



[After Trump Series 2] Prospects for U.S.-South Korea Cooperation in an Era of U.S.-China Strategic Competition

Great Power Competition and Asia's Economic Architecture: An Agenda for US-ROK Cooperation

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The United States and China are locked in a dynamic of strategic competition across a wide array of domains covering the military, economy, and technology. Increasingly, the contest is acquiring overtones of system-to-system competition, in what is frequently depicted as a zero-sum contest between open and authoritarian societies. Economic interdependence could very well become a casualty to intensified U.S.-China rivalry. Given the high degree of economic integration between the two largest economies in the world, wholesale decoupling would entail prohibitive costs, but there are also questions as to whether China and the United States have the political will and wherewithal to execute a more limited detangling of their economies (with a likely focus on emerging technologies).

The implications for Asian countries are profound. The takeoff of many economies in the region has been predicated on a relatively open, rules-based trading system and a stable regional environment underpinned by American leadership. China's fast-paced growth and its incorporation into the trading system led to growing levels of regional integration as attested by China's current place as top trading partner for all countries in Asia. A key driver of this regionalization was the expansion of cross-border supply chains which aimed to maximize efficiency by tapping into the comparative advantages offered by different locations and could thrive in an environment of policy predictability and moderate geopolitical tension.

No such conditions exist today. Concerns with China's market-distorting policies have intensified. These include the widespread use of state subsidies to champion specific industries, the lack of a playing field due to the preferences and perks awarded to state-owned enterprises (SOEs), restrictions on foreign direct investment (FDI), and its closed digital ecosystem. China's doubling down

on its state-capitalism model to achieve self-sufficiency in emerging technologies—if successful—has implications for the future of the existing regional division of labor for economies which have hitherto engaged in high-tech trade with China (South Korea, Japan, and Taiwan, for instance).¹ Moreover, the rise of Chinese economic power has also created worries that Chinese leadership may exploit economic interdependencies during episodes of bilateral friction (the restrictions on Australian cotton imports are just the latest episode).²

The United States and its partners in the region, including South Korea, share many of these concerns. However, the sharp fluctuations in U.S. foreign economic policy and a transactional approach to alliances over the past few years have precluded effective collaboration among like-minded countries to address the China challenge. A singular handicap for the United States is its growing marginalization of the emerging regional economic architecture and its inability to articulate a long-term strategy of economic engagement with the region. This paper explores these challenges and identifies opportunities for the United States and South Korea to work together in shoring up a rules-based regional economic architecture.

An emerging regional trade architecture *sans* the United States

At the most fundamental level, the regional architecture defines membership and participation. The overlay of regional institutions and inter-state agreements determines which nations will benefit from preferential market access and have a voice in shaping the rules governing cross-border trade and investment flows. The benefits are not only circumscribed to increased economic competitiveness and gains from trade, but there is a foreign policy dividend as well. Insertion into the regional architecture signals long-term commitment, enables the dissemination of shared standards and norms, and confirms the shared intent to deepen ties among members. Importantly, the regional economic architecture in the Asia-Pacific has not been defined in exclusive terms, setting aside rival economic blocs. On the contrary, the regional fabric is multilayered with overlapping memberships and different levels of policy coordination.

The future of the regional economic architecture in Asia is of critical importance to the United States. Asia is poised to consolidate its lead as the most dynamic region in the post-pandemic world economy. Many governments in the region have been among the most successful in containing

¹ Schaede, Ulrike. *The Business Reinvention of Japan* (Stanford: Stanford University Press, 2020).

² Pannett, Rachel. “China’s Economic Squeeze on Australia Extends to Cotton,” *The Wall Street Journal*, October 16, 2020, <https://www.wsj.com/articles/chinas-economic-squeeze-on-australia-extends-to-cotton-11602839413>.

COVID-19 outbreaks, thereby limiting the duration of lockdowns and avoiding major tears to the social fabric. Moreover, the planks of regional trade architecture are quickly coming together with the arrival of mega trade groupings. In the past, Asia stood out for its reluctance to sign preferential trade agreements with binding commitments. Not anymore. A frenzy of bilateral trade agreements has now given way to the arrival of two large-scale regional and transregional trade agreements: the Comprehensive and Progressive Trans-Pacific Partnership Trade Agreement (CPTPP) and the Regional Comprehensive Economic Partnership (RCEP).

The CPTPP is the successor agreement to the original TPP that was abandoned by U.S. President Donald Trump upon his arrival to office. The remaining eleven countries salvaged the trade agreement by keeping intact the ambitious tariff liberalization schedules and suspending twelve provisions mostly in the intellectual property (IP) chapter that had been core American demands. In so doing, they left the door open for a potential U.S. return, but also demonstrated their ability to move on if the United States continues to eschew regional trade undertakings. After more than seven years of negotiations, the RCEP agreement appears ready for signing by the end of this year. RCEP also lost an important member along the way: India, which cited concerns over a ballooning trade deficit with China to step aside. Although a blow to RCEP, the importance of the emerging trade grouping should not be overlooked, pooling together 15 nations with common trading rules.

The glaring absence from this budding regional trade architecture is the United States.

Taking stock of “America First” trade policy

With his views of international trade as a zero-sum contest and the trade deficit as an adequate tally for success or failure, President Trump promised a redo of American trade policy. “America First” trade policy rests on a profound skepticism of the multilateral trading system, a preference for bilateral talks that award the United States greater negotiation leverage, and unbridled unilateralism relying on tariffs and export controls as main tools of foreign economic policy. As American views on China have hardened, the Trump administration is not alone in its belief that the World Trade Organization (WTO) is incapable of controlling its unfair trading practices. Likewise, other U.S. administrations have been critical of the WTO Appellate Body for overstepping its bounds through its rulings. However, the Trump administration has gone further than any other previous U.S. government by letting the Appellate Body cease to function by blocking new nominations without offering a blueprint for reform; hinting at a potential tariff reset where the U.S. could eschew tariff bindings to extract reciprocity from other members; and periodically threatening to withdraw from the WTO,

thereby further putting into question the viability of the international body.³

In Asia, the Trump administration's first term yielded a renegotiation of the United States–Korea Free Trade Agreement (KORUS FTA) in 2018 and phase one bilateral agreements with Japan (December 2019) and China (January 2020). The amendments to the trade deal with South Korea were modest, and mostly focused on easing Korea's safety and emissions auto standards and backtracking on the removal of U.S. tariffs on trucks until 2041. A significant issue in the bilateral trade agenda was South Korea's agreement to restrict by 30% exports of steel in order to avoid a 25% U.S. national security tariff.⁴ Negotiations with Japan produced a digital agreement that mostly incorporated the disciplines of the original TPP and a narrow market access agreement. Japan extended the same tariff cuts in agriculture from the TPP, with the exception of rice, and the United States liberalized some industrial products but did not include the automobile sector. For that reason, the bilateral deal does not meet the WTO standard of liberalizing substantially all trade. The phase one deal with China hit pause on the tariff war, but did not lead to a major rollback of the tariffs (for instance, the U.S. still has tariffs on \$360 billion worth of Chinese products). China agreed to liberalization of FDI in some sectors, but the core of its industrial policy was left intact. The most notable aspect of the deal is China's purchase commitments of \$200 billion, which is unrealistic and trade diverting.

Significantly, all these bilateral negotiations were spurred by the imposition of U.S. unilateral tariffs or threat thereof. The opening salvo of the trade war with China was a 301 investigation into China's unfair technology transfer and intellectual property practices. The WTO has since ruled that the 301 tariffs applied to trade with China are illegal.⁵ A novelty of the Trump era has been the active use of Section 232 of U.S. trade law, whereby the executive can restrict imports if they are deemed to harm national security. On shaky grounds, the Trump administration applied "national security" tariffs on steel and aluminum products in the spring of 2018 that mostly impacted allies and partners, and threatened a 25% national security duty on automobiles. Hence, the trade negotiations with South Korea and Japan were mostly damage-control exercises to avoid punitive tariffs rather than a more ambitious endeavor to deepen bilateral ties. The Trump administration has largely marginalized congress in its Asia trade policy: The revised KORUS FTA did not require a congressional vote and the

³ Feinberg, Andrew. "Trump just threatened to pull out of WTO unless the US keeps winning cases," Newsweek, April 10, 2020, <https://www.newsweek.com/trump-just-threatened-pull-out-wto-unless-us-keeps-winning-cases-1497326>

⁴ Schott, Jeffrey J. and Euijin Jung, "KORUS Amendments: Minor Adjustments Fixed What Trump Called 'Horrible Trade Deal,'" (Washington, DC: Peterson Institute for International Economics, November 2018), <https://www.piie.com/system/files/documents/pb18-22.pdf>

⁵ Keaton, Jamey. "US tariffs on China ruled to be illegal by world trade body," *The Detroit News*, September 15, 2020, <https://www.detroitnews.com/story/business/2020/09/15/us-tariffs-china-ruled-illegal-world-trade-organization/5803181002/>.

deals with China and Japan are executive agreements that could be easily undone by a future president.

COVID-19 and the nationalist temptation

The global pandemic has produced large-scale loss of life (with 1,162,512 deaths and 43,787,411 infections worldwide as of October 27, 2020) and has wreaked havoc on the world economy. The projections from the International Monetary Fund and WTO are grim: a global contraction estimated at -4.4% and -1.7% for emerging and developing Asia;⁶ and a drop in merchandise trade flows of -9.2% in 2020.⁷ While the long-term consequences of the COVID-19 crisis remain unknown, it had an immediate and negative effect on open trade policies. Many countries responded to the demand surge for medical supplies and protective equipment by imposing export restrictions. At last count, 91 jurisdictions have imposed 200 restrictive measures.⁸ These measures are nevertheless self-defeating. They eliminate incentives for producers to scale up production and invite foreign retaliation that could cut off access to critical products and components. A better set of alternatives includes refurbishing stockpile programs, diversifying domestic and international suppliers, and securing international commitments to keep medical supply chains open.⁹

In the view of many officials in the United States, Europe, and Asia, the production disruptions due to the pandemic illustrate the risks of extended production networks, in particular an over-reliance on China as a manufacturing hub. Hence, calls for reshoring production using government incentives have increased. For example, the Trump administration has been considering the use of tax incentives and a potential \$25 billion reshoring fund to extricate production chains out of China.¹⁰

⁶ “World Economic Outlook, October 2020: A Long and Difficult Ascent,” (Washington, DC: International Monetary Fund, October 16, 2020), <https://www.imf.org/en/Publications/WEO/Issues/2020/09/30/world-economic-outlook-october-2020>

⁷ “Trade shows signs of rebound from COVID-19, recovery still uncertain,” World Trade Organization press release, October 6, 2020,

⁸ Simon Evenett, “In light of COVID-19, should supply chains be reconfigured?” (remarks, Peterson Institute for International Economics, October 21, 2020), <https://www.piie.com/events/light-covid-19-should-supply-chains-be-reconfigured>.

⁹ Mireya Solís, “The post-COVID 19 world: Economic nationalism triumphant?.” Brookings, July 10, 2020, <https://www.brookings.edu/blog/order-from-chaos/2020/07/10/the-post-covid-19-world-economic-nationalism-triumphant/>.

¹⁰ Shalal, Andrea, Alexandra Alper, and Patricia Zengerle, “U.S. mulls paying companies, tax breaks to pull supply chains from China,” Reuters, May 18, 2020, <https://www.reuters.com/article/us-usa-china-supply-chains/u-s-mulls-paying-companies-tax-breaks-to-pull-supply-chains-from-china-idUSKBN22U0FH>.

The South Korean government announced in June a reshoring program that also envisions tax incentives and subsidies to encourage firms to return home.¹¹ The Japanese government included a \$2.25 billion fund in its COVID-19 countermeasures budget to encourage both reshoring and supply chain diversification into Southeast Asia in cases where production is heavily concentrated in a single country. Significantly, the Korean and Japanese incentive programs are not conceived as a decoupling exercise and the amount of subsidies provided is small compared to their stock of FDI in China. At best, these programs should be seen as diversification exercises and not a wholesale restructuring of supply chains.

A new page for American trade policy?

American trade policy has been in flux. It moved from a failed attempt during the Obama administration to clinch trans-Pacific and trans-Atlantic trade deals, to an emphasis on bilateral talks and unilateral measures in the Trump era that have neither reduced the trade deficit nor brought back jobs. Hence, the question arises as to whether a Biden administration could produce a reset of trade policy with better outcomes at home and abroad.

With an emphasis on multilateralism, an appreciation of the value of alliances, and a desire to work with like-minded democracies, the upcoming Biden administration will cut a more familiar figure for U.S. allies and partners. A more constructive approach to WTO reform and greater coordination with allies on China policy could be forthcoming. However, a return to the status quo ante on China policy and trade policy is unlikely. The United States and China are locked in a dynamic of strategic competition for the foreseeable future and there is bipartisan consensus on the need to curb Chinese market-distorting policies especially in high-tech sectors. There are no indications at present that the next administration will do away with the tariffs on China without requiring concessions from Beijing nor is it clear how it will handle the phase one trade deal with China which President-elect Biden himself has denounced as deeply flawed.

Rather than a quick pivot to large-scale trade negotiations, the Biden administration will probably focus on boosting domestic competitiveness with investments in infrastructure and technology development and will prioritize needed repairs to the safety net.

On the other hand, some of the economic policies advertised during the campaign may be of concern for U.S. trade partners. With the “Make in America and Buy in America” slogan, the Biden

¹¹ Stangarone, Troy. “South Korea’s Struggle to Bring Manufacturing Home,” The Diplomat, September 14, 2020, <https://thediplomat.com/2020/09/south-koreas-struggle-to-bring-manufacturing-home/>.

team has carved a major role for the federal government in purchasing domestic products to the tune of \$400 billion, with a stated intention of redrawing international rules on government procurement. Tariffs could be coming down the pike (in the form of carbon adjustment fees) for countries that fail to deliver on their emission reduction targets,¹² and there are plans for a claw-back provision making companies return tax benefits if they offshore production. For the first days of its term, the Biden campaign has promised a review of critical supply chains that would cover not only medical supply products, but also semiconductors, telecommunications, and key raw materials. The onshoring campaign is not geared toward “pure self-sufficiency but broad-based resilience,” seeking to work with allies to avoid dependence on China or Russia for critical products.¹³

Going forward, it will be important for the Biden administration to articulate a positive case for U.S. leadership based on win-win economic ties that goes beyond shared defensive concerns vis-à-vis China. Such a leadership bid must provide a strategy for the United States to return—and help shape—the regional economic architecture.

Leveraging the U.S.–Korea partnership to sustain a rules-based trade architecture

Listed below are a number of areas where the United States and South Korea share interests and can work together to tackle new forms of protectionism, maintain open supply chains, and boost multi-lateral and regional trade governance:

1) Curbing COVID-19 protectionism

- The United States and South Korea should take a stand against export protectionism in medical supplies and personal protective equipment, urge WTO members to abide by the transparency and reporting requirements of these temporary measures, and promote transparency in stockpiling programs and cooperate to develop trusted supplier networks.

2) Coordinating on WTO reform

¹² Alden, Edward. “No, Biden Will Not End Trade Wars,” Foreign Policy, October 2, 2020, [https://foreignpol-
icy.com/2020/10/02/biden-trump-trade-wars-election-2020/](https://foreignpolicy.com/2020/10/02/biden-trump-trade-wars-election-2020/).

¹³ “The Biden plan to rebuild U.S. supply chains and ensure the U.S. does not face future shortages of critical equipment,” Biden for President, 2020, <https://joebiden.com/supplychains/#>.

- The ongoing trilateral effort (U.S., EU, Japan) would benefit from South Korea's participation as it seeks to develop updated rules on industrial subsidies and disciplines for state-owned enterprises. The United States and South Korea should advocate fixing the Appellate Body system to enable the reactivation of its dispute settlement mechanism. For the United States in particular, this will require articulating concrete reform measures that would satisfy its concerns with judicial overreach.
- 3) Disseminating regional and transregional standards on the digital economy
- The United States and South Korea have advanced tech sectors and common interests in ensuring strong IP protections, freedom of data flows, and rules to promote the digital economy. They should collaborate with countries that abide by these standards to negotiate a plurilateral trade agreement on the digital economy.
- 4) Admission to the CPTPP
- Both the United States and South Korea remain outside the regional trade agreement with the most ambitious tariff elimination targets and with a rulebook that addresses state capitalism trading practices: the CPTPP. Admission bids on their part would greatly strengthen the reach of this trade grouping by encouraging existing members to ratify and encouraging others to join.¹⁴
 - The CPTPP chapter is closer to the United States–Mexico–Canada Agreement's IP provisions (with no extended protection on biologicals) and the U.S. could make a push for targeted revisions on environment and labor standards.¹⁵ CPTPP members will have asks of their own, including assurances that the U.S. will not resort to unilateral tariffs against members for alleged unfair trading practices. This could take the form of a U.S. commitment to not bypass the CPTPP dispute settlement process with a 301 investigation.

The United States and Korea can work together to prevent disruptions to much needed supply chains,

¹⁴ Cutler, Wendy. "Reengaging the Asia-Pacific on Trade: A TPP Roadmap for the Next U.S. Administration" (Washington, DC: Asia Society Policy Institute, September 30, 2020). <https://asiasociety.org/policy-institute/reengaging-asia-pacific-trade-tpp-roadmap-next-us-administration>

¹⁵ Dollar, David and Mireya Solís, "The United States should join the TPP" in "A list of specific, actionable foreign policy ideas for the next president," Brookings, October 27, 2020: <https://www.brookings.edu/blog/order-from-chaos/2020/10/27/a-list-of-specific-actionable-foreign-policy-ideas-for-the-next-president/>

reactivate the trade adjudication function of the WTO, and support a rules-based approach to deal with the China challenge through CPTPP membership. It is a tall order, but it is what the times call for.

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