202.464.1982 1800 K Street NW

THE PENINSULA

South Korea Scrambles to Adjust to a Trump Economy

Published December 2, 2024

Author: William Brown

Category: South Korea

It is hard not to be sympathetic to South Korean President Yoon Suk-yeol as he tries to disentangle likely changes in US economic policies by the second Donald Trump administration. He, like dozens of his peers, is clamoring to come to Washington as soon as possible to influence decisions before they are set in stone. As a *Joongang Ilbo* editorial from November 7 states, it is “all-hands-on-deck for Korean policymakers.” Trump’s policy changes should not be a surprise. Trump has telegraphed changes to US trade and investment policies for at least a year, and polls speculating on the election’s outcome had been evenly divided.

At the top of Trump's economic priorities is the threat of widespread tariffs, as much as 10-20 percent on all US imports and much higher ones for China. A study by the Korea Institute for International Economic Policy (KIEP) suggests the highest rates would cause a loss of USD 22 to 42 billion in annual South Korean exports and a half point or more in GDP growth. Much is unknown, and the impacts may be lessened if the US dollar continues to climb on the possibility of smaller US trade deficits. South Korea is particularly vulnerable because its trade surplus with the United States has soared to record levels in the last two years, no doubt catching the attention of the incoming president. Trump has the delegated authority to raise tariffs by executive order, as he did in his first term and as President Joe Biden did more recently. However, Trump may seek congressional approvals to authorize more permanent tariff schedules—something that may prove more challenging. A big question, showing the early nature of these discussions, is whether such tariffs would be imposed on countries with free trade agreements (FTAs) with the United States, such as South Korea, Mexico, and Canada. If not, Korean exporters could be given an advantage because competitors in Japan and Taiwan are not under such an umbrella trade act. What seems most certain at this point is some increases in tariffs, which officials of the Trump administration will likely use as leverage to negotiate bilateral deals. South Korea should thus prepare for the possibility of renegotiating the Korea-US FTA (KORUS FTA).

The US Inflation Reduction Act (IRA) and the CHIPS and Science Act, which were constructed by the Biden administration, are likely targets of the incoming Trump administration. They were designed to boost domestic production, create new jobs, address climate change, and reduce US overreliance on China for critical materials and technologies. Facing Republican criticism for their contribution to the US sovereign debt and market intervention, the Trump administration will likely aim to redirect the trillion-dollar spending packages, if not dissolve them. However, the legislations were enacted by close votes in Congress, and much of the funds have already been allocated, so it will be hard—if not impossible—for the new administration to retract them entirely. Even Republicans like the money that is spent in their districts. All being said, the projects may be trimmed at the margins, movement toward electric cars may be slowed, and Korean firms with existing investments will have to show their agility, perhaps shifting to more profitable hybrid models. Trump plans to push a more decentralized approach to governance than we have seen in recent decades by moving decisions out of federal hands, but whether he will be successful is hard to predict. The federal government, in all its permutations, is hard to tamp down, as the new administration will no doubt discover yet again. And Congress, representing 435 local districts that each have different demands for federal or foreign assistance, especially when it comes to Korean chip or battery factories, will play a role.

Both large and small Korean firms, initially caught off guard by the quick passage of the IRA and CHIPS Act less than three years ago, have been among the most adept at positively reacting to them. Now, they must shift gears again, dealing with a changing set of rules and incentives. Korean firms have some key advantages, especially if the KORUS FTA holds up, but also many sunk costs. They often have the best technologies and an excellent knowledge of the US economy and politics. Whether they can be competitive, given the expensive strings attached to the projects, and make profits to sustain their operations is the biggest question. Subsidies, in whatever form, will not last forever.

The South Korean government should also figure out what is in the country's national interests, not necessarily the firms' best interests. Big Korean investments in the US industry, especially as domestic investment and GDP growth falters at home, may not make a lot of sense.

More problematic for President Yoon is the fact that both Republicans and Democrats have moved away from the liberalized trade regime that had been the cornerstone of US policy since World War II. The system focused on the General Agreement on Tariffs and Trade (GATT) and later the World Trade Organization's (WTO) guiding principle of nondiscrimination in trade, as laid out in the Most Favored Nation (MFN) concept. Each WTO member treated each other equally, although with exceptions—for instance, in reference to developing countries needing help with their exports. Tariff and non-tariff barriers were gradually knocked down, and no raises were allowed, which allowed for a one-way street to liberalization. The trade liberalization regime depended on a grand scheme in which countries did not demand strict tariff-to-tariff reciprocity: a country could charge much more in import tariffs than its partner, but it could not discriminate against that partner with lower tariffs for someone else. South Korea played such a role exceedingly well, gradually lowering tariffs as befits a rising economy while protecting key industries such as steel, automobiles, and agriculture and subsidizing new industries such as semiconductors.

Ironically, at the height of the success of the "Washington Consensus," with China and Russia joining in the early 2000s, the system began falling apart. Through neglect of the WTO's judicial and enforcement mechanisms, China's state monopolies and Russia's private oligarchs were able to take advantage and corrupt the system with their huge size and anti-competitive, socialist tendencies. It should be noted that the United States also shoulders much of the blame for this neglect.

FTAs, based on reciprocity and exclusivity—the opposite of nondiscrimination—further eroded the MFN concept and led to trade diversion, where investments were based on market access rather than comparative advantage. China, for instance, built an entire auto industry that was aided by a high tariff wall and willing foreign automakers, including Korean and American.

The new leadership in the White House and Congress think—and not without reason—that given this breakdown in the Washington Consensus, tighter boundaries that protect a more decentralized internal economy can benefit all Americans, not just the poor and rich. But tighter boundaries are not a model that the smaller Korean economy, built on trade, can reasonably adopt. We can expect Trump to favor the idea of reciprocity and deal one-on-one with trade partners rather than global non-discrimination agreements that take decades to negotiate.

President Yoon should try to reclaim the Washington Consensus for South Korea and a host of other smaller trading countries such as Taiwan, Singapore, Hong Kong, Vietnam, and maybe even Japan. The countries may be economic competitors, but all would gain from a restored and fortified WTO. Even the United States would ultimately benefit.

William B. Brown is interim Senior Advisor at the Korea Economic Institute of America and the principal of Northeast Asia Economics and Intelligence, Advisory LLC (NAEIA.com). The views expressed here are the author's alone.

Photo by Lee Jun Young from the official Flickr account of the Republic of Korea.

Shares