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**Trade Policy Options for Korea  
Outside the Doha Round**

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**ABSTRACT**

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The Doha Round of Multilateral Trade Negotiations within the World Trade Organization has reached an impasse from which it may never recover. Policymakers in Korea, as in other countries, must decide how to deal with this failure and what policies to pursue in its stead. Here I discuss some of the options, ranging from abandoning the WTO disciplines and raising tariffs, to unilateral reduction of tariffs to zero. Much of the discussion concerns the formation of bilateral or regional free trade agreements, which should be structured to avoid some of their less desirable features.

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## **Trade Policy Options for Korea Outside the Doha Round\***

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The Doha Round of Multilateral Trade Negotiations within the World Trade Organization has reached an impasse from which it may never recover. Policymakers in Korea, as in other countries, must decide how to deal with this failure and what policies to pursue in its stead. Here I discuss some of the options.

These options include the following: Korea could simply do nothing; that is, keep its trade barriers at the level they are now and, in some cases, welcome the reprieve that Doha Round failure gives domestic industries from suffering the increased international competition that a successful Round might have entailed. I will argue that this would be a mistake. Second, Korea could view the failure of the Round as a failure of the WTO itself, and renege on its commitments not to raise trade barriers. This would be an even greater mistake.

Only slightly more positively, Korea could accept the disciplines of the existing WTO framework and seek to make even greater use of its provisions for activist trade policies. This would mean increasing use of safeguards tariffs, antidumping duties, and countervailing duties, thus using such administrative protection to the fullest extent permitted by international rules. That would not necessarily undermine the multilateral trading system, but it too, I will argue, would be harmful for the Korean economy.

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\* I have benefited from conversations on this topic with Bob Stern and Honggue Lee.

Other options would entail pursuing trade liberalization outside of the Doha Round framework. Most obviously – and undoubtedly most likely – would be for Korea to negotiate bilaterally with an increasing number of trading partners to form Free Trade Areas (FTAs) and similar arrangements. It has already done this with the United States, although the agreement has not yet been ratified in either country. With or without a US FTA, Korea could pursue FTAs with many other partners. These arrangements have both pros and cons, but absent progress on the multilateral front, these offer Korea the best chance available for securing greater market access abroad. It should pursue these options wherever they arise, taking care to limit as far as possible the adverse effects that such arrangements may have.

Finally, Korea could in principle move unilaterally in the direction of free trade. This would involve reducing its tariffs from their current levels substantially toward zero, and removing any other nontariff barriers that it currently has. As a trade economist well schooled in the benefits of free trade, I naturally can see the virtues of this approach, and to the extent that Korea's trade barriers are currently high, I would strongly advocate it. However, Korea's average tariffs today, as I understand it, are below 10% *ad valorem*, and these tariffs provide a meaningful incentive for other countries to negotiate with Korea to reduce them on a bilateral basis. Since bilateral tariff reductions, by creating market access abroad for Korean exporters, benefit Korea more than unilateral tariff reduction, I will argue that it is probably not advisable for Korea to pursue the unilateral route at this time.

### *The Doha Round Impasse*

The Doha Round is the ninth round of negotiations for multilateral trade liberalization initiated under the auspices of the General Agreement on Tariffs and Trade (GATT), and it is the first such round attempted under the GATT's successor, the World Trade Organization (WTO). The Round has been fraught with divisive disagreements among the negotiating countries, beginning even before the Round began at the Doha Ministerial Meeting of the WTO in 2001. The previous attempt to initiate such a Round, at the Seattle Ministerial in 1999, failed in part because of such fundamental disagreements between high-income and low-income countries. These and other disagreements were temporarily put aside, in Doha in the aftermath of the September 11 2001 terrorist attacks, and the Doha Round began with high aspirations to open markets in both high- and low-income countries to the benefit especially of the latter. With this in mind, the Doha Round was christened the Doha Development Agenda.

The disagreements remained, however, and soon resurfaced. The countries of Europe resisted substantial opening of their markets in agriculture, and the United States resisted substantial reductions of its subsidies in agriculture, both of which were forcefully demanded by the low-income countries as well as by each other. At the same time, most low-income countries resisted the substantial market opening in both manufacturing and services that high-income countries insisted were the quid pro quo for even the minimal liberalizations that they were offering. These rifts became most apparent at the Cancún Ministerial in 2003, when a group of low-income countries – now usually called the Group of Twenty – coalesced for the first time in order to resist letting the US and EU set the framework for negotiations. That meeting ended in failure.

Since the Cancún debacle, the Doha negotiations have stumbled only hesitantly forward. The framework that eluded negotiators in Cancún was achieved in Geneva in 2004. The next Ministerial Meeting, in Hong Kong in 2005, managed to end in success, but only because the negotiators reduced their aspirations for progress to a bare minimum. By the summer of 2006, so little progress was being made that Pascal Lamy, Director General of the WTO, suspended the negotiations. In February 2007 he announced that negotiations had resumed, but while he now claims to see a high level of commitment to conclude the Round, nobody is predicting a successful conclusion to the Round any time soon.

Meanwhile, the Trade Promotion Authority that the US Congress had granted to President Bush has now expired. This means that, if the Round does reach a successful conclusion, it is unclear how it will be ratified by the United States. At the rate that it is now progressing, one might reasonably expect such ratification to become an issue only after the next presidential election in the US, but whether this will make ratification easier or harder remains to be seen.

In short, the Doha Round is far from a sure thing. I would hope that Korea, like other WTO members, is participating actively in the negotiations and doing all that it can to push them toward a successful conclusion. But realistically one should not count on that success, and Korea's trade policy today needs to be formulated on the assumption that the Doha Round will fail.

*Options: Do Nothing*

The likelihood that the Doha Round will fail is undoubtedly good news to some in Korea. For reasons I have never really understood, Korean farmers have been perhaps the most visible demonstrators against the WTO and the Doha Round since at least the Cancún Ministerial when one of them gave up his life for the cause. In Hong Kong, also, the only demonstrators to capture much attention from the press were from Korea. I can only assume, therefore, that these opponents of the WTO must be pleased at the Doha Round's lack of progress. Given the reluctance with which other high-income countries have offered to reduce protection and assistance in agriculture, I am not sure that they had much to fear, realistically. But they must surely view it as a victory for their cause.

Of course farmers in Korea are only a small minority. The much larger majority of Korean workers have, whether they know it or not, prospered handsomely from the world trading system and Korea's ability to export. Fortunately, previous rounds of GATT trade negotiations have already brought tariffs in most high-income countries to low levels on the products that Korea now succeeds in exporting. Tariffs remain high in textiles and apparel, but wages in Korea have risen to the point that it produces little in these sectors and is involved in exporting primarily when it can manage production in other lower-income countries. Therefore, the current state of the world trading system is largely favorable to Korea, and the status quo is not a bad place to be.



On the other hand, Korea has prospered by steadily expanding its exports and its presence in a widening range of industrial products. To continue that expansion, it would benefit from further liberalization, especially in the lower-income countries of Asia where it has a geographic advantage. Also, as Korean wages continue to rise, one may expect Korea, like other high-income countries, to move increasingly into services. Here, liberalization under the WTO has only just begun, and the Doha Round held hopes for substantial progress. Thus, although it may be acceptable from the Korean perspective that trade liberalization has come to a halt, it is surely not optimal. Korea's rapid progress through most of the last several decades has been facilitated by trade and by trade liberalization. If that stops, so may Korean growth.

***Options: Retreat from Trade***

It therefore hardly needs stating that a retreat from trade would be an even worse option for Korea. But it does need to be stated, because a failure of the Doha Round will be viewed by some as a failure of the WTO system as a whole, and therefore as a signal that countries' obligations as WTO members are no longer binding. In spite of Korea's success as an exporter, it inevitably still has numerous firms that compete with imports, both in sectors where Korea never had comparative advantage and in others where it has lost an earlier comparative advantage as its income and wages have risen. These firms and their workers, like import competing workers everywhere, will demand protection, and if the WTO is seen as defunct, it will become harder to say no. It may not be only the Korean farmers who, in the future, seek sympathy for, and policy relief from, the threats from imports.

Resisting these demands will require strong political will on the part of politicians and bureaucrats who understand the importance of trade. Fortunately, from what I have seen in Korea, this understanding is more widespread than it seems to be in the United States. I therefore am optimistic that, if a retreat from liberal trade does take place in some parts of the world, Korea will be one of the last countries to join that retreat. I hope I'm right.

***Options: Use the WTO More Aggressively***

In fact, the possible failure of the Doha Round does not by any means imply the demise of the WTO. The 151 countries that are now members of the WTO are bound by their commitments under international law to abide by its provisions, and I am actually quite confident – barring some unforeseen calamity and breakdown of international norms – that the world trading system will survive unscathed subject to the constraints delineated in the WTO agreements. More likely than that countries will abandon those commitments is that they will begin to use more aggressively the provisions that the WTO provides for them, both to restrain trade themselves under certain circumstances, and to initiate complaints against other countries who do this inappropriately. Thus we may see increased use of tariffs by countries claiming justification under the WTO Safeguards Clause or as WTO-legal antidumping or countervailing duties. And we may see increased filing of complaints against alleged illegal practices that, if successful, may lead eventually to WTO-sanctioned retaliatory tariffs. If this occurs, some might argue that Korea should participate out of self defense in the wave of trade actions.

I have seen it argued that such a proliferation of trade actions is to be expected precisely because countries have postponed them in recent years during the Doha negotiations. The argument is that countries wanted to avoid disrupting the negotiations and therefore restrained themselves from actions that they could have done legally under WTO rules. If so, then there must now be a backlog of legitimate trade actions just waiting to be undertaken as soon as confidence in the success of the Doha Round is broken.

So far, however, I see no evidence that this is happening. The Doha Round negotiations were suspended in the summer of 2006, but this did not unleash a flood of dispute settlement cases. Figure 1 shows the numbers of cases initiated in the WTO during the 12 months to July 12, 2007, (the most recent case listed by the WTO as of this writing), together with the numbers of cases filed in each preceding 12-month period. The number of cases since the Doha-Round suspension is only slightly larger than in the previous four years, and much smaller than in the earlier years after the WTO was created.

Thus, it is not clear that other countries will in fact become more aggressive with their use of trade policies and complaints. But even if they do, the case for Korea responding in kind is not obvious. The economics of “trade wars” suggests that, while countries may view themselves as gaining when they unilaterally depart from free trade, collectively they all are likely to lose when they all do it.<sup>1</sup> A sufficiently large country may, perhaps, deter such a breakdown of international cooperation by committing to retaliate. But while South Korea is a significant player on the world stage and a vibrant economy, it is not large enough to play that role. It would, in my view, only hurt itself by more aggressive use of trade policies.

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<sup>1</sup> See Johnson (1954), Grossman and Helpman (1995).

Some might argue, independently of whether other countries do this, that membership in the WTO entitles countries to use its provisions for safeguard, anti-dumping, and countervailing duty protection, and that therefore countries *must* use these policies in order to derive full benefit from their membership. This misunderstands the reason that these policies are permitted by the WTO. For the most part, these policies are permitted in spite of their adverse consequences for the world trading system and for the economic well-being of countries that use them. They are justified, instead, primarily by the need to co-opt protectionist interests that might have otherwise prevented the GATT and WTO from ever being created. Permission to use these policies does not at all imply an international consensus that their use is desirable.

As for the more active use of WTO Disputes, I would say that Korea should indeed use that mechanism whenever appropriate – that is, whenever other countries violate WTO rules with adverse consequences for Korea. However, the case for initiating WTO disputes is no greater without the Doha Round than with it. And in any case, the objective in such disputes must be to persuade other countries to discontinue undesirable policies, not to invoke the retaliation that may become necessary if they don't. While the threat of authorized retaliation is a necessary component of the Dispute Settlement Mechanism in order for it to work, the effect of retaliation itself is harmful, usually for all concerned.

***Options: Free Trade Agreements***

I have ignored, so far, the option that seems most likely to be chosen and that has, indeed, already been pursued by Korea and by many other countries: the negotiation of bilateral

or regional Free Trade Agreements (FTAs) and other such preferential arrangements. It was when the previous round of multilateral trade negotiations, the Uruguay Round, was stalled that the United States entered into its first economically significant FTA, with Canada.<sup>2</sup> Until then, the US had been a staunch proponent of multilateral negotiations exclusively. But when the Uruguay Round appeared to be making no progress, the US dropped its resistance to bilateralism and negotiated an FTA, first with Canada in 1989 and then including Mexico in the three-country NAFTA, which went into effect in 1994. Since then the US and numerous other countries have negotiated FTAs throughout the world.

As shown in Figure 2 from the WTO, more than 350 such arrangements have been notified to the GATT or WTO over the last half century, and more than 200 of these are regarded as “active.” This is something of an exaggeration, since many agreements appear twice in this tabulation, once for goods under GATT and again for services under the General Agreement on Trade in Services (GATS). Nonetheless, it is clear that many such arrangements have been created, and it is also the case that many more are currently being negotiated. The United States, for example, at last report was negotiating with at least ten other countries.<sup>3</sup>

The existing agreements in Figure 2 include three that involve Korea: with Chile, Singapore, and the European Free Trade Association (Iceland, Liechtenstein, Norway, and Switzerland). In addition, Korea has now concluded an FTA with the United States, though this is yet to be ratified in either country. And it is my understanding that Korea has engaged in negotiations towards FTAs with Canada, Japan, Mexico, India, and the

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<sup>2</sup> Before that the US negotiated an FTA with Israel in 1985.

<sup>3</sup> See USTR (2006), which is the most recent document I’ve been able to find listing this information.

Association of Southeast Asian Nations (ASEAN). The US-South Korea FTA is particularly important because of the size of the two countries and their trading relationship, as well as because of the incentive it provides for other countries in the region to hasten negotiation of other FTAs.<sup>4</sup>

Thus it seems clear that such preferential arrangements will continue to encompass more and more countries, with or without the Doha Round, and that Korea will inevitably be part of that movement. This is not necessarily a good thing, either for the world or for Korea itself, as such arrangements are well known in economic theory to be less than optimal and possibly distinctly harmful, even to the participants, due to trade diversion. However, the empirical evidence that we have suggests that most FTAs have been or are likely to be beneficial to their participants, and even that participants stand to gain more than non-participants lose.<sup>5</sup> Thus the proliferation of FTAs, which may accelerate due to failure of the Doha Round, may actually be beneficial.

In order to maximize the benefits from the proliferation of FTAs, they should be configured to mimic as far as possible the benefits from multilateral free trade. To achieve this, Korea should use its considerable economic and political leverage to insure that the FTAs to which it agrees discriminate as little as possible against outside countries. This will require careful attention to several aspects of these agreements: rules of origin, provisions for expansion, sensitive sectors, and commitments beyond trade.

#### *Rules of Origin*

Free trade agreements, because they leave their participants free to levy their own different tariffs on imports from outside countries, necessarily include rules of origin. To

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<sup>4</sup> See Barfield (2007).

<sup>5</sup> See Brown et al. (2006) for estimates of the welfare effects of a variety of potential FTAs.

avoid imports entering one member country at a low tariff and then crossing tariff-free to another member that has a higher tariff, trade among members is free only for goods that are deemed to have originated within the FTA. What this means, however, can be very complex and often constitutes the cumbersome fine print of a free trade agreement. Because rules of origin tend to be technical and therefore ignored except by specialists, they can easily be written to favor domestic producers and to discourage imports.<sup>6</sup> Indeed, it is possible for the net effect of an FTA to be even more protectionist against imports from outside countries than if the FTA had not been formed at all, and this is in addition to its trade diverting implications.

If economists could agree on a set of ideal rules of origin, then these could be written into the GATT Article XXIV that spells out the legal justification for FTAs. If that were the case, my advice here could simply be that Korea enter only those FTAs that are legal under Article XXIV. That would not assure that rules of origin would be harmless, since actual FTAs have never, to my knowledge, been challenged in the GATT or WTO. But it would be a start.

However, economists have not agreed on what form rules of origin should take. This is not surprising, given that FTAs are intrinsically inferior to multilateral free trade, so that conventional welfare economics would dictate rules of origin that completely undermine an FTA's discriminatory nature. In a sense, the stringency of rules of origin is simply a reflection of the political forces that led to the FTA in the first place, as opposed to moving to multilateral free trade. Often, one can discern which sectors of an economy were able to exert the greatest protectionist pressure on an FTA's negotiators by looking at the stringency of the rules of origin.

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<sup>6</sup> See Deardorff (2004).

It is therefore important not just that rules of origin be relatively permissive, but that they be uniform across sectors in order to avoid being co-opted by the interests of particular domestic industries. I, for example, would favor a uniform rule of origin requiring, say, that fifty percent of a product's value added be produced within the countries of the FTA in order for it to qualify for tariff-free movement across the FTA's internal borders. But I would rather raise this percentage, and keep it uniform, than allow separate industries to specify their own rules of origin as was done in the NAFTA for automobiles and textiles and apparel.

### *Expansion*

It is customary for FTAs to include provisions for expanding them to include other countries. Unfortunately, those provisions typically permit new members only with the individual assent of each incumbent member. This means, in turn, that each existing member of an FTA can negotiate with new members whatever terms they like, and they therefore need not admit new members at all.

As a result, instead of FTAs expanding to include new members, one customarily sees new bilateral FTAs negotiated between individual members of an existing FTA and third countries. Korea, for example, is negotiating FTAs with the US, Canada, and Mexico, all members of the NAFTA, rather than simply trying to add Korea to the NAFTA group. This is a cumbersome process that may not succeed in all three cases, and if so trade will be less than completely free among the four countries. Furthermore, even if all three of these bilateral FTAs are created, the result will be something less than an FTA encompassing all four countries. The NAFTA rules of origin, for example, will



not permit Korean-produced goods to cross tariff-free into the US if they had first entered into Mexico perhaps for further processing.

One could avoid this problem, presumably, by having a single set of negotiations involving both the new country and all of the incumbent member countries simultaneously, just as the NAFTA added Mexico to the US-Canada FTA in negotiations that included all three countries. Unfortunately, such negotiations may become even more cumbersome and unmanageable, given that the members of an FTA are usually unwilling to delegate any of their negotiating function to a central body, as members of the European Union have done for its expansion.

It would be preferable, therefore, if FTAs were simply to specify from the outset that *any* country could join their group on the same terms as the existing members, without the need for additional negotiations and thus impediments. If that were the case, then FTAs would be discriminatory only against countries that themselves chose not to join, and one could imagine that FTAs would expand over time to encompass more and more of the world, approaching in the limit the ideal of multilateral free trade.

Barfield (2007) refers to this as the FTA having a “docking provision,” which he says “would allow other nations in the region to join when they were ready.” He does not envision such a provision applying globally, but states the more modest aspiration that it apply to a regional grouping of countries that have agreed in principle to the objective of free trade, such as the Asia Pacific Economic Cooperation (APEC) group of countries.

For this to work, the language of an FTA would have to be written with a view to such expansion. It could not, for example, specify the member countries by name, but only generically. And ideally it should not include particular provisions that only make

sense for particular countries or country pairs, since these would invite appeals for similar provisions tailored to new members. But the central function of an FTA could easily be stated to apply to whatever countries ultimately become members: that there should be tariff-free trade among members subject to a rule of origin that is defined for all members as a group.

### *Sensitive Sectors*

In their ideal form, FTAs encompass all trade among member countries. In practice, countries often identify “sensitive sectors” for which free trade among members is delayed, perhaps indefinitely. As one would expect, these are usually sectors in which producers are most likely to be displaced by trade. This means, in turn, that these are the sectors in which the costs of trade, the benefits of trade, and also the net benefits of trade, are largest. If the response to this sensitivity is only to slow down the process of liberalization, but not to stop it altogether, then that is probably wise. An alternative would be not to identify such sensitivity in advance, but rather to use safeguards policies – which provide temporary protection in response to injury from trade – after the fact if the disruption from trade turns out to be large, but this alternative is more or less equivalent to exempting sensitive sectors.

The danger in dealing with sensitive sectors is twofold. First, once it is accepted that some sectors may be sensitive, a great many sectors are likely to request that status, thus undermining the broad liberalization that an FTA should entail. Second, sensitive sectors may become permanently exempted from liberalization. The FTA itself may state that they are exempted, or fail to list them among sectors to be liberalized. Or it may promise liberalization in these sectors but postpone it so far into the future that it ceases

to be credible. The danger of the latter is that participants in the sector will therefore fail to undertake the adjustments that would have lessened the cost of trade liberalization, so that when the time comes to do it, they argue successfully for further, and therefore implicitly indefinite, postponement.

To avoid this latter eventuality, I would argue that all sectors, even sensitive ones, should be put on some sort of immediate track toward free trade in an FTA. For example, tariffs might be reduced linearly to zero in every sector over a period of some number of years, with that number being larger in the case of sensitive sectors. That way, even those sectors will experience some small tariff reduction immediately and each year thereafter, providing the demonstration that the FTA is real, even for them, and producing the incentive to deal with it.

#### *Other Commitments*

At a minimum, an FTA entails zero tariffs on goods traded among the member countries. But in practice, FTAs are much more than that (and also, often, much less than that, due to the exempted sectors just discussed). FTAs today usually cover trade in some services, as well as goods, and they have provisions concerning many other issues, such as international investment, intellectual property right enforcement, environmental standards, and labor standards. In fact, some would say that the primary motive for large countries like the US to enter into such agreements with its smallest trading partners lies in these other issues, not in trade *per se*.

Whatever the motive, the presence of these other issues in FTAs complicates them considerably. It is a commonplace of international trade theory that the gains from trade accrue to both partners, so that an ideal trade agreement might be expected easily to

benefit both parties. The same is true of some of the other issues that find their way into FTAs, but not necessarily of all of them. If a country is pushed to implement more stringent standards than are appropriate for its level of income, for example, this may produce primarily an income transfer from itself to the country demanding the higher standard. This is most clearly the case with patent rights, as I have written in Deardorff (1990), but the same is true, in a sense, with environmental and labor standards.

The danger, then, is that the non-trade portions of an FTA become essentially transfers between countries based on their negotiating power and expertise, transfers that essentially extract the gains from trade from the weaker partner. Jagdish Bhagwati, who has expressed long-standing skepticism about the desirability of preferential trading arrangements, waxes even more critical when he confronts their tendency to incorporate non-trade provisions. See for example his US Congressional testimony regarding FTAs with Singapore and Chile, in Bhagwati (2003).

The lesson for Korea is twofold, although probably unlikely to be heeded. First, it should resist pressures from larger trading partners such as the US to include non-trade provisions in trade agreements with them. And second, it should refrain from incorporating such provisions in the FTAs that it negotiates itself with weaker partners. Other issues, such as intellectual property rights, labor standards, and environmental protection, all are legitimate concerns, but they should be handled in separate negotiations, unrelated to trade, in order not to undermine or divert the gains from trade.

***Options: Unilateral Liberalization***

The final, and certainly the simplest, option for any country is just to reduce its tariffs unilaterally. For any country whose tariffs are still high, which includes many developing countries, that is the option that any responsible economist would advocate. High tariffs are very costly to a country overall, and while reducing them is also costly to those they protect, the benefits of doing so are well known to outweigh the costs. Unilateral trade liberalization should be undertaken for the country's own sake, not because other countries demand it, and it should be done in such a way as to minimize the adverse effects on those who will bear the costs. This means that tariffs, once they are reduced to the point that they are not prohibitive, should be reduced gradually. If possible, the tariff reductions should also be accompanied by policies to assist displaced workers and firms in adjusting into new and expanding occupations and industries.

None of this, however, is relevant for Korea, where tariffs are already relatively low. The average tariff on imports into Korea is less than ten percent. That, in my opinion, puts Korea in a different situation than high-tariff countries. No doubt that average tariff conceals individual tariffs that are much higher, and these should in principle be reduced unilaterally for the reason just stated. However, the fact that they remain high when average tariffs are low suggests that the political cost of reducing them may also be extreme. Therefore this advice is unlikely to be taken.

What about the much larger number of tariffs that are not zero but also are not high? Doesn't the argument for unilateral trade liberalization apply to them as well, but to a smaller degree? Yes, but it is not the whole story. In a world of many tariffs, countries lose not only from their own tariffs but also from the tariffs of other countries, which limit the market access of their exports. These are most likely to be reduced either

in a multilateral trade negotiation like the Doha Round, or in bilateral and regional negotiations leading to FTAs. Since success of the Doha Round is uncertain, it makes sense for countries to pursue market access through FTAs.

But FTA negotiations, more than multilateral ones, require the exchange of market access. If one party to a negotiation already has zero tariffs, then it may have nothing to offer in exchange for tariff reductions by another country. In that case it may find itself left outside of whatever bilateral and regional agreements are formed.

A good example of this is Hong Kong, which for many years has had essentially zero tariffs. The only FTA that now includes Hong Kong is with China, of which politically it is formally a part. As far as I know, no other country is seriously proposing an FTA with Hong Kong, and the fact that its tariffs are already zero seems a plausible reason. Of course, Hong Kong is not suffering, but that is largely because it has been a tremendous beneficiary of the multilateral liberalizations that have brought tariffs in high income countries to the low levels that they are today.

One might ask, if keeping low tariffs as bargaining chips for future negotiations is desirable, then why isn't keeping high tariffs for the same purpose even more desirable? Won't the concessions that a country is able to extract from other countries rise with the level of its own tariffs and thus the amount of market access that their removal can provide?

The answer is yes, but the cost to the country of those higher tariffs rises even faster. A standard result in the theory of tariffs is that the dead weight loss due to a tariff rises with the square of the size of the tariff, as illustrated in Figure 3. This means, on the one hand, that low tariffs really are not very costly at all, while on the other hand large

tariffs are very costly indeed. For example, a 20% ad valorem tariff, though only four times as large as a 5% tariff, will cause a dead-weight loss that is 16 times as large. In contrast, the benefits that one country derives from another country's tariff reductions are roughly proportional to the reductions themselves, not their square. Thus large tariffs are simply too costly, relative to their value in negotiations, to use as bargaining chips.

From this I conclude that Korea, most of whose tariffs are already low, should probably not engage in further unilateral liberalization, except perhaps in a few sectors where tariffs are still high and the political costs of reducing them can somehow be overcome. If the Doha Round were not moribund, my advice would be different. But if bilateral negotiations are likely to become the only means toward freer trade for Korea's exports, then keeping some low tariffs on imports with which to buy that access would be wise.

### ***Conclusion***

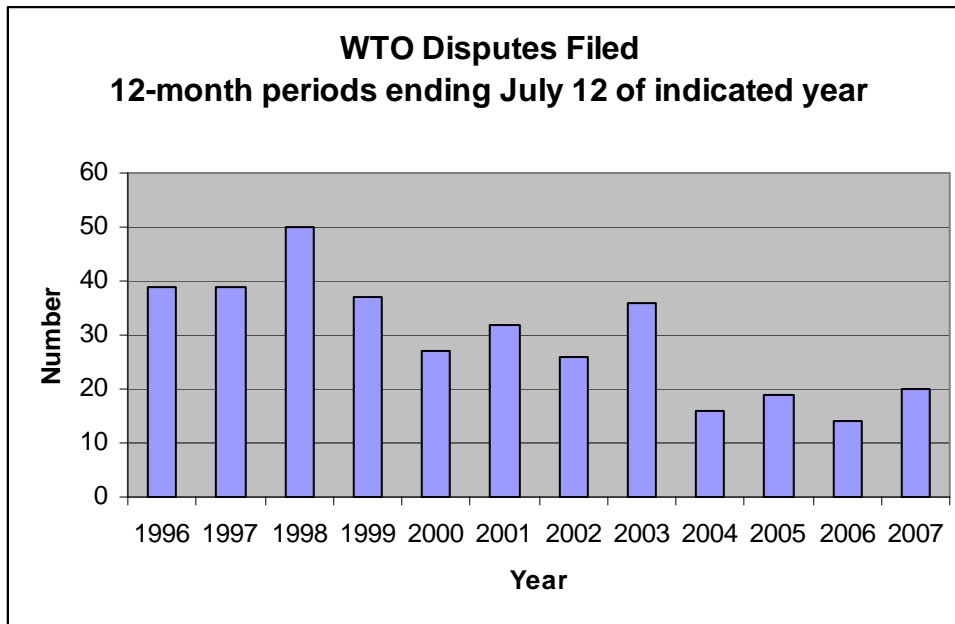
My advice to Korea, then, is for the most part to continue in the direction that it has been going, outside of the Doha Round. That is, unless the prospects for a successful Round improve, Korea should continue negotiating bilateral and regional free trade agreements with willing partners, taking care as far as possible to make these agreements as nondistorting (in their rules of origin) and open to other countries (in their accession clauses) as possible. These agreements should cover all traded sectors of the economy, if at all possible, and should avoid including non-trade issues. Korea should not give up on the world trading system, just because the Doha Round may have failed, by increasing its

levels of protection, but neither should it unilaterally reduce its tariffs that are already relatively low.

I must emphasize, however, that this advice is conditional on the failure of the Doha Round. If prospects for those negotiations somehow improve, then Korea should – and I am confident that it will – become a more active proponent of multilateral liberalization within the Round. Korea’s economic success over the last several decades has been remarkable, and it has come in large part from its participation in the world trading system. Continuing that success through bilateral and regional trade agreements may be possible, but these will never benefit Korea or the world as much as multilateral liberalization.



Figure 1

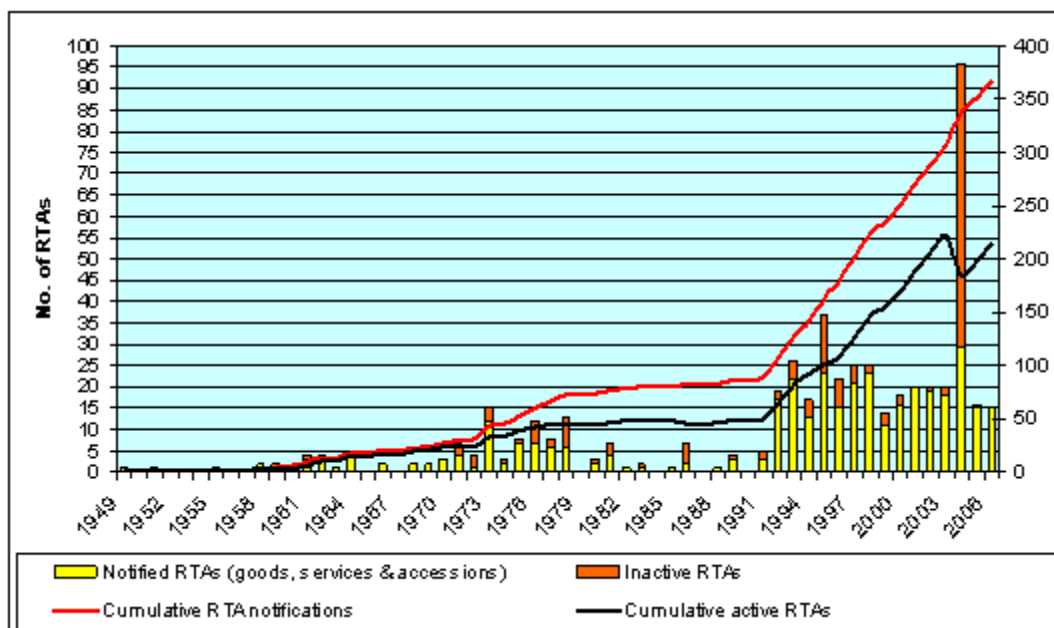


Source: WTO, [http://www.wto.org/english/tratop\\_e/dispu\\_e/dispu\\_status\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/dispu_status_e.htm)

Figure 2

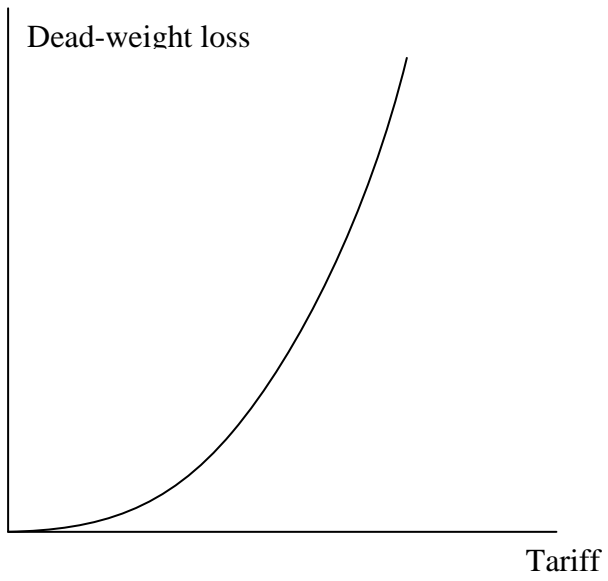
### Evolution of Regional Trade Agreements in the world, 1948-2006

The following Chart shows all RTAs notified to the GATT/WTO (1948-2006), including inactive RTAs, by year of entry into force.



Source: WTO Secretariat, [http://www.wto.org/english/tratop\\_e/region\\_e/regfac\\_e.htm](http://www.wto.org/english/tratop_e/region_e/regfac_e.htm)

Figure 3  
Dead-Weight Loss Due to a Tariff



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