

**Dealing with Domestic Conflicts in FTA
Negotiations:
Lessons from the Korea-Chile FTA and NAFTA**

Se Young Ahn

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Executive Summary

Dealing with Domestic Conflicts in FTA Negotiations: Lessons from the Korea-Chile FTA and NAFTA

Se Young Ahn*

I. Introduction

As R. Strauss, who negotiated the Tokyo Round, stated, “*as a US ambassador of STR [Special Trade Representative], I spent as much time in negotiation with domestic constituents (US labor unions, industry, etc.) and the US congress as I did negotiate with our trading partners.*” The real obstacles in Free Trade Agreement (FTA) negotiations in the Asia-Pacific region are not the geopolitical, cultural, economic, and historical barriers existing in this region, but the domestic constraints, namely domestic conflicts, stemming from the fierce political reaction of “the losers” in FTA market opening.

As a matter of practice, we are now witnessing this kind of domestic conflict in FTA negotiations in the US-Korea deal. Korea’s recent experiences—Korea’s FTA negotiations with Chile and Japan—also reinforce this argument. The most significant constraint in FTA negotiations is not international negotiation between two governments, but domestic negotiation with various domestic constituencies, such as organized farmers and labor, the national assembly, NGOs, etc. The Korean and Chilean governments signed the FTA in February 2003. But this Korea-Chile FTA failed to be ratified by the Korean National Assembly three times due to tremendous political reactions from organized farmers. By the same token, the ratification of NAFTA in President Clinton’s administration was confronted by fierce political opposition

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coming from Congress, organized farmers and labor, and NGOs.

This paper aims to analyze the domestic conflicts that arise in FTA negotiations in the Asia-Pacific region, particularly focusing on four major countries: the US, Japan, China, and Korea. After examining the recent development of FTAs in the region and the theoretic framework of domestic conflicts in FTA negotiations in Chapter II, Chapter III presents a case study on the Korea-Chile FTA and NAFTA that provides some lessons from Korean and US experiences. Finally, Chapter IV highlights policy implications for effective economic integration in the Asia-Pacific region, particularly for the four major players.

II. Recent Development of FTAs in the Asia-Pacific Region and Domestic Politics of FTAs

1. Recent Development of FTAs in the Asia-Pacific Region

Traditionally, the US considered regionalism a stumbling block that discouraged the expansion of multilateral free trade. However, since the inauguration of NAFTA (1994), it has changed its stance and now considers FTAs as a building block that can create a synergy with the WTO's multilateralism. With this revised policy, the US is now pursuing upgrades to NAFTA¹⁾ and a FTAA (Free Trade Area of America), which includes 34 countries of Central and South America, as well as FTAs with a number of other countries.

The US has ratified FTAs with Israel, Jordan, Singapore, Chile, Australia, and Morocco. In addition, FTAs have been signed with five Central American Countries, the Dominican Republic, Thailand, and Bahrain and await congressional approval. FTA talks are currently in progress with the five members of SACU,²⁾ Colombia, Ecuador, Peru, and Panama. As a result, according to Schott's analysis,³⁾ current US trade with its FTA partners

1) J. Schott, S. C. Bradford, and T. Moll, "Negotiating the Korea-US FTA," International Institute of Economics (IIE) (2005), pp. 273-275.

2) Botswana, Lesotho, Namibia, South Africa, and Swaziland.

accounts for more than one-third of total US goods traded.

At the 14th Asia-Pacific Economic Cooperation (APEC) Leaders' Meeting in Vietnam in November 2006, US President George W. Bush called for a bold strategy for a trans-Pacific APEC-wide Free Trade Area as a long-term goal. This is an ambitious step by the US to encourage trans-Pacific economic integration and taken to respond to the rapidly changing geopolitical landscape of the region—an emerging “new regionalism in East Asia” and the rising Chinese economy.

As for the three big players of East Asia, even though Japan, China, and Korea are latecomers to the proliferation of FTAs in the world, they are currently actively pursuing them. China is rapidly transforming its trade policy from a previous one of focusing on accession to the WTO to one centered on FTAs.⁴⁾ Before entry into the WTO in 2003, China focused on fulfilling WTO accession conditions. However, since 2003, China has adopted an active FTA policy. Therefore, China concluded the CEPA (Closer Economic Partnership Arrangement) with Hong Kong (June 2003) and Macau (October 2003). Chinese Prime Minister Zhu Longzhi proposed the idea of a China-ASEAN FTA at the 2000 China-ASEAN Summit held in Singapore. Two years later, the China-ASEAN Basic Agreement was signed at the 2002 China-ASEAN summit held in Cambodia.

The two parties agreed to start tariff reductions in the trade of manufactured goods in July 2005 and to ultimately reduce tariffs to zero for most items by 2010 with the ASEAN 6 and by 2015 with the ASEAN 4 (Cambodia, Laos, Myanmar, and Vietnam). In addition, there are currently inter-governmental negotiations with a number of countries, including Chile, Pakistan and Australia, and joint-research with Korea.

Until the end of the 1990s, Japan held a negative view of FTAs because of a belief that FTA expansion had a negative impact on the world free trade system.⁵⁾ However, since 2000, Japan too has shifted its trade policy. It first

3) Schott, Bradford, and Moll.

4) S. G. Cao, “The development of FTA in East Asia and Chinese response,” paper presented at the 2002 International Forum on North East Asia Trade Policy Cooperation & Overseas Conference, Nanjing, China, organized by the Korean Association of Trade and Industry Studies, July 2002.

concluded an EPA (Economic Partner Agreement) with Singapore in 2002 and then signed FTAs with Mexico, the Philippines, and Thailand in 2005. Currently, inter-governmental negotiations with ASEAN and Malaysia are ongoing. Japan has also undertaken joint- research with China, and it plans to conclude an FTA with the ASEAN 6 by 2012 and with the ASEAN 4 by 2017.

Even though Korea is a latecomer to signing FTAs, it has been moving steadily towards economic integration with Chile (2004), Singapore,⁶⁾ and the European Free Trade Association (EFTA).⁷⁾ Currently Korea is negotiating FTAs with Canada, Mexico, and India. Korea and ASEAN agreed on an FTA in the trade of goods in April 2006 and are negotiating an FTA in the trade of services and investment. In addition, joint research with a number of countries and economic groupings, including China, the EU, and MERCOSUR, are currently underway. The most remarkable and in some sense surprising breakthrough of Korea's FTA policy is the opening of official negotiations between Korea and the US.⁸⁾

2. Theoretical Framework of Domestic Politics of FTAs

Putnam argues that FTA negotiations represent a kind of two-level game.⁹⁾ It is convenient to analytically divide FTA negotiations into two stages: The level I game is to bargain with foreign trade partners, leading to a tentative agreement—diplomacy; the level II game is to negotiate domestically with various groups of constituencies to persuade domestic constituencies to

5) Urata, S., "Japan's Strategy toward FTA", paper presented at a workshop for the Asia-Pacific Bilateralism in Berkeley, California, March 21-22, 2003.

6) Signed in August 2005 and effective in March 2006.

7) Signed in December 2005.

8) Negotiations began in June 2006 and are supposed to end by March 2007, just three months before the end of the US Trade Promotion Authority. For details of the US-Korea FTA, see S.Y. Ahn, "Domestic Politics of FTAs and Negotiation Strategy for Economic Integration in East Asia: The Korean Perspective," paper presented at the Asia-Pacific Economic Association Conference, University of Washington, Seattle, July 29-30, 2006.

9) R. Putnam, "The Diplomacy and Domestic Politics: The Logics of Two-Level Games," *International Organization*, 42, 3, Summer (1988), 435-436.

ratify the tentative agreement—domestic politics.

It is important to understand what circumstances affect the domestic politics of FTAs. Four factors are especially important in the Putnam model: the nature of negotiation issues, reaction of domestic constituencies, politicization of the issues, and political leadership.

First, the nature of negotiation issue is heterogeneous or homogeneous. When the interests of constituencies are relatively homogeneous, it is not so difficult for governments to conduct a level II game. That is, it is not so difficult to navigate through domestic politics. For example, if both the South and North Korean governments agreed to a peace treaty, the interests of both constituencies are very homogeneous (everybody welcomes it), so it is very easy for each government to ratify the peace treaty.¹⁰⁾

On the contrary, if the interests of constituencies are heterogeneous, domestic politics (level II game) becomes very complicated and difficult. Heterogeneous in this case means that some domestic groups win or benefit from the result of negotiations and other groups lose. The prime example is an FTA negotiation. An FTA means the wide opening of domestic markets. In this scenario it becomes inevitable that declining, import-competing industries will be seriously affected (injured) by the foreign imports of FTA partners. We call these kinds of industries “the losers.” However, internationally competitive industries benefit from the ability to penetrate the partners’ markets. They are “the winners.”

Second, the reaction of domestic constituencies is symmetric or asymmetric. This factor is related to the political reaction of constituencies based on two assumptions. The first assumption is the symmetry of political reaction. If all eligible constituencies participate in the level II game (losers and winners show a very similar political reaction), domestic politics are not so difficult to navigate for a government. Because even if the losers fiercely react politically against negotiations, the government will have the political support of the winners. In this sense, the winners play the role of “endorsement group” in domestic politics. The second assumption is the asymmetry of political reaction. When the costs of the proposed agreement are

10) K. Y. Lyu, “Study on the Korea-Japan FTA Negotiation through the Two-Level Game,” *Korea Trade Research*, 29 (2004), 35-58.

highly concentrated in specific domestic groups (losers), it is reasonable to expect that those constituents whose interests are most affected will exert a fierce political reaction in the level II game process.¹¹⁾

In the case of an FTA, it is likely that the costs are highly concentrated among the losers, while the benefits are spread among a large number of winners, for example, consumers. For this reason, the losers will show a strong political reaction whereas the winners tend to enjoy a “free ride” by handing off their political concerns. A prime example is the Korea-Chile FTA: when Korean grape cultivators and farmers’ associations fiercely reacted by arguing that the import of Chilean grapes would destroy their agricultural business. The winners (Korea’s electronic and automotive industries), on the other hand, did not participate actively in the level II game process by politically supporting the government. In this regard, they can be labeled as free riding on the FTA.

Third, the salience of domestic politics in the level II game also varies with the politicization of the issues. Politicization often activates politicians and groups who are less worried about the costs of negotiation issues.¹²⁾ Marginal groups like consumer groups and NGOs not belonging to either the winners or losers are persuaded to exercise political influence by allying with losing groups, consequently aggravating the level II game.

Finally, domestic politics are largely influenced by political leadership. When a government is vulnerable to or weak in the face of the political reaction of the losers, particularly when the government faces a coming election, it is difficult to expect strong political leadership in the level II game. Political leadership here means presidential political leadership. In the US the expression “Presidential Liberalism, Congressional Protectionism” is used. It means that generally in democratic states, the administrative body holds more liberal attitudes towards trade policy than the legislative body, which is more closely associated with advocating the economic interests of its electorate. Therefore, with respect to FTAs, political leadership refers to how a president exerts his or her political leadership against the political reaction of the losers and the legislature in the process of domestic ratification.

11) Putnam (1988).

12) J.Q. Wilson, *Political Organization* (New York: Basic Books, 1975).

III. Lessons from Korean and US Experiences

1. Domestic Conflicts in the Korea-Chile FTA¹³⁾

1) Analytical methods

To analyze the domestic politics of the Korea-Chile FTA, literature reviews, web searches, and surveys were conducted. First, various working papers and reports were collected and analyzed. These were produced by the Korea Institute for International Economic Policy (KIEP), the Korea Institute for Industrial Economics and Trade (KIET), Korea International Trade Association (KITA), and the Federation of Korea Industries. Data was also obtained from the Chilean Ministry of Agriculture and Forestry (www.minagri.gov.cl), and the Office of the United States Trade Representative (USTR). Regarding web research, the author used searched articles on the Korea-Chile FTA from major Korean newspapers using the Korean Integrated News Database System (KiNDS) internet portal site at www.kinds.or.kr. Furthermore, information on the FTA is cited from the websites of farmer associations, including *Junnong*, and NGOs, such as the Citizens' Coalition for Economic Justice, revealing very strong reactions against the FTA. The author also reviewed information from the websites of relevant government agencies, such as the Korean Ministry of Agriculture and Forestry and the Korean Ministry of Foreign Affairs and Trade, political parties, and individual politicians. Third, a survey was carried out on eleven groups of domestic constituencies, including farmers, business managers, white-collar workers, blue-collar workers, labor union leaders, college students, government officials, journalists, NGOs, consumers, and trade associations. The survey was carried out by mail, e-mail, and telephone and was conducted from June 2002 to August 2002; 525 valid responses from the questionnaires were used for analysis.

13) S.Y. Ahn, "Analysis on reaction of domestic constituents in FTA negotiation: the Case of Korea-Chile FTA," *Korea Trade Review*, 28 (2003), 55-79.

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2) Analysis on the four determinants of domestic politics in the process of the Korea-Chile FTA negotiations

a. Nature of negotiation context: very heterogeneous

The nature of the negotiating context in the Korea-Chile FTA was very heterogeneous. In the case of the Korea-Chile FTA, the losers were easily distinguished from the winners, who benefited from increases in production and exports. For example, the Korean automotive, electronics, and automotive parts (tires and batteries) industries, and microwave oven and textile producers were the major winners. They benefited by enhancing their market shares in Chile. On the other hand, the agricultural sector, such as fruit cultivating farmers, were the losers as they would be affected by increased imports from Chile. The most problematic item was grapes.

The dramatic surge of Chilean grapes into the Korean market could cause serious damage to Korean grape growers. Farmers argued that imports of Chilean grapes would increase by 66% due to tariff elimination on grapes and that this would result in devastation to the farmers.

b. Reaction of domestic constituencies: very asymmetric

The reactions from the winners and losers to the Korea-Chile FTA were highly asymmetric. In the process of governmental negotiations between Korea and Chile, approximately 22,000 farmers demonstrated in front of the National Assembly and the government complex building. There were various types of demonstrations, from attempts to enter the government complex building to burning flags.

The survey results were also clearly in accordance with these reactions. Among the eleven groups of respondents, farmers, blue-color workers, NGOs, consumers, and labor union leaders had the most negative reactions to the FTA while government officials, journalists, college students, and business managers showed the most positive attitudes.

However, business managers in the automotive and electronic industries (the winners) were not inclined to actively express their political support for the FTA. An important reason for the free riding of Korea conglomerates comes from the fact that they are extremely cautious and wary of becoming

openly involved in political issues, particularly in political debates with Korean NGOs, organized labor unions, and farmer organizations. These kinds of attitudes stem from the historical development of Korean conglomerates. The conglomerates are often criticized for having been excessively protected or supported by the Korean government at the expense of SMEs and labor.

These kinds of asymmetric political reactions of winners and losers can be explained by the breakdown cost and the compliance cost. The compliance costs of the Korea-Chile FTA, which Korean grape farmers (losers) had to pay, were expected to be so high as to represent a threat to the livelihood of those farmers. If negotiation breakdown costs for the winners were also high, the winners also would be expected to show active political support for the FTA. However, the breakdown cost for the automotive industry, which was to benefit the most, was not expected to be so high. The Korean automotive industry had exports worth \$13.3 billion (2001), but after the Korea-Chile FTA Korea's exports were expected to increase by only \$0.4 billion.

According to the empirical survey, farmers, blue-color workers, and NGOs held the most negative attitudes toward the FTA among the eleven groups of domestic constituencies surveyed: 59% of organized farmers, 38% of blue-color workers, and 37% of NGOs replied that they had very negative attitudes toward any Korean FTA.

On the other hand, the business community, government officials, and journalists showed the most positive attitudes towards FTAs: only 8% of journalists and government officials replied that they had negative attitudes towards any of Korea's FTAs.

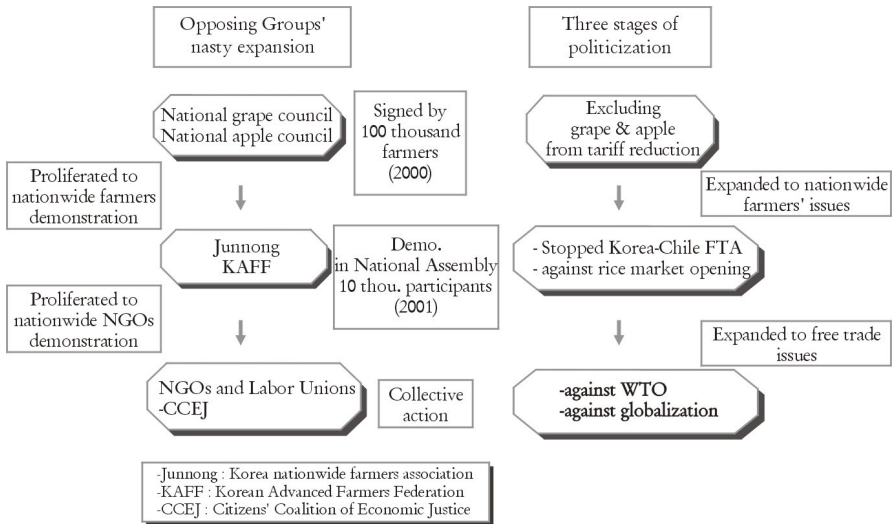
3) Politicization of FTA issues: excessively politically sensitive issue

The slogan for opposing the Korea-Chile FTA was "sacrifice of Korean farmers and benefit of Korean big business (conglomerates)!" In Korea, any government policy that may cause disadvantage to small- and medium-sized firms, labor unions, and farmers—those considered as socially weak—is highly likely to escalate to an excessively sensitive political issue. In this way the Korea-Chile FTA became a politically charged issue through three stages as seen in Figure 1.¹⁴⁾

In the first stage, the National Grape Council and National Apple Council insisted that grapes and apples must be excluded from the Korea-Chile FTA (tariff reduction) as sensitive items. However, the Korea-Chile FTA was not yet a political issue at this stage. In the next stage, the question of grapes and apples became a nationwide agricultural issue. The Korean Nationwide Farmers' Association (*Junnong*) and the Korean Advanced Farmers Federation (KAFF) argued that Korea must stop FTA negotiations and opposed the opening of the rice market. Gradually, the FTA issue became more and more a political issue based on the argument that the Korea-Chile FTA would destroy the whole Korean agricultural industry. In the last stage, NGOs and labor unions joined in the anti-FTA movement and, in turn the anti-FTA issue escalated into an anti-WTO and anti-globalization movement. What caused the level II game of the Korea-Chile FTA to worsen was politicians' intervention in domestic politics.

According to this analysis, Korean politicians with political bases in rural

Figure 1. The Three Stages of Politicization in the Korea-Chile FTA



14) See <http://www.nonghyup.com>, <http://www.kiep.go.kr>, <http://www.krei.re.kr>, <http://www.maf.go.kr>, <http://www.minagri.gob.cl>, and <http://www.mofat.go.kr>.

regions exercised a “strong political reaction” along with the loser groups whereas the party leaders of both opposition and ruling parties generally held a relatively “mild” or “reserved” standpoint.

4) Political leadership: weak presidential political leadership

In a democratic country, presidential political leadership can be effective only when the president and his or her administration deliver their intention to the general public through the mass media. During this period from the 1998 to July 2002 when the Korea-Chile FTA deal was in negotiations, former Korean president D.J. Kim mentioned the Korea-Chile FTA a total of four times, but never tried to emphasize a strong need for the FTA or to persuade the public. He just delivered the results from the APEC summit meeting, mentioning Korea would drive forward the FTA with Chile. It was a mere expression of intention to promote the FTA.

As Putnam points out, he only exercised a kind of “diplomatic leadership,” not real political leadership to persuade domestic constituencies. The president’s political leadership mentioned here means direct dialogue with opposing constituencies, such as farmers. It is highly likely that the president feared a political backlash from farmers, NGOs, and labor unions in the coming election.

2. Lessons from NAFTA

1) Domestic politics in NAFTA negotiations

NAFTA is a regional market opening agreement among the three countries of North America. The US, Canada, and Mexico agreed to slash all tariffs down to zero for 99% of their trade volume by 2003 and to remove almost all non-tariff barriers. Efforts in trade barrier removal were exerted all the way up to the long-standing strategic sectors that the three governments had historically declined to open or deregulate: energy and railroad industries in Mexico; culture industries, including publications, news media, and TV programming, in Canada.

Ironically, this kind of wide opening of mutual markets made NAFTA's domestic politics (level II game) very difficult, particularly in the US. As a matter of fact, the level I game (inter-governmental negotiations among the US, Canada, and Mexico) took only one year, starting in 1991 and ending in August 1992. The level II game (domestic politics) in Canada and Mexico was not so difficult: the two countries had almost completed the ratification process by the fall of 1993. However, the US faced fierce political opposition and resistance to the extent that there was a prevailing concern that President Clinton would fail to get NAFTA ratification in the US Congress.

The nature of NAFTA negotiations is heterogeneous. US organized labor and SMEs proclaimed themselves the serious losers in the US, and environmental organizations worried about the effects of NAFTA on the environment. These groups held that a massive production shift from the US to Mexico would take place that would eliminate a large number of jobs in labor-intensive industries in the US. In fact, the average wage per hour in the US was \$14.31 in 1991 whereas that in Mexico was only \$2.32 or less than one-sixth of that in the US. The presidential candidate Ross Perot, a typical NAFTA opponent, argued that 5.9 million jobs would move to Mexico in the extreme case due to NAFTA.

The AFL-CIO also argued that NAFTA must not be Free Trade but Fair Trade ("The North American *Fair* Trade Agreement"), and claimed that the most serious problem with NAFTA was "employment export."¹⁵⁾

Environmentalists worried about the dangerous spread of environmental pollution from Mexico to the US: polluted air and chemical waste produced in *maquiladoras* near the US border could pollute the El Paso region in Texas and the whole area of the Mexico Bay.¹⁶⁾

When it came to agriculture, which is traditionally presumed to be a very

15) The AFL-CIO and the United Automobile Workers viewed NAFTA as "an economic and social disaster for U.S. workers and their communities." In American Federation of Labor and Congress of Industrial Organizations, *U.S.-Mexico Free Trade: Exploring Both Sides*, Washington, D.C., February 1991.

16) U.S. Representative David Bonior (Democrat, MI) claimed that "Since NAFTA, factories have moved to Mexico to take advantage of cheap labor and lax environmental standards." In Bonior, "Slam the Brakes on Fast Track." Also see a report prepared by the National Safe Workplace Institute (1991).

sensitive deal-breaker in most FTA negotiations, US farmers' standpoint vis-à-vis NAFTA was delicate and not so definitive. US grain (particularly corn), oilseed, and beef producers were supposed to be losers whereas US fruit and vegetable producers were considered winners.

US big business and multinationals were also viewed as winners who would benefit from an increase in their exports to Mexico, especially in capital—and technology—intensive industries. With regard to the political reaction of constituencies, the losers, NGOs, and environmental groups organized the anti-NAFTA front and demonstrated fiercely against NAFTA. Political tension escalated rapidly between anti-NAFTA groups and pro-NAFTA groups in the US. However, contrary to the Korean experience in its FTA with Chile, the US winners were not silent. They took very active steps in supporting the government's effort to ratify NAFTA.

The financial institutions and conglomerates established the Business Roundtable to organize a pro-NAFTA frontline and raise funds for publicity. Their support activities did not end there. They sent a clear political message to US congressmen that they would give more political contributions to the pro-NAFTA congressmen than the anti-NAFTA congressmen through the PACs (Political Action Committees). In the end, 33.2% of contributions from US business PACs was given to pro-NAFTA Democrats compared to 25.7% for anti-NAFTA Democrats. On the Republican side, 34.7% went to pro-NAFTA Republicans versus 26.8% for the anti-NAFTA Republicans.¹⁷⁾

Significant support came from US academia. Twelve US Nobel Prize-winning economists gave public support to NAFTA through a letter to President Clinton. The letter, edited by MIT professor Rudiger Dornbusch, stated:

“Dear Mr. President, ... While we may not agree on the precise impact of NAFTA, we do concur that the agreement will be a net positive for the United States.... Specifically, the assertions that NAFTA will spur an exodus of U.S. Jobs to Mexico are without basis...”

17) L. Mishell, and R.A. Teixeira, “The Political Arithmetic of the NAFTA Vote,” Economic Policy Institute, Washington DC, November 1993.

These US economists asserted that NAFTA would enable the US to enhance its international competitiveness as well as the welfare of American people by reorganizing US labor-market and industrial structure. For example, increased demand from Mexico would create 170,000 jobs in the US.

NAFTA proponents argued that NAFTA's trade creation effect and job creation would exceed its trade diversion effect and job losses.¹⁸⁾ In this sense, the political reaction of US constituencies to NAFTA was not as asymmetric as that of the Korean constituencies.

However, the negotiation and ratification of NAFTA became a politically charged issue as it did in the Korean case. The anti-NAFTA campaign created a unique image of NAFTA: NAFTA is good only for big multinational corporations and high-income brackets at the expense of mid- and low-income Americans suffering from job losses, lower wages, and dangerous working environments.

As for politicians, both Democrats and Republicans were very vocal about NAFTA to politically capitalize on their positions in elections. The difficulty for President Clinton was that his ruling Democratic Party was largely against NAFTA because US Democratic support traditionally came from the NAFTA losers: SMEs, mid- and low-income Americans, labor unions, etc. As a consequence, domestic conflicts drove President Clinton into a corner in the level II game.

2) The Clinton administration strategy

The strong political leadership of President Clinton along with a very effective and comprehensive policy package enabled the ratification of NAFTA despite the difficulties in domestic politics.¹⁹⁾ The Clinton administration's strategies can be summarized as follows.

First, President Clinton and his administration made every effort to convince the American public by repeatedly emphasizing how the US and the

18) They recognized the anti-NAFTA argument regarding the negative effects on US jobs and trade balance: NAFTA would shift some US jobs to Mexico and enable Mexico and Canada to export more products to the US.

19) Effective since January 1, 1994.

American people would benefit from NAFTA. Vice President Gore took a risk by holding a debate with Ross Perot on CNN. These efforts had a tremendous positive impact on public opinion. The President made the Department of Commerce, US Treasury, Department of Labor, and the Presidential Economic Advisor responsible for publicizing the benefits of NAFTA and the so-called “USA NAFTA Team” was organized in the White House as the headquarters for public relations activities. Publicity was conducted at the national and grass-roots levels.

The second strategy was to listen to the anti-NAFTA voices and to reach a compromise in negotiations—to accommodate anti-NAFTA claims and sometimes compromise. As a consequence of this effort, some NAFTA clauses related to the environment and labor markets were revised as long as they did not impair the basic principle of the original NAFTA agreement. For example, the US, Canada, and Mexico agreed to establish special organizations in an effort to strengthen environmental protection: the Commission for Environmental Cooperation (CEC) and the Border Environment Cooperation Commission (BECC).²⁰⁾

The Clinton administration’s third strategy was to seek a political solution through active lobbying and political deal making with Congress members. To this end, the “NAFTA A-team” was established in the White House. Key members of this A-team, including Treasury Secretary Bentsen, former USTR Ambassador Kantor, and Commerce Secretary Daley, lobbied Congress members. This political deal making and lobbying was focused on the senators and congressmen from states where NAFTA was expected to have direct effects, such as California, Florida, Texas, etc.

In this regard, President Clinton stood at the forefront of important political deals with anti-NAFTA congress members. To illustrate, he agreed to create the North American Development Bank (NADB) to support BECC projects in an effort to get political support from Democratic congressman Esteban Torres of California.²¹⁾

As a result of President Clinton’s political leadership, the US Congress

20) See <http://www.ustr.gov/naftareport/fastering.htm>.

21) U.S. Department of Commerce, “NAFTA 5 Years Report—Fostering Higher Wage Jobs” at <http://www.ustr.gov/naftareport/fastering.htm>.

passed the NAFTA bill by 234 votes to 200 on November 17, 1993. In the Senate, NAFTA was passed with the support of 61 votes in favor and 38 against. Ratification in the Senate was easier than in the House of Representatives.

IV. Policy Implications

In reality, there are many existing obstacles and barriers to economic integration in the Asia-Pacific region: huge gaps in economic development and economic scale, differences in domestic political systems and industrial structure, cultural disparities, etc. Therefore, it is very difficult to determine and suggest common policies suitable to all the countries of the Asia-Pacific region, from the US and Japan to poor and authoritarian Myanmar. Therefore, based on the results of the case study on the Korea-Chile FTA and NAFTA, this chapter cautiously highlights some policy implications for the future direction of FTA policies in the region with a particular focus on the four major players—the US, Japan, China, and Korea.

By examining Putnam's four determinants of domestic politics, we can see that serious domestic conflict is expected in a level II game when it comes to FTAs in the Asia-Pacific region. As this study points out, this is because all four of Putnam's determinants are likely to run counter to the smooth creation of FTAs. Therefore, each government must give equal importance to the level I and level II games when pursuing FTAs. This means that persuading opposing domestic constituencies is as important as negotiating with the trading partner.

However, we must note that even in the Asia-Pacific region, domestic conflicts surrounding FTAs vary by country and according to their political system and industrial structure, etc. Such domestic conflicts are more visible in the democratic US, Japan, and Korea than in such one-party systems as China because in democratic states, politicians and legislative bodies advocate the economic interests of the electorate as seen in the case study of the Korea-Chile FTA and NAFTA.

Japan's long-term ruling Liberal Democratic Party (LDP) has its traditional

political basis in rural areas. There are a number of so-called “Agrarian Groups” among LDP members. They are particularly sensitive and responsive to the interests of their farmer electorates and, therefore, resist any market opening that may potentially harm them.

In Korea, the administration of President Roh Moo-Hyun has been reluctant to adopt any policy agenda that may harm labor and farmers, who are considered socially weak. US FTA policy is also largely framed by US business lobbying and congressional pressure. Therefore, the potential losers in an FTA are likely to have significant political clout in these three countries, making a level II game extremely difficult.

The case of China, however, is much different. The Chinese government is substantially free, at least thus far, from domestic conflict in the pursuit of FTAs because of the weak political voice of domestic constituencies.

However, it is important to note that even in the US, Korea, Japan, and China, not all FTAs face serious domestic conflicts. For example, Korea’s FTA with Singapore and EFTA did not experience any serious domestic conflict since these kinds of FTAs did not create definitive winners and losers in the Korean economy, and as a result the FTAs were not politicized (politicization being another of Putnam’s four determinants).

The second political implication is that political leadership is also a crucial factor for the success of FTAs in the region. As mentioned in the case of NAFTA, the success of FTAs requires above all strong political leadership to build a national consensus on the FTA and to overcome political resistance.

In the US, the expression “Presidential Liberalism, Congressional Protectionism” is used. Here, what is meant by political leadership is the leadership of presidents and prime ministers rather than that of politicians in the legislature.²²⁾

As discussed in Chapter III, during the process of NAFTA ratification, President Clinton faced the challenge of fierce political reactions from the traditional political supporters of the ruling Democratic Party, such as labor unions, the middle class, environmentalists, and religious and consumer groups (NGOs). Therefore, it was predicted that Clinton would fail to achieve

22) They are obliged to advocate the economic interests of their electorate as seen in the NAFTA case.

congressional ratification for NAFTA. Contrary to expectations, President Clinton successfully steered the passage of the NAFTA Bill by showing outstanding political leadership.

The role of political leadership can be summarized as follows. First, political leaders exert great effort in convincing the public of the broad benefits of the FTA, thereby enabling the government to override political opposition coming from loser groups. Second, political leaders seek political solutions through active lobbying and political deal making with members of the legislature. This political deal making and lobbying was focused on the legislative members from regions where the FTA was expected to have direct adverse effects.

Third, political leadership in FTAs also refers to international leadership to build mutual trust and understanding among the Asia-Pacific countries. The rapidly changing geopolitical landscape in the Asia-Pacific region, including the rising Chinese economy and new regionalism,²³⁾ has triggered an escalating hegemony game among Japan (the traditional economic leader), China (the emerging challenger), and the US, which does not want to see “an Asia-only regionalism” that excludes US participation.²⁴⁾

If all the economic powers—Japan, China, and the US—engage in a hegemony game to maximize their own national interests, they will be unable to reach a trade pact in the near future. They need to learn the lessons from the great reconciliation of former adversaries in Europe—Germany and France—that led to the creation of the EU. The big players in the Asia-Pacific region have to show international political leadership by making concessions, if necessary, at the negotiation table to eventually create the APEC-wide Free Trade Area proposed by US President Bush at the 2006 APEC Summit Meeting in Vietnam.

Forth, WTO-consistent “mid-level FTAs” are advisable as the second-best option for FTAs among the US, Japan, Korea, and China where strong domestic opposition to market opening is expected. In this regard, it is worth

23) F. Bergsten and the International Institute of Economics, “The US and the World Economy: Foreign Economic Policy for the Next Decade,” *IIE* (2005), pp. 3-12.

24) Se Young Ahn, “Geopolitical Implications of the US-Korea FTA”, Hawaii, working paper at the East-West Center, December 2006.

introducing the three categories of FTAs: high-level FTAs, mid-level FTAs, and low-level FTAs.

High-level FTAs represent deep economic integration of the Asia-Pacific countries with maximum effect. In fact, most of the governments involved in FTA negotiations have officially stated that they are pursuing this kind of high-quality FTA. This deep integration is also highly recommended in theoretical arguments. However, as the fierce domestic conflicts in the Korea-Chile FTA and the NAFTA cases show, if the US and Korea, for example, pursue a high-level FTA aimed at almost complete opening of mutual markets, they will not be able to stand against the fierce political reactions of the losers.

Regarding FTAs, all major trading countries in the Asia-Pacific region have their potential weak points, such as agricultural market opening, collapse of SMEs, and massive unemployment. Considering the difficult domestic politics, concluding so-called low-level FTAs that exclude “most of” the politically sensitive items might be a good alternative. If negotiators from the four major countries agree to exclude most of the sensitive items from FTAs, they would be better off concluding low-level FTAs.

However, the FTAs in the region must be negotiated within the framework of WTO jurisprudence. This kind of low-level FTA would violate GATT/WTO rules. GATT XXIV-8 insists that the exceptionality of regional trade agreements from “The Principle of the Most Favored Nation” dictated in GATT Article I should be recognized, but, in return, duties and other restrictive regulations of commerce must be eliminated on “substantially all the trade” between its signatories.²⁵⁾

If neither high-level nor low-level FTAs are possible, the only remaining feasible alternative is to have a mid-level FTA that allows the negotiating countries to exclude “significant items”²⁶⁾ from the FTA as long as this

25) A free-trade area here is a group of two or more customs territories in which the duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, and XX) are eliminated on substantially all the trade between the constituent territories in products originating in such territories.

26) Under this mid-level FTA, a good part of sensitive items would be excluded from the FTA.

“significant exception” is not against the GATT/WTO bottom line, particularly GATT XXIV-8.²⁷⁾

This proposal for mid-level FTAs is likely to ignite debate among scholars and trade experts in the Asia-Pacific region. Their argument will be focused on the very narrow effects of the FTA. Mid-level FTAs would be able to nullify a large part of the FTA by excluding many sensitive items.

In discussing the FTAs in the Asia-Pacific region, we must take into consideration the inevitable trade-offs between their feasibility and their economic and geopolitical effects. The effects of the FTAs are so significant that the four major countries are far better off concluding a mid-level FTA rather than consuming excessive time and energy pursuing a high-level FTA seeking deep integration. In this sense, we must learn the lessons from the European experience. The process of deep economic integration was very lengthy before reaching the final incarnation of the EU in 1992. The lengthy process of gradual integration, EEC(1958)- ECM-EC-EU, took approximately four decades.

Finally, the effective policies aimed at establishing sustainable and comprehensive domestic foundations for the losers would enable governments to enhance their ability to persuade domestic interest groups. As evident in the strategies of the Clinton administration which listened to anti-NAFTA voices and, in many cases, accommodated their claims, the level I game (inter-

27) The GATT XXIV-8 for the purposes of this agreement:

- (a) A customs union shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that (i) duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated with respect to substantially all the trade between the constituent territories of the union or at least with respect to substantially all the trade in products originating in such territories, and (ii) subject to the provisions of paragraph 9, substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union;
- (b) A free-trade area shall be understood to mean a group of two or more customs territories in which the duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, and XX) are eliminated on substantially all the trade between the constituent territories in products originating in such territories.

governmental negotiation) cannot move forward effectively without this kind of comprehensive domestic program to address the concerns of anti-FTA groups and losers. A prime example of this is the US TAAA (Trade Adjustment Assistant Act). This TAAA, created by President Kennedy in the 1960s and reinforced in 2002, significantly alleviated domestic conflict over FTA negotiations. Bergsten argues that the US spends only \$1 billion to \$2 billion annually to directly address the cost of adjusting to market opening, suggesting that the US budget for the TAAA should be increased up to the extent that it would enable national support of the FTA at the level II game.²⁸⁾ The Korean TAA bill was also put into operation in 2006, but its legal coverage is essentially limited to the manufacturing sectors. If Korea wants to effectively reach FTAs with its major trading partners (including the 2006-2007 US-Korea FTA deal), Korea must adopt comprehensive domestic programs covering not only the manufacturing sector, but also the service and agricultural sectors. These programs must include not only direct monetary subsidies and compensation but also effective training to relocate laid-off labor.

V. Concluding Remarks

This paper presents a case study of the US-Korea FTA and NAFTA and points out that the most significant barriers to the creation of FTAs in the Asia-Pacific region, particularly among the four major players—the US, Japan, China, and Korea—are domestic rather than external constraints. To effectively address these difficult domestic conflicts, this research suggests four policies: strong political leadership, international leadership, pursuit of mid-level FTAs, and sustainable and comprehensive domestic support for the losers. The most important policy recommendation, however, is the pursuit of mid-level FTAs. A mid-level FTA is highly recommended for the 2006-2007 US-Korea FTA negotiations.

What would happen if the US and Korea successfully concluded the deal in the form of a mid-level FTA? It could act as an icebreaker for economic

28) Bergsten, pp. 38-42.

integration in the region as a whole. After the successful conclusion of a US-Korea FTA, competitive liberalization²⁹⁾ might prevail in the region. The US-Korea FTA would create new incentives and pressures for other countries in the region to join the proliferation of FTAs. It would be Japan and China who move first toward Korea to reach an FTA because the US-Korea FTA would negatively affect both Japan and China through a trade diversion effect. Substantial Chinese agricultural exports and Japanese manufacturing exports to Korea would be diverted due to US exports after the US-Korea FTA. Therefore, the initial US-Korea mid-level FTA might lead to the proliferation of FTAs among the four major countries and enable Korea to become an FTA hub country in the region, eventually moving towards the APEC-wide Free Trade Area that US President George W. Bush proposed at the APEC Leaders' Meeting in Vietnam in November 2006.

Finally, the research and recommendations presented in this paper have some limitations that need mentioning. The concept of a mid-level FTA is not yet clearly defined and needs further clarification. The definition of a mid-level FTA is closely related to the concept of "substantially all the trade" stipulated in GATT XXIV-8. However, the exact concept and meaning of "substantially all the trade" have not been clearly defined among WTO member countries. Some countries want to interpret it in a broader sense; other countries want to confine its meaning to very strict boundaries. In addition, this paper makes policy recommendations for effective FTA negotiations in the Asia-Pacific region based on only two case studies. More case studies are required to test the applicability of policy recommendations presented here and build on the results of this paper.

29) The basic direction of US FTA policy, as Zoellick and Bergsten point out, is the concept of "competitive liberalization," under which US negotiations with trading partners create new incentives and pressures for nonparticipating countries to join the process.

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Executive Summary

Even though the US, Japan, Korea, and China were latecomers to the global proliferation of FTAs, they are currently aggressively pursuing FTAs. There are, however, many obstacles and barriers to economic integration in the Asia-Pacific region, including huge gaps in economic development and economic scale, differences in domestic political systems and industrial structure, cultural disparities, etc. As is evident from the fierce political opposition to and reactions against the US-Korea FTA negotiations, the real obstacles to FTAs in the Asia-Pacific region are not geopolitical, cultural, economic or historical, but rather domestic, namely, domestic conflicts stemming from the fierce political reaction of “the losers.”

Therefore, this paper analyzes the domestic conflicts that arise in FTA negotiations in the Asia-Pacific region. The paper introduces Putnam’s “two-level game model” as a theoretic framework for domestic conflict in FTA negotiations and presents two case studies: the Korea-Chile FTA and NAFTA. It then draws lessons from the Korean and US experiences. The results of the Korea-Chile FTA case study indicate that Putnam’s four determinants run counter to the smooth creation of an FTA, making a level II game extremely difficult. These determinants are: the heterogeneous nature of the FTA negotiation context (creation of winners and losers in a national economy); asymmetric political reactions (free-riding winners and fiercely opposing losers); excessively sensitive political FTA issues; and weak political leadership. The lessons from NAFTA highlight the particular importance of political leadership in concluding FTAs. As President Clinton’s leadership in the NAFTA ratification process shows, effective political leadership can overcome political resistance and lead to a national consensus on an FTA that allows its successful conclusion.

This paper suggests four policies for the three major Northeast Asian countries and the US that effectively address domestic conflicts arising from FTAs: strong political leadership, international leadership of the big three (the US, Japan, and China) that are engaged in a hegemony game, pursuit of mid-level FTAs, and sustainable and comprehensive domestic foundations addressing the concerns of the losers. The most important policy recommendation, however, is to pursue mid-level FTAs as the second-best option among the US, Japan, China, and Korea—where strong domestic opposition to market opening is expected. Finally this study suggests that successful conclusion of the 2006-2007 US-Korea FTA negotiations in the form of a mid-level FTA would encourage competitive liberalization in the

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region that could facilitate the Japan-Korea FTA and the China-Korea FTA as well as the US-Japan FTA. This proliferation of FTAs among the four major countries would act as an icebreaker for the effective economic integration in the Asia-Pacific region, eventually moving towards a APEC-wide Free Trade Area proposed by US President Bush at the 2006 APEC Summit Meeting.