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Executive Summary

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Clinton's Trip to Asia: Time to Show U.S. Leadership

Richard D. Fisher, Jr., Robert P. O'Quinn, and Daryl M. Plunk

President Bill Clinton must address the Asia–Pacific region's pressing economic and security challenges when he travels to Asia later this month. In the wake of their most serious economic crisis since World War II, Asian countries need strong encouragement to implement market-opening economic reforms, and America's allies in Northeast and Southeast Asia need to be reassured that the United States will remain vigilant in the face of new threats from North Korea and China.

APEC Summit. APEC must prove that it can create greater free trade throughout Asia. But leadership is needed also to refocus its efforts on reforms based on free-market principles and policies. President Clinton should press Asian leaders to strengthen free-market reforms in order to address the economic crisis that is causing great suffering across the region. This crisis, which began when insufficient free-market reform in their financial and banking sectors caused a decline in investor confidence, caused currency values to fall and led to hard recessions in many Asian countries. Specifically, at the APEC Leaders' Meeting in Malaysia on November 17 and 18, President Clinton should:

- Urge APEC countries to rely more on free-market reforms and less on aid from the International Monetary Fund to revive their economies. Asian leaders should increase banking sector transparency, allow bad banks to close, and strengthen free trade.
- Urge APEC to adopt a more results-oriented approach to trade liberalization. If APEC does not change its non-binding approach and start insisting on real commitments to open trade and investment, its efforts to create a free trade zone by 2020 are likely to fail, and the United States will be forced to focus on the World Trade Organization (WTO) to achieve trade and investment liberalization.
- Warn Asian leaders that any retreat from reforms that increase economic freedom, such as Malaysia's actions barring foreign currency trading, only delay economic recovery.

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- Endorse a millennium round for the WTO in 2000 to lower trade barriers. The Clinton Administration has been reluctant to do this.

Japan Visit. President Clinton's visit to Tokyo on November 19 and 20 will test his ability to demonstrate America's concern about threats to Japan's economic and military security. Japan has been unable to revive its economy, which could contract over 2 percent this year and continue contracting next year. It also faces a growing missile threat from North Korea. China is building new cruise missiles and anti-satellite laser weapons, which also could endanger U.S. forces in Asia. Japan has no defense against such North Korean or Chinese weapons. In addition, while in Tokyo, President Clinton should:

- Tell the Japanese that the alliance with Japan remains the most important U.S. alliance in the region and that Japan's economic recovery is vital to ensure that other economies do not fall victim to the spreading recession.

- Urge the Japanese government to implement deeper tax cuts and more sweeping deregulation of its economy as key measures to help reverse its economic decline.

- Urge the Japanese government to approve implementing legislation for the 1996 Defense Guidelines that would allow better support for U.S. military forces based in Japan but engaged in other combat zones like Korea.

- Explain to the Japanese that they must cooperate with the United States and spend more to build missile defenses that will deter North Korea or China from using their missile forces in Asia.

South Korea Visit. While in South Korea on November 20–22, President Clinton should help newly elected President Kim Dae Jung formulate a response to difficult economic and security challenges. South Korea's economy, once a model for developing nations, is beset with recession and needs fundamental reforms. South Korea and the United States continue to face a heavily armed North Korea, which is building new missile—and possibly nuclear—threats. President Clinton's 1994 Agreed Framework with Pyongyang, which sought to get North Korea to halt its nuclear weapons program in exchange for economic and energy aid, has not reduced the North Korean threat. To help South Korea meet its economic and security challenges, President Clinton should:

- Praise President Kim for his commitment to bring down protectionist barriers. Tangible progress has been made, as shown by the recent agreement on automobiles. Other areas requiring action include the lack of adequate intellectual property protection for foreign pharmaceuticals and the remaining tariff and non-tariff barriers to agricultural imports.

- Caution President Kim against providing government subsidies for failing companies. Painful as bankruptcies are, they are a part of the reform and restructuring that will produce a stronger, more competitive economy. Clinton should ask South Korea's businessmen to embrace and support Kim's free-market policies.

- Propose an alternative to the failed Agreed Framework with North Korea, in close concert with Seoul and Tokyo, to include a package of trade and aid offers.

- Link a new aid package to the fulfillment of the Basic Agreements ratified by the North and South in 1992, including expansion of North–South trade, citizen exchanges, a pullback of troops from the border, and phased reductions of armaments and troops.

- Announce the appointment of a special U.S. presidential envoy to oversee these policy adjustments and communicate with the Pyongyang regime at high levels.

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CLINTON'S TRIP TO ASIA: TIME TO SHOW U.S. LEADERSHIP

RICHARD D. FISHER, JR., ROBERT P. O'QUINN, AND DARYL M. PLUNK

As President Bill Clinton prepares to make his second trip to Asia later this month, America's allies and friends are expecting him to show strong U.S. leadership. Each destination along his route—Malaysia for the Asia–Pacific Economic Cooperation (APEC) forum, Japan, and South Korea—will present dilemmas requiring tough recommendations and decisions.

For example, it appears unlikely that APEC will meet its goal of creating a free trade and investment area in the Asia–Pacific region by 2020. During the November 17 and 18 APEC Leaders' Meeting in Kuala Lumpur, President Clinton should confront other heads of state with the unpleasant truth that APEC is not achieving its goal of trade liberalization. In addition, he should encourage them to move beyond the consensus, non-binding approach and adopt a results-oriented and enforceable method to achieve trade and investment liberalization throughout Asia.

While he is in Japan on November 19 and 20, and in South Korea from November 20–22, President Clinton will meet with close U.S. allies facing tremendous economic and security challenges. It is critical that he assure the leaders of these two countries, both of which are facing new threats from North Korea, that America remains committed to its security alliances. He also should urge Seoul and Tokyo to undertake deep fundamental economic reforms that reduce the role of the state and open their economies to increased foreign trade and investment.

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CHALLENGING APEC TO ACHIEVE RESULTS

President Clinton will confront widespread economic and political disarray in Asia, as well as an organization that is rapidly losing momentum, when he meets with other APEC heads of government in Kuala Lumpur. During the past year, economic turmoil has scarred APEC's Asian members. An economic panic ignited in Thailand during July 1997 and then swept through Indonesia, Malaysia, and South Korea. This year, Indonesia's gross domestic product (GDP) is expected to shrink by 30 percent, Korea's by 7 percent, Malaysia's by 5 percent, and Thailand's by 8 percent.

One of APEC's newest members, Russia, defaulted on its external debts this summer. Across the Pacific, the reduction in Asia's demand for primary goods exports slowed economic growth rates in APEC's American members—Canada, Chile, Mexico, Peru, and the United States. Asia's declining demand is expected to lower the U.S. GDP growth rate by about 1 percent next year.

In addition, the economic collapse ushered in political changes in many of APEC's Asian members. The Philippines voted for Joseph Estrada as its new president. South Korea elected long-time opposition leader Kim Dae Jung as its new president, and opposition leader Chuan Leekpai was installed as Thailand's new prime minister. Widespread rioting forced Indonesia's longtime dictator, President Suharto, to resign in favor of the country's vice president at the time, B. J. Habibie.

The Road to Kuala Lumpur. The rapidly changing economic and political environment in the Asia–Pacific region gives President Clinton an opportunity to reassess APEC. Former Australian Prime Minister Bob Hawke launched APEC during a November 1989 meeting of trade ministers from East and Southeast Asian countries, Canada, New Zealand, and the United States in Canberra. As APEC's 1993 chairman, President Clinton organized the first APEC Leaders' Meeting in November 1993. There, the members adopted an Economic Vision Statement setting as APEC's goal "the progressive development of a community of Asia–Pacific economies with free and open trade and investment."

The next APEC chairman, President Suharto of Indonesia, forged a historic agreement at the APEC Leaders' Meeting in Bogor, Indonesia, in November 1994. In the Bogor Declaration of Common Resolve, President Clinton and the other heads of government agreed to create a "free trade and investment area in the Asia–Pacific." They also agreed to implement this plan by no later than 2010 for developed economies such as Japan or the United States and no later than 2020 for developing economies such as China and Indonesia.

At the Leaders' Meeting in Osaka, Japan, in November 1995, APEC adopted "concerted unilateralism" as the means for creating a free trade and investment area. Under this process, instead of negotiating a formal regional integration agreement such as the North American Free Trade Agreement (NAFTA), each member agreed to propose its own action plan for realizing the common goal of free trade and investment. Through the next year, Philippine President Fidel Ramos was unable to get members to advance individual trade barrier reduction plans.

Nevertheless, at Vancouver in November 1997, Canadian Prime Minister Jean Chrétien won agreement for an Early Voluntary Sector Liberalization (EVSL) initiative identifying 15 sectors for the rapid removal of tariffs and non-tariff barriers. Discussions on the first nine sectors were scheduled to begin in 1998 under Malaysian leadership and to be completed before the APEC meetings in Kuala Lumpur. Discussions on the remaining six were scheduled to begin in 1999 under New Zealand's leadership.

Declining Progress. Since the Vancouver meetings, the EVSL initiative has made little progress. Trade officials reached a mutual recognition of standards agreement for telecommunications, but achieved nothing in eight of the first nine priority sectors. Japanese trade officials blocked tariff reductions on fish, fish products, and forestry products. Trade officials from developing Asian country members disdained immediate tariff reductions on other products.

Instead of working to advance APEC's trade and investment liberalization agenda, APEC's current chairman, Malaysian Prime Minister Mahathir Mohamed, has been consumed by economic turmoil and a swelling political crisis. Instead of addressing Malaysia's fundamental economic problems, Mahathir spent the past year blaming currency trader George Soros and Jews for Malaysia's economic difficulties.

On September 2, 1998, Mahathir sacked his long-time Deputy Prime Minister and Finance Minister, Anwar Ibrahim, and re-imposed capital controls that barred foreign trading of the currency. On September 20, Mahathir had Anwar arrested on trumped-up charges of sexual misconduct. Anwar's arrest and his subsequent brutal beating at the hands of the Malaysian police galvanized Mahathir's opponents to organize large public protests. Disruptions may occur during the APEC meetings.

APEC's Deficiencies

Although APEC's goal of free trade and investment is good for Asia and the United States, it is time for the United States to recognize that APEC has limitations that may prevent it from reaching this goal. APEC's fundamental problem is that it aims to achieve regional free trade and investment without negotiating a regional integration agreement.

Regional integration agreements, such as the European Union, Mercosur, or NAFTA, specify negotiated timetables for removing tariffs and other trade and investment barriers. Such agreements are legally binding on signatory countries and contain dispute settlement systems to compel recalcitrant governments to honor the liberalization commitments. APEC relies on the willingness of each member to liberalize trade and investment unilaterally.

APEC's concerted unilateralism process is an alternative to the sort of comprehensive negotiations through which most trade and investment liberalization has been achieved. It assumes that the interest groups favoring liberalization are so strong that lobbying by export firms and their workers is no longer essential to overcome lobbying from protected firms and workers.

This assumption is at best unrealistic. Although such unilateral liberalization is economically desirable, it is proving politically difficult. Some APEC members have liberalized unilaterally in recent years, but the difficulties encountered by APEC in trying to implement its very limited EVSL initiative demonstrate that, when it comes to whether an Asia–Pacific free trade and investment area can be achieved by 2020 through concerted unilateralism, a healthy skepticism is warranted.

Concerted unilateralism reflects the Asian way of doing business, especially the weak rule of law. APEC's Asian members fear that negotiating a real regional integration agreement for the Asia–Pacific region would expose this weak rule of law—a key cause of the Asian economic panic. By opting for concerted unilateralism, they could claim to support liberalization while putting off the economically beneficial but politically difficult decisions to open highly protected sectors of their economies into the distant future.

Through the Bogor Declaration, President Clinton has committed the United States to do three things that Congress is unlikely to approve:

- **First,** the Bogor Declaration pledges the United States to remove all barriers against exports and inward investment from China, Russia, and Vietnam by 2010. Under the Jackson–Vanik Amendment to the Trade Act of 1974, the President may not grant permanent, unconditional normal trade relations (NTR) status to China, Russia, and Vietnam. Instead, the President may grant permanent, conditional NTR to a country that had a communist government in 1975 if that country signs a trade agreement with the United States and allows free emigration. Russia currently has this status.

  If such a country does not allow free emigration but is making progress toward free emigration, the President may issue a waiver annually. China has its conditional NTR renewed each year on this basis. Vietnam lacks any form of NTR. Thus, the Bogor Declaration will require that Congress not only repeal the Jackson–Vanik Amendment with regard to China, Russia, and Vietnam and grant them permanent, unconditional NTR, but also give them the same preferred free trade status that Canada and Mexico now have under NAFTA. Congress is not likely to fulfill Clinton's APEC commitments.

- **Second,** the Bogor Declaration commits the United States and other developed APEC members to open their markets to foreign exports and investments by 2010, a full ten years before developing APEC members are required to reciprocate. Such an unbalanced liberalization schedule is politically problematic for almost all Members of Congress.

- **Third,** since APEC opted for concerted unilateralism rather than comprehensive negotiations for a regional integration agreement, the regional integration agreements exemption from World Trade Organization (WTO) nondiscrimination rules does not apply to APEC. Therefore, WTO rules will require the United States to apply any tariff reductions or other trade liberalization measures implemented under APEC to all other WTO members. This means that the European Union and non-APEC American countries such as Argentina and Brazil will benefit from all APEC tariff reductions and other trade liberalization measures without having to open their own markets. Although such unilateral liberalization is desirable, Congress is not likely to let the European Union and other American countries benefit from APEC liberalization as free riders.

Talking Points at the APEC Leaders' Meeting

At the APEC meeting, President Clinton will be challenged to revive faith in free-market policies and question APEC's effectiveness in dealing with the Asian economic crisis. He can use the APEC summit to urge Asian leaders to embrace free trade as the way to create a stronger basis for future economic growth. The APEC forum remains valuable to the United States because it brings together governments that otherwise have little formal contact, such as China and Taiwan, to address their common economic concerns.

President Clinton should stress to APEC's leaders that, unless they move beyond their current non-binding approach and adopt results-oriented methods, they can achieve the goal of an Asia–Pacific free trade and investment area only as part of a larger WTO plan for global free trade and investment. WTO negotiations would have a major advantage over APEC negotiations because they would include Europe, the other major center of economic activity, and on most issues (with the exception of agriculture), the European Union is likely to side with the United States. Therefore, President Clinton should:

- **Urge APEC leaders to increase progress toward economic reform as the best response to the Asian economic crisis.** The President should stress that the root of this crisis was the collapse of economic confidence caused by insufficient transparency in financial markets. He should note that the lesson is that the benefits of more open trade can be secured only when markets are protected by rules that cannot be manipulated to benefit the few at the expense of the many. This means that Asian countries should proceed with reforms that make their financial markets more transparent, reduce the role of government regulation, and strengthen the rule of law.

- **Urge APEC to adopt a more results-oriented method to achieve trade liberalization.** President Clinton should tell APEC's leaders that concerted unilateralism and open regionalism cannot achieve APEC's objective of an Asia–Pacific free trade and investment area by 2020. If members will not adopt a new approach and negotiate comprehensive regional integration agreements, the United States will have to support the WTO as the best path to trade and investment liberalization. To make APEC's efforts more relevant to achieving the goal of free trade in Asia, President Clinton should urge APEC to change its consensus-based format and consider results-oriented trade liberalization agreements that are binding on members.

- **Endorse a millennium WTO round beginning in 2000.** President Clinton has not supported Sir Leon Brittan's call for a millennium round of comprehensive WTO negotiations. This is a mistake. President Clinton will host the third WTO Ministerial Conference in Washington in 1999. In Kuala Lumpur, he should stress his commitment to asserting U.S. influence to win support for approving a new round at this conference. The WTO is scheduled to launch further talks on liberalizing trade in agricultural products by the end of 1999 and trade in services in 2000. President Clinton should seek to expand these discussions into a comprehensive round that includes tariffs on primary and industrial products, investment, and competition policy issues.

- **Challenge APEC leaders to endorse the abolition of all tariffs by 2015 as a key goal for a millennium WTO round.** A new WTO round would need a significant goal, such as abolishing all remaining tariffs by a date certain.
- **Press APEC leaders to endorse the negotiation of an investment liberalization agreement as a key goal of a millennium round.** The major remaining gap in WTO coverage is investment. Exporting and foreign direct investment are two alternative methods that firms use to service foreign markets. It makes little economic sense to provide a non-discriminatory rule for trade in goods but not for investment. Trade and investment are closely intertwined in today's global economy. Both should be liberalized.

REASSURING AN IMPORTANT ALLY

President Clinton's November 19 to 20 visit to Tokyo occurs at a time of great anxiety among the Japanese over economic and security issues. Japan is in economic recession, with record high unemployment and a banking sector in crisis, and its consensus-oriented political system has proved unable to produce a strong policy response. North Korea fired a long-range missile over Japanese territory on August 31, highlighting Japan's complete vulnerability to missile attack. Many Japanese felt snubbed when Clinton did not visit Tokyo on his June trip to Asia.

Thus, while he is in Tokyo, the President should reassure the Japanese that the United States remains firmly committed as Japan's principal security ally, especially in the area of missile defense. But he must also urge the government of Prime Minister Keizo Obuchi to complete painful economic reforms, especially banking sector reform, deregulation, and tax cuts, lest a continued Japanese economic downturn imperil chances for an economic recovery in Asian markets and beyond.

Japan's Economic Meltdown

Japan is nearing its second year of economic contraction—1.8 percent for 1998, according to Japanese government estimates, although other estimates run as high as 2.6 percent. Corporate bankruptcies in September of this year were up 17.9 percent over last year. And consumer confidence has been hit by record levels of unemployment, bankruptcies, and falling household incomes. Two indicators of growth are also down: Consumer spending fell 3.3 percent from April to June, and corporate investment fell 21 percent during the same quarter. Japan's economy may continue to contract another 1 percent next year.

Global Impact. Japan's recession is having a global impact. Lower Japanese economic growth means fewer imports, perhaps as much as 11 percent fewer this year, and this is affecting economic growth in both Asia and the United States. In 1997, U.S. exports to Japan fell by $2.1 billion. Japan will also invest less in Asia. Its banking sector currently holds about $1 trillion in bad loans, and its inability to make new loans is further dampening domestic and regional economic activity. Continued weakness in the yen could lead China to devalue its own currency, which would cause Hong Kong and others to follow suit, setting the stage for a new round of Asian deflation. This, in turn, could cause a further slowdown in the U.S. economy, which would affect other Asian countries, Latin America, and Europe.

For many months, the Clinton Administration and leaders in Europe and Asia have been urging Japan to undertake aggressive economic reforms in its financial sector, to lower taxes to stimulate domestic demand, and to deregulate its economy. But Japan's consensus-oriented political system has been unable to produce bold steps in banking reform and consumption stimulation.

Insufficient Financial Reform. Japan's economic recovery will require banking sector reform.

Uncompetitive banks saddled with non-performing debt are unable to make new loans necessary for investment and economic growth. After months of painful debate, on October 16 the Obuchi government passed a banking sector reform package setting up a $520 billion fund to help recapitalize banks. The plan would involve the identification of insolvent banks and a period of temporary nationalization during which bad loans can be sold and the banks recapitalized. However, many banks may be unwilling to participate because of the stigma of failure it would entail. Furthermore, Japan's banking sector must become much more competitive to be able to offer more services to customers.

Deregulation. Increased banking sector competitiveness, in turn, will require deregulation that allows more foreign participation in Japan's banking sector. Despite Japan's promise last April to make its financial markets more open, the Japanese can remit only $400 worth of foreign currency without having to notify the government—less than they could before April. This dampens their ability to invest in more profitable foreign bank services. Such restrictions also have the effect of depressing consumer consumption, which the government has tried to boost by offering modest tax rebates and, soon, free coupons for its citizens. Marginal tax rates remain among the highest in the world: 60 percent for personal income and 46.5 percent for corporate profits.

Vital Military Ties

America's military deterrent capability in Asia is critically enhanced by the U.S.–Japan security relationship, enshrined in the 1961 Mutual Cooperation and Security Treaty. Today, from Japanese bases, over 50,000 personnel serve to deter attack against Japan and to deter conflict on the Korean Peninsula. Japan has provided generous host-nation support to defray the cost of the U.S. presence: about $2.1 billion in fiscal year 1998, down from $2.3 billion the previous year.

Growing regional threats and political pressures in Japan have led Washington and Tokyo to refine their security relationship. This process took two important steps forward in 1996. To defuse growing public opposition to the U.S. military presence in Okinawa, in December 1996, the United States reached an agreement with Japan on the phased return of about 21 percent of the land used by U.S. forces to civilian control by about 2001.

In April 1996, President Clinton and Japanese Prime Minister Hashimoto issued the U.S.–Japan Joint Declaration on Security to devise new "Guidelines" which clarify the extent of Japan's logistic or emergency support for U.S. forces repelling an attack on Japan or engaged in "out of area" conflicts that affect Japan's security. Although the Guidelines are not directed against any specific country, they would assure Japanese support for U.S. forces seeking to repel a possible North Korean invasion of South Korea.

China has loudly protested the Guidelines because of the possibility that Japan could render rear-area support to U.S. forces that would assist Taiwan in the event of a Chinese attack. Both Tokyo and Washington have refused to bow to Beijing's demand that the Guidelines be amended to omit Taiwan. However, the Guidelines require implementing legislation in Japan, which has been held up in Japan's Diet.

Missile Threats. A key test for the U.S.–Japan security relationship will be meeting the growing threat posed by North Korean and Chinese missile forces. North Korea's August 31 launch of the Taepo Dong missile, which flew over Japan, shocked the Japanese people. But this three-stage missile also demonstrated North Korea's potential to build intercontinental missiles that could reach the United States.

North Korea's 780-mile-range No Dong missile can reach most potential targets in Japan, and China has based its 1,100-mile-range DF–21 near North Korea, enabling total coverage of Japan. In the future, China will deploy long-range Tomahawk-class cruise missiles that could be launched from ground, naval, or air platforms. These threats have increased Japan's interest in cooperating with the United States to develop theater missile defense (TMD) systems and its own reconnaissance satellites.

China strongly opposes U.S.–Japan TMD cooperation—an act of legitimate defense. However, the U.S. Department of Defense recently revealed that China is developing laser-based anti-satellite capabilities.

Talking Points in Japan

President Clinton should use his visit to Tokyo to boost Japan's flagging morale, urge Japan to take the necessary steps to revive its economy, and assure the Japanese that the U.S.–Japan alliance can be strengthened to help preserve peace in Asia. Specifically, the President should:

- **Tell the Japanese their country is America's most important partner in Asia.** In Tokyo, President Clinton needs to reassure the Japanese that the U.S.–Japanese alliance is the United States' most important bilateral relationship in Asia. The President's refusal to visit Japan after his visit to China last June and his much-promoted effort to create a "strategic partnership" with undemocratic and potentially hostile China created resentment in Japan. But as he tells the Japanese of their importance to the United States, he also should urge them to undertake bold economic reforms to put their economy back on a path to growth.
- **Urge Japan to lower its marginal tax rates to encourage domestic investment.** The President should urge the Japanese government to consider tax cuts that are deeper than those announced by the Obuchi government, from 60 percent to 50 percent, for personal income. Corporate taxes, to be reduced to 40 percent, should be much lower to encourage investment, which is necessary to increase Japan's economic activity and growth.
- **Explain the need for Japan to deregulate its economy.** President Clinton should urge Japan to remove the maze of economic regulation that was designed to protect its domestic markets but now depresses economic activity. Financial regulations that bar citizens from making more profitable foreign investments and have the effect of denying foreign investment in much of Japan's service sector are counterproductive. The President should state clearly that the United States has been urging deregulation and seeing scant result for far too long. It is now the Japanese who are losing, as foreign investors who otherwise might create new jobs in Japan cannot do so because of excessive regulation.
- **Urge Japan to implement the new Defense Guidelines.** Clinton should urge the Japanese government to pass the legislation necessary to implement the 1996 Defense Guidelines. Doing so will reassure Americans that Japan intends to provide needed logistical support to U.S. forces should they become engaged in conflicts that affect Japan's security. Implementing the Defense Guidelines will help deterrence by putting potential aggressors like North Korea and China on notice that the U.S.–Japan security relationship is being strengthened to meet future challenges.
- **Stress that missile defense cooperation is essential for Japan's security.** The President should stress that it is critical to begin cooperation with the United States toward building missile defenses for Japan. He should urge Japan to share its technical expertise in areas that also could help U.S. missile defense programs. And he should counter China's opposition to U.S.–Japanese missile defense cooperation by stating that missile defense is non-nuclear and purely defensive: It threatens no one.

HELPING SOUTH KOREA MEET ITS CHALLENGES

On November 20–22, President Clinton's Asia trip will take him to Seoul. Summit talks are slated with President Kim Dae Jung, the noted democratic activist who was sworn in as Korea's chief executive in February after decades of leadership in his nation's often oppressed opposition. Although his presidency marks another step forward in Korea's democracy movement, Kim Dae Jung inherited an economy in grave crisis and threats from North Korea that are of increasing concern in Washington. President Clinton should confront both the economic and security conundrums in Korea during his Seoul visit.

Korea's Economic Challenges

With an economy once touted as the "Korean miracle" and offered as a model for developing nations, South Korea now faces the need for fundamental economic reform. Its achievements depended heavily on central government control of business decisions and on massive debts. The government directed commercial banks to fund the *chaebol*, or massive business groups, at below-market rates. Consumers, on the other hand, often were saddled with interest rates high above market rates.

Thus, the government subsidized the *chaebol* and placed the burden on Korea's citizens. Lacking access to scarce capital, Korea's small and medium-size business sectors remain weak and underdeveloped. The government further bolstered *chaebol* industrialization by closing the domestic market to foreign imports and investment with a tangled web of tariffs, quotas, and burdensome regulations.

Korea's $500 billion economy became too large to be led efficiently by government bureaucrats. Without the "invisible hand" of the free market, bad decisions and policies multiplied. Massive government-blessed investments were made in steel, shipbuilding, consumer electronics, semiconductors, and automobiles. Korea is now faced with massive production, which is over capacity in these sectors, and inadequate demand in domestic and international markets.

By the end of last year, South Korea was unable to service its mounting corporate debt. It turned to the International Monetary Fund (IMF) and received a $58 billion loan package. This is important to the United States because American taxpayers provide about 18 percent of the IMF's total funding. There is concern that IMF money might be used to bail out failing Korean companies. Not only would this prolong Korea's painful recovery program by propping up companies that should be allowed to go bankrupt, but it would unfairly subsidize companies that could compete with U.S. firms. In approving President Clinton's latest request for IMF funding, Congress called on the President to certify that Korea is not using IMF money to subsidize failing companies.

Korea is undergoing its worst economic crisis in decades. GDP likely will shrink by 6 percent to 7 percent this year. Unemployment in the third quarter reached 7 percent and may hit 10 percent by year's end. At best, economic growth may remain stagnant next year. Solid recovery may be several years off. The impact on the U.S.–Korean trade alliance has been dramatic: U.S. exports to Korea this year are off by 45 percent, compared with 1997.

Economic Liberalization. To his credit, President Kim has embraced economic liberalization as the key to his nation's economic recovery. He has taken concrete steps to end decades of protectionism, such as allowing foreign companies to have up to 100 percent equity ownership in Korean firms, permitting hostile takeovers by foreigners, and allowing foreigners to buy real estate in Korea for the first time.

On October 20, the Office of the U.S. Trade Representative (USTR) announced a breakthrough in opening the long-protected Korean automobile sector. USTR Charlene Barshefsky explained that Korea will "eliminate or streamline onerous standards and certification requirements, substantially reduce the tariff and tax burden on foreign motor vehicles...and provide effective redress to any anti-import activity."[1] She also warned, however, that "the proof of performance…will be in the dedication of President Kim's administration to the implementation of this program."[2]

The USTR's concern over reform implementa-

1. Office of the U.S. Trade Representative, Press Release No. 98–93, October 20, 1998.
2. *Ibid*.

tion is warranted. Korea's entrenched economic bureaucracy is thoroughly accustomed to the benefits of central government control. Many bureaucrats are loath to relinquish their authority over banks, domestic industries, and foreign companies and imports. They remain fiercely protective of the industries they regulate and will not willingly step aside and allow unfettered foreign participation.

Strong and effective top-down implementation of President Kim's liberalization policies is required to prevent bureaucratic resistance and delay. Similarly, Korean businesses must end their protectionist attitudes and accept foreign competition as beneficial and not threatening.

The Continuing North Korean Threat

The U.S.–Korea security alliance remains dominated by the serious military threat posed by communist North Korea. The Pyongyang regime has produced one of the world's worst economies, with widespread famine and starvation among its oppressed people. Yet the regime maintains one of the world's largest standing armies and has used its nuclear weapons and long-range missile development programs to extort support from the United States and the international community.

The North's forward deployed forces require the continued presence of 37,000 U.S. troops in South Korea at a cost to U.S. taxpayers of about $3 billion per year. Over the past two years, there have been several serious North Korean provocations against the South, including two commando incursions. In September, North Korea shocked the world by successfully testing a long-range missile. In addition, North Korea has sold its missile technology to Iran and Pakistan, further threatening regional security in South Asia and the Middle East.

Paying Pyongyang. The Clinton Administration's response to the growing threat has been to make North Korea one of America's largest recipients of foreign assistance. Since 1994, more than $272 million has been spent by the Clinton Administration on the North in the form of humanitarian food assistance, payment for the North to return Korean War-era remains of U.S. personnel listed as missing in action (MIA), and energy assistance under the October 1994 U.S.–North Korea nuclear deal.

The so-called Agreed Framework benefits to the North include improved trade and political ties with Washington, a $50 million-per-year fuel oil supply, and the construction of two nuclear reactors valued at about $5 billion. Together with a consortium of about a dozen nations, the United States is raising funds to support this process, although Seoul has pledged to pick up most of the tab. In return, the North agreed to freeze its current nuclear program, preventing it from processing any more weapons-grade plutonium than it already has.

The Clinton Administration claims that the nuclear threat has been checked, but there are noteworthy caveats. Washington backed down on its earlier demand that the North provide a full accounting of the plutonium it produced in the past. Inspection of its fuel storage sites, which the North is obliged to allow under other international treaty obligations, has been delayed for years to come. As a result, the North may have assembled nuclear bombs secretly with the enriched fuel it already possesses. Even senior Clinton Administration officials have admitted this publicly.

Avoiding Dialogue. As part of the deal, the North promised to resume substantive dialogue with the South to reduce tensions. So far, it has refused to do this. The channels through which the North has allowed contact with the South have produced no meaningful bilateral progress. Instead, Pyongyang has engaged in a succession of contacts with the United States, extracting maximum financial concessions and clearly hoping to isolate the South.

The Framework is more than four years old, yet the North has not delivered on its pledge to pursue tension reduction with the South. The military threat is becoming more serious in light of the North's missile advancements. And the North continues to supply missile technology to rogue states. Meanwhile, 37,000 U.S. troops stationed in South Korea remain in harm's way.

U.S.–North Korea policy is clearly a failure. Members of Congress who have been called on to appropriate hundreds of millions of dollars to support that policy are losing patience, and support exists in both parties for altering the current course. Last month, Congress approved the Administration's request for $18 million to fund its North Korea policies—but not without certain conditions. For example, the White House is being pressed to certify that the North has frozen its nuclear program, that Pyongyang will end its aggressive missile development program, and that it will stop stonewalling talks with the South.

The August 1998 revelation that the North was building a secret underground facility was of particular concern to Congress, since many suspect it is related to the regime's nuclear program. On November 9, Pyongyang rejected the Clinton Administration's request that it allow outside inspection of the suspect site. This is fresh evidence that the North will not comply with the reasonable conditions set by Congress.

Talking Points in South Korea

It is increasingly likely that the Clinton Administration's North Korea policy could collapse as congressional support for continued funding continues to drop. Thus, it is time to consider alternatives. To address economic and security issues in Seoul, President Clinton should:

- **Praise President Kim for his commitment to bring down Korea's protectionist barriers.** Tangible progress has been made, as shown by the recent agreement regarding automobiles. Other areas requiring action include the lack of adequate intellectual property protection for foreign pharmaceuticals and the remaining tariff and non-tariff barriers to agricultural imports.
- **Caution President Kim against government subsidies for failing Korean companies.** Painful as they are, bankruptcies are a part of the reform and restructuring process that will produce a stronger, more competitive economy.
- **Ask President Kim to do his utmost to check lingering protectionism in his economic bureaucracies.** President Clinton should appeal directly to Korean businessmen and ask them to embrace and support President Kim's free-market policies.
- **Offer contingency plans in the event that the Agreed Framework process collapses.** It is not likely that the North will fulfill the conditions required by Congress, even though these conditions are reasonable. Congress has called the North's bluff with respect to Pyongyang's commitment to peace, reconciliation, and reform. If the North continues to be defiant and uncooperative, the United States, Seoul, and their allies should end their support for the Framework process.
- **As an alternative to existing policy, in close concert with Seoul and Tokyo, begin discussion of a substantial package of trade and aid offers to the North.** A significant portion of the billions that have been pledged for the decade-long reactor construction project could be used as leverage in negotiating with the North.
- **In return for a new trade-and-aid package offer, call on the North to engage in serious high-level peace talks with Seoul.** The baseline for those talks should be the Basic Agreements that were ratified by the North and South Korean governments in 1992. Virtually ignored by the Clinton Administration, these pacts were negotiated by the prime ministers of each side and outline specific, practical steps for easing political and military tensions. They include expansion of North–South trade, citizen exchanges, a pullback of troops from both sides of the border, and phased reductions of armaments and troops. Washington, Seoul, and their concerned allies should develop guidelines that peg delivery of aid and other benefits to the North on Pyongyang's cooperation with this process.
- **Announce the appointment of a seasoned senior U.S. negotiator as special presidential envoy to oversee these policy adjustments and communicate with the Pyongyang regime at**

high levels. The United States will have to move decisively to sell its new policies to Pyongyang. A senior envoy must convince the North's leaders that this new package would serve the mutual interests of all concerned nations and that America's resolve to end the threat to peace posed by Pyongyang's military machine is solid. The Heritage Foundation first proposed this appointment in November 1994. Congress supported this proposition last month, and the Clinton Administration has taken steps to identify an appropriate and effective figure.

CONCLUSION

During his November 16–22 trip to Asia to attend the APEC forum and visit Japan and South Korea, President Clinton should seize the opportunity to reaffirm America's commitment to helping its allies and friends reverse the most serious economic crisis to envelop Asia since World War II and address new security threats.

President Clinton should stress on all three stops that the proper route to economic recovery rests in a firm commitment to reforms that increase economic freedom and reduce government intervention. At the APEC Leaders' Meeting, he should point out that APEC is losing its momentum in increasing trade and investment in the Asia–Pacific region. APEC countries must commit themselves firmly to reducing trade barriers or, failing that, support a new millennium round of the World Trade Organization.

In Japan and Korea, President Clinton should urge leaders to deregulate their economies to allow more foreign investment and promote domestic growth. He also should reassure them that the United States remains ready to deter emerging threats to its allies in Asia, especially missile threats emanating from North Korea and China.

In Korea, President Clinton needs to acknowledge that the 1994 Agreed Framework is not working and is not helping to convince North Korea to seek peace with South Korea. He should propose a new deal with the North that links future economic aid to its improving relations with South Korea. And he should reassure America's allies and friends that Washington has not forgotten its critical interests in Asia's peace and prosperity.

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