability to use Section 232 to place tariffs on South Korean automobiles. The importance of this deadline was reinforced in a Court of International Trade ruling in another case of the administration's use of Section 232. The administration could still be able to use the law if the current action is deemed ineffective. It could also look to use other tools, such as the International Emergency Economic Powers Act, to impose tariffs, creating ongoing uncertainty for South Korean automobile producers.<sup>21</sup>

## *SOUTH KOREAN GOVERNMENT AND PUBLIC VIEWS OF REVISED KORUS FTA*

The negotiation of the original KORUS FTA and its ratification in 2012 generated a highly emotional debate in South Korea, including public protests and clashes inside the halls of the National Assembly between pro- and anti-KORUS FTA politicians. The response to the 2018 negotiations over modifications was significantly more muted.

The National Assembly's December 7, 2018, vote to ratify the changes merited little coverage in South Korea's major newspapers even though the United States had insisted on modifications and few if any South Korean constituencies appeared to have desired a renegotiation.<sup>22</sup> Although the negotiations and ratification occurred as South Korea's economic growth slowed, public debate was minimal. In 2018, South Korea's gross domestic product (GDP) rose by 2.7 percent, the slowest annual rate in six years. The country's unemployment rate has steadily risen since 2017, peaking at 4.4 percent in February 2019, the highest since the months following the 2008 financial crisis.<sup>23</sup> Youth unemployment and underemployment rates are particularly worrisome. At the end of 2017, nearly 40 percent of university graduates had been unemployed over the previous decade.<sup>24</sup> In response, the Moon government announced measures aimed at revitalizing economic growth, including a stimulus package and multiple cabinet reshuffles. In the summer and fall of 2018, the sense of economic stagnation helped push Moon's approval ratings below 50 percent for the first time. Yet this discontent did not manifest in significant opposition to the revised KORUS FTA.

A number of factors explain the lack of animus toward the KORUS FTA modifications. First, the relatively minor changes will likely inflict minimal economic damage to South Korea's import-competing industries, particularly in the next few years. In the fall of 2017, when it appeared the Trump administration would insist on major changes or even withdraw from the agreement, a majority of Koreans expressed concern that the United States would make excessive demands. More than half preferred to abolish the agreement altogether in this case.<sup>25</sup> In 2018 and 2019, South Korean government officials involved in the negotiations expressed relief that the United States had made fewer demands than expected. More extensive or economically punishing U.S. demands could have triggered a backlash.

Second, a majority of South Koreans believe in the importance of trade for their country's economic well-being, which likely contributed to their subdued response to the KORUS FTA renegotiations. Trade accounted for more than 80 percent of South Korea's GDP in 2018; recent public opinion polls, including one taken in 2018 when anxiety over the domestic economy's performance began to rise, indicate high levels of faith in the importance of trade for economic development.<sup>26</sup> Also in 2018, the Pew Research Center reported that 57 percent of South Korean respondents said that trade leads to job creation, one of the highest rates in the economically advanced countries surveyed. In addition, 56 percent said that trade leads to higher wages, the highest rate among economically advanced countries and a notable increase from the 45 percent who expressed this view in the 2014 Pew survey.<sup>27</sup>

Third, the North Korea issue contributed to South Koreans' quiescent response to KORUS FTA modifications. Official modification negotiations began in February 2018, one year after tensions on the Korean Peninsula spiked. Pyongyang had conducted dozens of missile tests and a nuclear test, and Trump administration officials had in turn threatened to launch a preventive military strike against North Korea. In February 2018, the Moon government attempted to use North Korea's surprise decision to participate in the Pyeongchang Winter Olympic Games to reduce tensions,

jumpstart an inter-Korean dialogue, and broker an opening of U.S.-North Korea talks on denuclearization. As Pyongyang's outreach to Seoul and Washington advanced throughout 2018, the Moon government and its supporters appeared wary of taking actions on trade that could jeopardize the emerging pro-diplomacy atmosphere. Some South Korean business leaders held a similar view.<sup>28</sup>

However, questions could still arise over whether the United States is unfairly singling out South Korea. As mentioned, the Trump administration has not explicitly exempted South Korea from potential Section 232 automobile tariffs, despite doing so for Canada, Japan, Mexico, and the EU. Canada and Mexico received a pass due to the successful conclusion of the U.S.-Mexico-Canada Agreement (USMCA) that replaced the North America Free Trade Agreement (NAFTA). Japan and the EU also received exemptions as long as their trade agreement negotiations with the Trump administration continue. Japan and the United States have concluded a partial agreement, though it does not include explicit language on automobiles. South Koreans could ask why they are being penalized despite the successful conclusion of the KORUS FTA revisions that included concessions to U.S. demands on automotive trade. If the Trump administration were to revive its threat to impose tariffs on South Korean automobiles, the resulting uptick in anti-U.S. sentiment could reduce the Moon government's political room to maneuver with the United States through a variety of bilateral discussions, including the upcoming burden-sharing negotiations over the cost of basing U.S. troops in South Korea and continued negotiations with North Korea.

Negotiations on the renewal of the U.S.-ROK burden-sharing Special Measures Agreement (SMA) began in the fall of 2019. The previous agreement was completed in February 2019, weeks after its predecessor SMA expired because the two sides could not find a compromise. The Trump administration's desire to make a deal before the February 27–28 Trump-Kim summit in Hanoi led the United States to accept a much lower increase in South Korea's contribution than it had originally sought—the deal requires an 8.2 percent increase in non-personnel costs. However, Seoul had to agree to an unprecedented one-year agreement; the previous two SMAs lasted for five years, and no U.S.-ROK SMA had ever lasted for fewer than two years.<sup>29</sup> The current SMA negotiations, which always are contentious, have been even more fraught due to the Trump administration's seeking major increases—400 percent in South Korea's case—in financial contributions from its base-hosting partners. While the United States has reportedly backed off its initial demands, the talks have again run past the expiration date of the current SMA.

U.S.-North Korea denuclearization talks and U.S.-ROK coordination on North Korea policy also loom over economic and cost-sharing negotiations. If U.S.-North Korea diplomacy falters and South Koreans perceive the Trump administration as blocking Moon's efforts at inter-Korean rapprochement, the Moon government and its successors will likely feel greater pressure to push back against U.S. demands. In this scenario, 2020 could see a perfect storm of U.S.-South Korea tensions mounting over North Korea policy, trade, and alliance relations.

## The Benefits of CPTPP Membership for South Korea

Shortly after taking office, Trump made good on his campaign pledge to withdraw the United States from the TPP. The remaining countries rechristened the TPP the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, suspended twenty elements, and clarified two additional provisions from the original twelve-party agreement.<sup>30</sup> As talks for the original TPP wound down, South Korea expressed interest in joining. However, because the countries involved were no longer willing to add another founding member, South Korea could not enter into the agreement.

Despite the changes and the U.S. departure from the CPTPP, South Korea has substantive reasons to consider joining. Despite its distinction as one of the most productive Organization for Economic Cooperation and Development economies in manufacturing, South Korea remains one of the least productive in services. As its manufacturing faces increasing competition from China and other developing countries, and as it further integrates its services into traditional manufactured products, high-standard agreements such as CPTPP will be important for South Korea's economic growth and the protection of intellectual property behind future exports.

CPTPP membership would also provide other practical benefits. In response to the recent dispute between China and South Korea over Terminal High Altitude Area Defense (THAAD) deployment, the U.S.-China trade conflict, and increasing pressure from the United States on the KORUS FTA and potentially automotive trade, the CPTPP would contribute to South Korea's efforts at trade diversification, particularly in providing a high-standards agreement with Japan.

Joining CPTPP would complement South Korea's participation in another regional trade agreement, the fifteen-nation Regional Comprehensive Economic Partnership, which—as of mid-December 2019—appears likely to be concluded in 2020.<sup>31</sup> South Korea already has free trade agreements with all CPTPP countries except Japan and Mexico, so its joining the CPTPP would expand its access to two large markets and upgrade its existing FTAs.<sup>32</sup> South Korea's membership in CPTPP could also encourage Southeast Asian countries to move toward higher standards, while allowing South Korea to enhance its partnership with Vietnam. South Korea was the second-largest source of foreign direct investment for Vietnam in 2018, and Samsung alone accounts for an estimated 25 percent of Vietnamese exports by value.<sup>33</sup>

Although joining CPTPP could smooth South Korea's conclusion of an FTA with Japan, the United States' absence from the agreement will likely complicate that process. In light of the tensions between Japan and South Korea and the diminished U.S. role as a mediator between the two, Japan could become the focus of debate in South Korea's National Assembly. In the summer of 2019, following a South Korean Supreme Court decision calling on Japan to compensate victims of forced labor during Japan's colonial occupation of Korea in the early twentieth century, South Korea also became a target of Japanese economic retaliation. In July, Japan imposed restrictions on materials used by South Korean companies to manufacture semiconductors, electronics, and computer products for sale globally. In August, Japan removed South Korea from its white list of trusted trading partners. In response, South Korea has pursued complaints at the World Trade Organization (WTO), removed Japan from its list of preferred trading partners, and threatened to terminate its General Security of Military Information Agreement (GSOMIA) with Japan. South Korea's

decision to suspend its nonrenewal of GSOMIA in November and a relaxation of Japanese export restrictions on sensitive materials to South Korea the following month marked the end of a downward turn in the bilateral relationship, but it will take time to fully stabilize the Korea-Japan relationship. To overcome expected reticence over an agreement with Japan, any effort to join CPTPP—absent a U.S. return—will need to be firmly grounded in South Korea’s economic interests and improved relations with Japan.

## Areas for Future Cooperation

With the KORUS FTA revisions approved by South Korea's National Assembly and implemented at the beginning of 2019, the United States and South Korea can now seek ways to improve their economic relationship and identify the areas most beneficial for future economic cooperation.

### *SOUTH KOREA'S NEW SOUTHERN POLICY AND THE UNITED STATES' INDO-PACIFIC POLICY*

A primary area for cooperation revolves around South Korea's New Southern Policy and the United States' Indo-Pacific Strategy. Both countries see the region as an important strategic area for future economic growth.

The Moon administration developed its New Southern Policy not only to build a new framework for economic and diplomatic cooperation with Southeast Asia, but also to diversify trade away from the United States and China, which account for nearly 40 percent of South Korea's exports.

At the same time, the United States has developed its vision of a free and open Indo-Pacific, including initiatives for cybersecurity partnership, digital connectivity, and infrastructure development. Now that Moon has endorsed the idea of cooperation between the New Southern Policy and the Indo-Pacific Strategy, the two countries should seek tangible opportunities for cooperation in areas such as regional infrastructure development and building cybersecurity capacity.

### *UNFAIR TRADING PRACTICES*

South Korea should join the efforts spearheaded by the United States and other like-minded countries, such as the trilateral U.S.-Japan-EU efforts on nonmarket-oriented policies and practices, in addressing China's unfair trade practices, including signing on to the recent proposal by the United States, Japan, and the EU to curb government subsidies.

Having experienced Chinese economic retaliation over the THAAD deployment, South Korea has a keen interest in ensuring that China competes with other states in a rules-based economic system. Like those of the United States, Japan, and the EU, South Korean firms face forced technology transfers, local content requirements, and unfair competition from China's state subsidies. They also face direct competition with Chinese firms in automotives, high-tech products, and shipbuilding. Ensuring a level playing field will help make South Korean firms more competitive with Chinese firms.

South Korea should work with the United States, Japan, and the EU to address China's unfair trading practices through reforms that would allow the WTO to better deal with the nonmarket challenges presented by the growing influence of China's state-owned enterprises.

Cooperation in this area could be critical in light of China's Made in China 2025 plan. Based on exports of products from the plan as a percentage of GDP, South Korea is the second-most vulnerable country to China's ambitions after Germany.

## *ENERGY SECURITY*

South Korea has no endowments of coal and petroleum and depends on imports to meet its energy needs. As the Moon administration attempts to transition away from coal and nuclear power, the United States could significantly expand exports of natural gas to South Korea in what could become a growing market. At the same time, private-sector actors on both sides are well placed to develop energy storage techniques and renewable energy sources.

## *THE FOURTH INDUSTRIAL REVOLUTION*

Artificial intelligence (AI) can reshape economies in the twenty-first century. Both the United States and South Korea have emphasized developing the essential fourth-industrial-revolution technologies behind AI. President Trump recently signed an executive order laying out the U.S. strategy for AI, and the South Korean government plans to increase research and development on five of these technologies.

As those technologies develop, governments will need to develop a common regulatory approach and ensure that the scale needed to develop the benefits of AI is achievable. Although autonomous vehicles and other AI applications have only begun to emerge, future conflicts could arise over the standards and regulations that will govern these issues. To minimize future disputes, the United States and South Korea should establish a committee to consult on those issues as they evolve. The two governments could also work together in regional and global forums, such as the Asia-Pacific Economic Cooperation (APEC), the G20, the International Telecommunications Union, and the WTO, to promote a common regulatory structure for this critical technological evolution.

The application of AI to the pharmaceutical and biotech sector provides another opportunity for cooperation. South Korea's government has pledged \$419 million to help grow its pharmaceutical and biotech industries in 2019. This investment will support research and development for AI-based new drugs and smart clinical-trial infrastructure. Given U.S. leadership in using AI to identify prospective patients for clinical trials and to interpret clinical-trial data, the pharmaceutical and biotech industries present clear opportunities for collaboration in developing groundbreaking new drugs. The two governments could consider developing joint funding practices for early-stage development in AI drug research.

## *AGRICULTURE*

The United States and South Korea should look for opportunities to expand agricultural sales. In 2018, South Korea was the sixth-largest export market for U.S. agricultural products, with \$8.3 billion in exports to South Korea. South Korea is the second-largest export market for beef and the fifth-largest for pork. However, the two nations could find opportunities to expand the scope of U.S. agricultural exports to South Korea.

As the CPTPP enters into force for Japan and six other countries, American farmers and ranchers face increasing challenges in the Japanese market. Although the new partial trade agreement between the United States and Japan will help alleviate this issue, it could also present opportunities to increase market share in South Korea.

*ECONOMIC COOPERATION WITH NORTH KOREA*

The failure of the United States and North Korea to reach an agreement on denuclearization has raised questions about the prospects for wider cooperation with North Korea and has highlighted the need for deeper discussions between the United States and South Korea on economic cooperation with the North.

The Moon administration has held expectations that the United States and North Korea would reach a denuclearization agreement allowing for inter-Korean economic cooperation. For that process to move forward, the United States and South Korea will need to develop a deeper understanding of the steps North Korea would need to take toward dismantling its programs to allow further inter-Korean economic partnership. This likely means that the two Koreas eventually will need to expand their relationship beyond projects that are relatively easy to pause if dismantlement stalls, such as inter-Korean railroads and tourism at the Mount Kumgang region inside North Korea, to larger-scale projects, such as the resumption of operations at the Kaesong Industrial Complex, a manufacturing facility jointly run by North and South Korea.

However, the need for agreement on North Korea should go beyond the question of which dismantlement steps would lead to what inter-Korean economic cooperation. The United States and South Korea should also reach an understanding of the types of labor market and investment reforms they would like North Korea to take as part of its economic opening.

This approach will be critical for two reasons. First, the U.S.-ROK disagreement over the terms of economic cooperation could allow North Korea to pit the United States and South Korea against one another as talks progress. Second, if there is any hope of exporting North Korean goods to the United States as South Korean goods under the KORUS FTA or of attracting foreign investment into North Korea, it will be necessary to ensure that such activity does not violate U.S. or UN sanctions on North Korea and for South Korea to negotiate robust arrangements with North Korea that ensure that individuals are paid directly for their work. Without these revisions, North Korean goods could face challenges in other countries as well.

The United States and South Korea should also develop an understanding of how the United States can support South Korea's economic objectives in North Korea, specifically as they relate to rebuilding North Korea's infrastructure. Economic cooperation will first require significant progress on dismantling North Korea's weapons programs. Should this occur, the United States and South Korea would benefit from a shared understanding of how the U.S. government can support the process and what role the U.S. private sector could play.

## Conclusion

To move toward a more productive economic partnership, the United States and South Korea will need to stabilize their economic relationship and resolve the uncertainty surrounding potential U.S. use of Section 232 national security investigations. A U.S. decision to use Section 232 to place tariffs on South Korean automotive exports to the United States will likely become politicized and impede efforts to cooperate on a wide range of economic issues.

South Korea has shown remarkable flexibility in the face of Trump administration economic pressure, turning potential sources of tension resulting from economic policy differences into areas for cooperation to reduce the political baggage affecting the overall security and political relationship. However, the emergence of political differences over North Korea or gaps in coordination on regional security issues in Asia could harm economic aspects of the U.S.-ROK relationship, including burden-sharing and the application of Section 232 to South Korea. Fortunately, areas such as economic partnership in the Indo-Pacific region, energy security, agriculture, the challenges that aging societies face, fourth-industrial-revolution issues, and coordination on inter-Korean economic initiatives hold promise for the future expansion of U.S.-ROK economic relations.

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