



Why the Korea-United States Free Trade Agreement is a Big Deal

Jeffrey J. Schott

Four years after the historic signing of the Korea-United States Free Trade Agreement (KORUS FTA), the Korean National Assembly and the United States Congress are finally completing legislation that will allow the FTA to enter into force by 2012. The delay has been costly; both sides have foregone substantial benefits that would have already been accrued from early adoption of the reforms mandated in the agreement. Despite the lost opportunities in the four years since the trade pact was signed, however, the economic value of the deal remains substantial, in both economic and political terms. This is why President Lee Myung-bak and President Barack Obama worked hard to negotiate a supplemental agreement in December 2010 that should help overcome the major political obstacles to ratification.

The KORUS FTA is a big deal in many respects. By the usual metric for assessing trade pacts, it covers more bilateral trade in goods and services—more than \$100 billion in two-way trade in 2010—than any US trade pact since the North American Free Trade Agreement (NAFTA). It was also the largest venture engaged in by Korea until the comparable FTA with the European Union was completed and implemented on July 1, 2011. Those standards, however, fail to assess the broader economic value of the trade pact in terms of spurring economic growth, promoting deeper cooperation on both economic and political matters, and catalyzing regional economic in-

tegration.

In short, the KORUS FTA is a big deal because of what it achieves in terms of trade liberalization, what it demonstrates with regard to the strong and enduring alliance between the partner countries, and what it establishes in terms of setting a world standard for the content and coverage of a free trade pact. This short paper examines these key points.

By way of introduction, it is instructive to recall the origins of the KORUS FTA, an improbable venture only a decade ago. To be sure, a bilateral FTA had been vetted in the late 1980s as a possible response to the Canada-US FTA signed in January 1988 but no serious talks were held; both countries placed priority on multilateral trade negotiations (MTNs) in Geneva and neither had much stomach for bilateral initiatives after the sharp backlash against NAFTA in the late 1990s.

However, the real driver of the trade initiative for Korea was not to emulate other US trading partners but to propel Korean productivity gains and economic growth. In 2000, then Trade Minister Han Duk-soo recognized that the Korean economy needed a “wake up” call; he believed that Korean industry and farmers required a jolt of competition from foreign suppliers and foreign investors in the Korean market if the country was going to keep pace with its rapidly growing neighbor, China, and fulfill

its ambition to become the economic and financial hub of northeast Asia. To that end, he encouraged Dr. Choi Inbom and me to analyze the economic benefits and political obstacles to launching bilateral FTA talks.¹ His charge to study the potential for free trade talks was politically courageous, since in 2000 most segments of the Korean economy vigorously opposed any hint of trade and investment liberalization. Korean farmers in particular were well sheltered behind thick walls of tariffs and quotas and protected politically by a large majority of National Assemblymen.

After careful study of the costs and benefits of pursuing a bilateral FTA, Korean officials concluded that a trade pact with its then leading trading partner would allow them to take the hard decisions to liberalize trade and investment that were needed to spur greater productivity and innovation by Korean companies, workers, and farmers. By “locking in” those policy reforms through international trade obligations, the pact would provide greater policy predictability and give both domestic and foreign firms greater security in planning their business strategies and pursuing new investments in the Korean economy. To be sure, foreign investors would create more competition for Korean firms but they would also provide benefits to the Korean economy by transferring their technologies and management practices.

Han Duk-soo’s vision proved prescient. Though it took several years for Korea to accept the challenge of economic reform, and several years for US officials to recognize that those courageous policy changes created new opportunities for bilateral cooperation, intensive bilateral consultations on what should be included in a

prospective deal began in late 2004. Soon after, the two countries concluded that a comprehensive trade pact could yield substantial benefits and could be crafted to accommodate the most sensitive political concerns of each country. A deal was struck in April 2007, and was revised the following month to incorporate provisions on labor and the environment demanded by congressional Democrats, who had gained control of Congress in the 2006 election. The deal was signed on June 30, 2007. Because the FTA was signed the day before the expiration of US trade promotion authority, the agreement still qualifies for “fast track” procedures for congressional consideration for implementing legislation.

A BIG DEAL IN SEVERAL RESPECTS

In terms of the coverage, depth, and scope of its liberalization, the KORUS FTA is a big deal. The KORUS FTA is a comprehensive agreement covering substantially all trade in goods, services, and agriculture. The only major product excluded from the trade reforms is rice; other sensitive agricultural products are subject to at least partial liberalization over a transition period. Most barriers to major Korean exports to the United States are eliminated within five years. Importantly, the FTA contains substantial obligations with regard to investment policies, intellectual property, and services liberalization in key sectors like insurance, finance and express delivery, and labor and environmental policies, among others.

Relative to other FTAs concluded in recent years, the prospective trade and GDP gains are notable. The US International Trade Commission estimated in 2007 that US merchandise ex-

¹ Choi, Inbom, and Jeffrey J. Schott. 2001. “Free Trade between Korea and the United States?” Washington: Institute for International Economics.

ports to Korea would increase by \$9.7–\$10.9 billion and US merchandise imports from Korea would increase by about \$6.4–6.9 billion, generating US GDP gains in the range of \$10.1 and \$11.9 billion.² In mercantilist terms, Korea commits to larger tariff cuts than the United States for the simple reason that Korean barriers are higher across the board. On that metric, US exporters gain relatively more access than Korean exporters. However, because it undertakes broader reforms of its own policies, Korea has relatively higher welfare gains. Recent analysis by Schott, Choi, and Gilbert reports Korean GDP gains from the KORUS FTA would be in the range of 0.2 to 6 percent,³ very similar to the GDP gains of 0.32 to 5.97 percent projected by KIEP.⁴

Second, the KORUS FTA sends important signals about the commitment of each country to the bilateral alliance and the commitment of the United States to remain fully engaged, both economically and politically, in the East Asian region. Recent provocative actions by North Korea underscore the importance of a strong and durable alliance between the United States and South Korea. When the autocratic North Korean regime tests nuclear devices, launches missiles, and fires at civilian settlements, it is important to demonstrate the solidarity of the US and South Korean people; the KORUS FTA provides a clear manifestation of our enduring partnership. This is why the eventual ratification of the deal has never been in doubt despite the long period of legislative inaction; neither

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² United States International Trade Commission (USITC). 2007. US-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects. USITC Publication 3949. Washington DC: US ITC.

³ Schott, Jeffrey J., Inbom Choi, and John Gilbert. 2011. "Competitive Regionalism: US and European Trade Pacts with Korea." Washington: Peterson Institute for International Economics, forthcoming.

⁴ Korea Institute for International Economic Policy (KIEP). 2007. "A Sectoral Assessment of a Korea US FTA and Policy Implications for the Korean Economy." Seoul: KIEP.

country would let disputes over a few provisions in a major trade agreement create friction in a strategically important bilateral alliance. The KORUS FTA is a big deal in geo-political and strategic terms.

Finally, the KORUS FTA is a big deal because it sets substantial precedents for major trade pacts negotiated all over the world. By most standards, the KORUS FTA is considered “state of the art” because of its comprehensive scope and detailed rights and obligations. No wonder that when the European Union and Korea began their bilateral talks in 2007, they used the KORUS FTA as their initial negotiating text. The KORUS FTA is also an important model for economic integration in the Asia-Pacific region, which effectively represents more than half of global output. Large portions of the pact are now being tabled by the United States as a draft text for the nascent Trans-Pacific Partnership (TPP) trade agreement. Several TPP participants already have or are currently negotiating bilateral trade pacts with Korea; the adoption of KORUS FTA type disciplines in the TPP agreement should facilitate the early participation of Korea in this broad regional compact.

WHY HAS IMPLEMENTATION OF THE KORUS FTA BEEN DELAYED?

If the deal was signed four years ago, why is ratification still pending in 2011? In retrospect, officials in both countries were guilty of excessive caution and timidity in addressing the concerns of domestic political constituencies whose support was needed to secure implementing legislation.

The initial obstacle involved US beef exports to Korea. Shipments had been blocked since December 2003 due to legitimate concerns about

evidence of bovine spongiform encephalopathy (BSE) or “mad cow” disease in the United States. Senator Max Baucus, Chairman of the powerful Finance Committee and champion of US beef interests, threatened to oppose the KORUS FTA unless the beef trade was liberalized. When the World Organization for Animal Health (OIE) reclassified the United States as a “controlled risk” country for BSE in May 2007, US officials argued that the food safety problem had been substantially resolved and remaining beef trade restrictions should be removed. Unfortunately, a series of incidents in which US shipments contained bone fragments led Korean authorities to resist full implementation of the OIE guidance.

By the time the two countries finally agreed on a deal covering most US beef shipments in June 2008, after an initial deal two months earlier collapsed amid massive public protests in Korea, the political window for moving legislation forward in the US Congress had all but closed. When the financial crisis broke out in September 2008, triggering a deep US and global recession, any prospective action on pending trade agreements with Korea, Colombia, and Panama, was put aside. US GDP plummeted 5.4 percent in the fourth quarter of 2008 and a further 6.4 percent at the start of 2009. Few US politicians wanted to talk about trade pacts that would contribute to the already massive churning and job dislocation in the US market. Running on a platform critical and skeptical of trade agreements, the Democrats won a large victory in the November 2008 election, winning both the White House and a substantial majority in both houses of Congress.

The second, and more important obstacle to US ratification, has been concerns about the auto provisions in the KORUS FTA voiced primarily by Ford, Chrysler, the United Auto Workers union, and their congressional repre-

sentatives. Indeed, the day before the pact was signed in 2007, key Democratic leaders in Congress warned that they would not consider implementing legislation for the KORUS FTA until the auto chapter was revised. President Obama echoed these concerns when he took office. Given the prospective bankruptcy of General Motors and Chrysler, and the massive job loss in the US auto sector, moving forward on the KORUS FTA with the auto industry in such dire straits would have been political folly. Instead, Obama rescued the firms through federal investment and subsidy and saved tens of thousands of jobs.

In retrospect, saving Detroit also rescued the KORUS FTA. The trade pact was basically shelved until the auto sector recovered in 2010. At that point, Obama was then able to revisit the trade deal with political IOUs in his pocket from US auto firms and workers that gave him more flexibility in crafting a supplementary deal that could be sold in both capitals. At their historic meeting before the Toronto G-20 summit in June 2010, President Obama and President Lee Myung-bak agreed to resolve outstanding problems with the KORUS FTA by the G-20 meeting in Seoul in November 2010.

Both sides wanted a deal and both misinterpreted the signals from the other on what the deal had to include. The Korean side thought that the original text would not be reopened but that supplementary obligations would be appended to the FTA; the US side thought that revisions had to be made in the terms of the auto deal and that Korea would add firm commitments on fully opening beef trade. The result: neither side was prepared to cut a deal in Seoul in November 2010. But the political will to do so remained, and three weeks later, the trade ministers shook hands on a supplementary deal that made changes to the auto provisions in the KORUS FTA and did not deal with beef.

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To his credit, President Obama did not subscribe to the managed trade proposals by congressional Democrats demanding balanced trade in autos. Asking Koreans to buy US cars in the same amount as Korea sells to the United States makes as much sense as asking US consumers to buy as much Korean food as Koreans buy from US farmers and ranchers! Instead, US trade negotiators focused on ensuring that US exporters faced a “level playing field” when competing for sales in the Korean market by targeting discriminatory nontariff barriers—e.g, discriminatory tax policies and fuel, emission, and safety standards—that have impeded import and distribution of foreign cars in Korea.

In a PIIE policy brief, I summarized the auto results as follows:

“Most of the auto changes focus on protecting the US market from imported automobiles for a few extra years. What this likely means for US companies and workers is less pressure from Korean imports and more competition from Korean cars produced in US plants. The new pact also rectifies several problems regarding Korean regulatory policies that had not been fully remedied in the original agreement. Combining the regulatory reforms and the Korean tariff cuts, US exporters should be able to sell more cars to Korea—though they will no longer benefit from immediate elimination of the Korean car tariff and they will now face tougher competition from European firms benefiting from the EU-Korea FTA.”⁵

Overall, the December 2010 supplementary deal made it somewhat easier for US exporters to sell cars in Korea while not affecting Korean access

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⁵Schott, Jeffrey J. 2010. “KORUS FTA 2.0: Assessing the Changes.” Policy Brief 2010:28. Washington: Peterson Institute for International Economics, December.

to the US market to any great extent. However, the changes in the balance of US and Korean concessions, in conjunction with the earlier Obama administration support for US auto-makers and autoworkers, had a notable effect on trade politics in the United States. Because of the December 2010 deal, the KORUS FTA attracted bipartisan support; key Democratic lawmakers, including then Ways and Means chairman Sander Levin, applauded the deal, as did the United Auto Workers and other unions (though not the AFL-CIO or Teamsters' union). They recognized that, in light of the substantial Republican victory in the 2010 mid-term election which gave that party a large majority in the House of Representatives, the Obama-Lee compromise was the best deal they could expect.

The new Republican leadership in Congress then added one final complication to the KORUS FTA ratification debate. Support by the Democrats for KORUS did not carry over to the other two pending FTAs, so the Republican leadership called for votes on all three pacts as a package to ensure that the Democrats would not delay implementation of the other pacts (which were signed before the KORUS FTA). The White House soon after concluded supplementary deals with Colombia and Panama but did not commit to a firm timetable for passing legislation this year. Accordingly, the Republicans upped the ante by refusing to reauthorize funding for the trade adjustment assistance (TAA) program that helps displaced workers adjust and find new jobs. Such "hostage taking" has become part and parcel of the US legislative process over the past two decades, but in this case no one wants to harm the hostages (the FTAs and TAA) held by the other side. This is why a deal will come together in late summer or early fall that ratifies the FTAs and restores most of the funding for the TAA program. After a wait of more than 50 months, the KORUS

FTA will finally receive the recognition in Congress that it deserves. **SO**

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Jeffrey J. Schott is a senior fellow at the Peterson Institute for International Economics (PIIE) in Washington. He formerly was a US Treasury official and a senior associate of the Carnegie Endowment. He has taught at Princeton and Georgetown Universities, and written more than a dozen books on international trade, including most recently "Figuring Out the Doha Round" (PIIE 2010). Contact: JSchott@PIIE.COM