The Impact of the U.S.-Korea Free Trade Agreement on Both Economies

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Abstract

Four and a half years after the agreement between the U.S and Korean governments, the U.S.-Korea Free Trade Agreement (KORUS FTA or KORUS) was finally approved by both the U.S. Congress and the Korean Parliament in late 2011 and has been in effect since March 15, 2012. KORUS is the most important free trade agreement for the U.S. since the North American Free Trade Agreement (NAFTA) that came into force in 1994. Korea has become an important trade partner of the United States, for which Korea is the 7th largest trading partner, 5th largest export market for agricultural products, 2nd largest market for U.S. services in Asia, and 10th largest market for information technology products. The total U.S.-Korea trade volume tripled over just two decades between 1990 and 2011. However, the relative importance of two countries' bilateral trade has declined in recent decades. This trend-line decline is expected to be reversed in the coming years because of the KORUS. Several studies have been conducted to estimate the potential effects of KORUS. The U.S. International Trade Commission (ITC) study in 2007 estimated that U.S. GDP would increase by $10 to $12 billion (about 0.1%) and U.S. exports would rise by $9.7 billion to $10.9 billion, if KORUS were fully implemented. A University of Michigan study, commissioned by the Korea Economic Institute, estimated that U.S. GDP would increase by $25 billion (0.14% of GDP). This estimate was larger than the US ITC result, in part because the study included the effects of liberalization in services trade. The Korea Institute for International Economic Policy (KIEP) estimated the potential economic impact of KORUS on Korea's economy. The study concluded that KORUS would lead to an increase of 0.42% to 0.59% in Korean GDP according to a static analysis and 1.99% to 2.27% according to a dynamic analysis. A study by the U.S. Chamber of Commerce in 2009 found that America would suffer a net loss of more than 345,000 jobs, $35 billion in lost export sales and U.S. GDP failing to grow by $40 billion, if KORUS were NOT implemented while the European Union

and Canada moved forward to implement FTAs with Korea.

Keywords: FTAs, U.S.-Korea FTA, KORUS FTA, Trans-Pacific Partnership (TPP), Economic Benefits of FTAs

FTAs and the Global Trading System

Four and a half years after the agreement between the U.S and Korean governments, the U.S.-Korea Free Trade Agreement (KORUS FTA or KORUS) was finally approved by both the U.S. Congress and the Korean Parliament in late 2011 and has been in effect since March 15, 2012. At present, the United States has FTAs in force with 20 countries, including the latest three countries of Colombia, Panama and Korea. KORUS is the most important free trade agreement for the U.S. since the North American Free Trade Agreement (NAFTA) that came into force in 1994.

Across the globe, an expanding network of FTAs has been formed in recent decades. They can play an important role in supporting global trade liberalization and so they are explicitly allowed under the World Trade Organization (WTO) rules. FTAs can cover entire regions with multiple participants or link just two countries. Under FTAs, partner countries enter into binding commitments to liberalize access to each others' markets for goods, services and investment. Many FTAs also address a range of other economic issues such as intellectual property rights, government procurement, environment and labor practices, and competition policy.

As of February 2012, there were 325 FTAs in the world encompassing 50% of world trade. In the Asia-Pacific region alone, there are now 250 FTAs, an increase of almost five times from 53 in 2000. In recent years, FTAs have become fashionable among countries eager to advance international trade as a way to further economic and job growth. The primary goal of an FTA is to reduce or eliminate tariff and non-tariff barriers to trade in order to promote bilateral trade. Following the global trend, both the United States and Korea have aggressively pursued FTAs in recent years with many strategic economic, security and trade partners. As of May 2012, Korea had 9 FTAs in effect and 6 FTAs under negotiation. Korea was also in the process of preparing for FTA negotiation with 7 additional countries, as Table 1 indicates. Similarly, the United States had 14 FTAs in effect as of May 2012, while engaging in negotiation for 7 more. Furthermore, the country was preparing to negotiate 4 more.

Table 1: FTAs for Korea and the United States
(as of May 2012)[1]

Korea	
FTAs in effect with:	Chile, Singapore, EFTA (European Free Trade Association), ASEAN (Association of Southeast Asian Nations), India, EU, Peru, U.S., Turkey
FTAs in negotiation with:	Canada, Mexico, Gulf Cooperation Council, Australia, New Zealand, Columbia
FTAs in preparation with:	China, Japan, Russia, Israel, Malaysia, Indonesia, Vietnam
United States	
FTAs in effect with:	Israel, NAFTA, Jordan, Singapore, Chile, Australia, Morocco, Bahrain, CAFTA (Central America FTA), Dominican Republic, Oman, Peru, Korea, Colombia, Panama
FTAs in negotiation with:	SACU (Southern African Customs Union), Ecuador, Thailand, FTAA (Free Trade Area of the Americas), UAE, Malaysia, TPP (Trans-Pacific Partnership)
FTAs in preparation with:	ASEAN, Egypt, Taiwan, Pakistan

An FTA is a bilateral or plurilateral agreement under which partner countries make legal commitments to remove trade barriers and to strengthen other economic and commercial ties. In that sense, FTAs are distinct from global multilateral trade agreements negotiated under the auspices of GATT and WTO. In an effort to promote global trade by eliminating the large overhang of protectionist measures in place from the early 1930s, multilateral tariff negotiations were opened in 1946, immediately after the end of the Second World War, and resulted in substantial tariff concessions affecting about one-fifth of the world trade. It was also agreed that an International Trade Organization (ITO) be established as a new specialized agency of the United Nations along with two other multilateral institutions, IMF and the World Bank, dedicated to international economic cooperation. However, ITO was never established due to the lack of political will, especially in the United States, and the tariff concessions and new trade rules, known as GATT, entered into force in 1948 along with a small secretariat.

Under the auspices of GATT, a series of multilateral trade negotiations known as "trade rounds" were launched, the most famous of which were the Kennedy Round of 1962-67, the Tokyo Round of 1973-79, and the Uruguay Round of 1986-94. The Kennedy Round dealt with tariff reductions and anti-dumping measures, even though it was less successful in resolving the second issue. The Tokyo Round focused on tariffs and non-tariff barriers to trade, and it was successful in reducing the average tariffs on manufactured products to 4.7% compared with about 40% at the time of GATT's creation. The tariff reductions under the Tokyo Round, phased in over a period of eight years, involved an element of harmonization, bringing the highest tariffs down proportionately more than the lowest. It also managed to produce a series of agreements on non-tariff barriers. However, the Tokyo Round failed to resolve the fundamental problems affecting agricultural products.

The limited achievement of the Tokyo Round, apart from the reduction in tariffs, was a sign that by the early 1980s the GATT regime was no longer as relevant to the new realities of world trade. Unlike the 1950s and 1960s, world trade in the 1980s had become far more complex, the volume of international investments was rising sharply, and trade in services, not covered by GATT rules, became very important to many countries. In 1986, therefore, the latest and most extensive Uruguay Round was launched in order to deal with not just tariff and non-tariff issues but also services, intellectual property, trade dispute settlement, textiles, and agricultural products. The Uruguay Round was concluded in 1994, when GATT was also replaced by the World Trade Organization (WTO) as a new permanent global institution.

At the WTO Ministerial Conference in Doha, Qatar, in 2001, it was agreed to launch new negotiations, including the implementation of various agreements already concluded. "Implementation" refers specifically to the problems in implementing existing WTO agreements by developing countries. In its 12th year, however, the Doha Round negotiations have all but failed, with no end in sight. As the traditional multilateral trade negotiations in the form of global trade rounds have lost their momentum, many countries have resorted to bilateral and plurilateral trade agreements such as bilateral and regional FTAs. Major trading nations like the United States and Korea have been especially active in the new free trade regime.

Totaling $3.8 trillion in 2011, international trade accounted for 25% of the $15.1 trillion of the U.S. economy. Even though the U.S. economy consisted of 22% of the world GDP in 2011, its exports ($1.5 trillion) represented only 8.3% of world exports and its imports ($2.3 trillion) accounted 12.6% of world imports. While international trade in the United States is not as important as in other advanced countries, U.S. exports nevertheless supported an estimated 9.2 million jobs in 2010, up from 8.7 million in 2009.[2] Despite sluggish U.S. economic growth between 2003 and 2010, export-related jobs increased by over 3 million during this period. For every billion dollars of exports, over 5,000 jobs were supported in the U.S. That is why President Obama issued an executive order on March 11, 2010, creating the National Export Initiative (NEI), which aimed to double U.S. exports over the next five years and create 2 million new jobs domestically. The NEI recognizes that exports will play a critical role in promoting American economic growth. Especially, exports play an important role in supporting a healthy and vibrant manufacturing sector. The nearly 3.7 million manufacturing jobs supported by exports account for 27% of all employment in the manufacturing sector. In this connection, free trade agreements play a critical role in promoting American exports and job growth.

For the Korean economy, international trade is far more important than for the United States. During the 10-year period of 2000-09, exports contributed to 68.5% of Korea's economic growth, much higher than domestic demand. According to the Korea International Trade Association, exports contributed to 62% of Korea's economic growth in 2010, and, without exports, Korea's economic growth rate in 2010 would have been 2.3% instead of 6.2%.[3] The Korean manufacturing sector employed 4.03 million workers in 2010, 80% of which was accounted for by the exports sector. Exports accounted for 860,000 new jobs in 2010, while the domestic sector experienced job loss of 54,000. Despite the overwhelming importance of international trade for the Korean economy, however, the country has been a relative late-comer as far as its FTA efforts have been concerned. The Korea-Chile FTA in April

2004 was the first FTA for Korea, while the first FTA for the United States originated two decades earlier in 1985 with Israel. Korea's trade volume with FTA countries accounts for only 34%, compared to 50% for the world's total FTA-related trade volume. Only when the six FTAs currently in negotiation by Korea are included, 51% of Korea's trade will be FTA-related. In this sense, the KORUS FTA has been a trailblazer in reorienting Korea's trade policy from global multilateral efforts such as the on-again and off-again Doha Round towards bilateral and regional FTAs promising more immediate results.

The Korea-EU FTA of 2011 was the world's biggest free trade deal since NAFTA in 1994. With Korea's FTAs now in effect with both the United States and the European Union, Korea's trade territory as of 2011 accounts for 56% of the global trade territory, which is the third behind Chile (77%) and Mexico (63%). If Korea concludes FTAs with China and Japan, Korea's trade territory (75%) would be the second largest, only behind Chile. If the Korea-China FTA is agreed to, Korea will be the only country linking China (with its manufacturing base for Korean parts and semi-processed products) with the enormous markets of the U.S. and EU for exports.

KORUS FTA

Korea, the 15th largest economy in the world with GDP of $1.1 trillion in 2011, is one of the most dynamic economies in the world and its economic achievement over the past four-and-a-half decades is truly miraculous. A decade after the end of the 1950-53 Korean War, Korea remained in 1965 one of the poorest countries in the world with a per capita GDP of only $106, lower than India's $121. In 2011, however, Korean per capita GDP of $22,331 was over 14 times that of India's at $1,572. This remarkable economic growth in Korea has been fuelled by its spectacular trade expansion. From less than $500 million total trade volume in early 1960s, Korea with its total trade volume of $1.1 trillion in 2011 has become the 9th country in the world whose total trade volume exceeds $1 trillion. Unlike other East Asian countries such as China and Japan, however, Korea's trade surplus has been relatively modest. For example, during 2010 and 2011 Korea had trade surpluses of $41 billion and $33 billion respectively, compared to $182 billion and $157 billion for China during the same period. Japan recorded trade surpluses of $31 billion and $78 billion in 2009 and 2010, but its trade balance turned into a deficit of $31 billion in 2011 due to the devastating impact of a severe earthquake and the subsequent tsunami.

Korea has become an important trade partner of the United States, for which Korea is the 7th largest trading partner, 5th largest export market for agricultural products, 2nd largest market for U.S. services in Asia, and 10th largest market for information technology products. The total U.S.-Korea trade volume tripled between 1990 and 2011. However, the relative importance of two countries' bilateral trade has declined in recent decades. The market share of Korean exports in the United States declined from 3.7% in 1990 to 2.6% in 2011, while U.S. exports in Korea declined from 24.3% to 8.5% during the same period. This trend-line decline is expected to be reversed in the coming years because of the KORUS FTA. The relative importance of the U.S.-Korea trade has declined steadily since early 2000s. In 2000, the United States was the biggest exporter to Korea, accounting for 21% of the total Korean imports and compared to only 7% from China. But the situation has been completely reversed, with China now accounting for 18% of the total Korean imports while the comparable U.S. share has fallen to only 9%. Today, it is struggling with Europe for third place, behind China and Japan. Until 2002, the United States was also the biggest market for Korean exporters, but it fell to the second place behind China after 2003.

Table 2: Annual U.S.-Korea Merchandise Trade

(Billions of U.S. dollars)

Year	U.S. Exports	U.S. Imports	Trade Balance	Total Trade
1990	14.4	18.5	-4.1	32.9
1995	25.4	24.2	1.2	49.6
2000	26.3	39.8	-13.5	66.1
2005	26.2	43.2	-17.0	69.4
2010	38.0	48.9	-10.9	86.9
2011	44.6	56.2	-11.6	100.8

KORUS can slow down or even reverse the steady decline in the traditionally strong U.S.-Korea trade relationship. The past record indicates that U.S. FTAs tend to increase the bilateral two-way trading volumes for the United States significantly. According to 2010 trade data, America's 14 free trade agreement partners represented only about 7% of global economic output outside the United States. But they accounted for over 40% of U.S. exports, while contributing 31% of U.S. imports. The impact of some of the recent U.S. trade agreements has been quite impressive in advancing such two-way trade flows.[4]

Table 3: The Impact of U.S. FTAs on Bilateral U.S. Exports and Imports

Trade Agreement	Change in U.S. Exports	Change in U.S. Imports
Australia (2004-08)	+59%	+41%
Bahrain (2006-09)	+48%	-20%
Chile (2003-08)	+341%	+122%
Morocco (2005-08)	+199%	+97%
Singapore (2003-08)	+68%	+5%

Mexico's exports to the United States in 2010 were 7.1 times higher than the 3-year average annual Mexican exports before the 1994 NAFTA. The overall Mexico-U.S. trade volume in 2010 was 6.1 times higher than the pre-NAFTA volume. Because of NAFTA, Mexico has attracted huge direct foreign investments from those companies eager to exploit Mexico's low wages and free access to the U.S. market for exports. Now, Mexico is the second largest host country for direct foreign investments in Latin America, after Brazil.

Economic Impact of KORUS FTA

Despite a much shorter FTA history than the United States, Korea has experienced similar growth patterns in its bilateral trade with FTA partner countries. During the seven years since April 2004 when the Korea-Chile FTA went into effect, the bilateral trade between the two countries rose 21.3%, compared to only 13.2% increase for Korea's global trade volume during the same period. Similarly, during the two years since the Korea-India FTA became effective in January 2010, the Korea-India trade volume rose 55.2%, while Korea's overall trade volume increased only 25.4% during the same period.

The United States boasts one of the world's most open economies, and this openness has been a key source of America's economic strength. Korea, on the other hand, has maintained significant trade barriers over the years. Before the KORUS FTA, for example, Korea's duties on imported agricultural products averaged 54%, compared with only 9% on average in the United States for the same agricultural imports. On non-farm goods, Korean tariffs averaged 6.6%, compared with 3.2% in the United States. By eliminating these high tariffs in Korea, KORUS should significantly expand U.S. exports to Korea in the coming years. Under KORUS, 78% of Korean imports from the U.S. became duty free immediately, including jeans (13% tariffs), handbags (8%), wine (15%), orange juice (50%), almonds (8%), and cherries (24%). Also, 86% of all Korean exports to the U.S. have become duty free immediately under KORUS. 95% of all bilateral goods trade will become duty free over the next three years, and in ten years virtually all tariffs will be eliminated. In addition to tariff relief, under KORUS both countries' exporters can benefit greatly from simplified import procedures. And the enormous U.S. service market, including U.S. Federal agency procurement sector, has been opened to Korean firms under KORUS.

The critical challenge for modernization of the Korean economy is upgrading its under-developed service sector. While the service sector *value added* as a share of GDP is 72.2% for G-7 countries, it is only 60.0% for Korea. The share of the service sector in the total employment is 74.9% for G-7 countries and only 67.3% for Korea. Furthermore, productivity of the Korean service sector is estimated at 1/3 of Switzerland and ½ of the United States. Such a poor state is due to the fact that the Korean service sector is concentrated in low-value *infrastructure services* such as wholesale and retail sales, lodging, and food services. Korea's service sector is painfully under-developed in the high-value *knowledge service industries* such as banking, finance, insurance, medicine, telecommunications, research and development. It is hoped that Korea can upgrade its service sector using the KORUS FTA as the catalyst, thereby truly modernizing the Korean economy to equal Western industrialized countries.

FTAs have contributed to a big increase in competitive advantages for Korean exporters. The combined automobile market size of those countries with which Korea has FTAs is now 35.1 million cars, compared to only 5.7 million cars for Japan's FTA countries. Because of KORUS, exports of Korean auto parts to the U.S. (with immediate elimination of 2.5% - 4% U.S. tariffs) were projected to increase by 36% in 2012 alone. A similar trend is expected for Korean exports of textile products, whose tariff rate in the U.S. was reduced by 13.1% on average. A major Japanese textile product company recently made $50 million direct investment in Korea in order to benefit from the KORUS FTA. Overall, Korea's FDI inflows increased by 42% during the first four months of 2012 compared to 2011.

A similar trend is present in the Korean shoe industry. After KORUS, American shoe importers have increasingly turned from China to Korea, as 98 out of 115 Korean shoes now have no U.S. tariffs. During the first quarter of 2012, Korean shoe exports to the U.S. and EU increased 29% and 43% respectively from the previous year because of FTAs. Therefore, Korean shoe exporters are closing down their factories in China and increasing shoe production in Korea, leading to job growth in Korea.

Several studies have estimated the potential effects of KORUS. The U.S. ITC study in 2007 estimated that U.S. GDP would increase by $10 to $12 billion (about 0.1%), and U.S. exports would rise by $9.7 billion to $10.9 billion, if KORUS were fully implemented.[5] A University of Michigan study, commissioned by the Korea Economic Institute, estimated that U.S. GDP would increase by $25 billion (0.14% of GDP).[6] This estimate is larger than the US ITC result, in part because the study included the effects of liberalization in services trade. The Korea Institute for International Economic Policy (KIEP) estimated the potential economic impact of KORUS on Korea's economy. The study concluded that KORUS would lead to an increase of 0.42% to 0.59% in Korean GDP according to a static analysis and 1.99% to 2.27%, according to a dynamic analysis.[7] A study by the U.S. Chamber of Commerce in 2009 found that America would suffer a net loss of more than 345,000 jobs, $35 billion in lost export sales and U.S. GDP failing to grow by $40 billion, if KORUS were NOT implemented while the European Union and Canada moved forward to implement FTAs with Korea.8 Korea's FTA with EU has been in force since July 2011, while its FTA with Canada is still under negotiation as of May 2012.

KORUS FTA and Trans-Pacific Partnership (TPP)

After a five-year standoff between Congressional Republicans and pro-trade advocates in the business community on the one side and Congressional Democrats, most unions and certain American car manufacturers on the other, KORUS FTA as well as the U.S. FTAs with Colombia and Panama finally became reality in 2012. After a long and difficult process of pushing these three FTAs among many interest groups, the Obama Administration now seems more interested in plurilateral trade deals over bilateral deals. Perhaps, a plurilateral trade deal such as TPP may have a better chance of overcoming U.S. domestic opposition than the multilateral Doha Round or bilateral FTAs.[9]

On November 12, 2011, the leaders of 9 TPP countries (Australia, Brunei, Chile, Malaysia, New Zealand, Peru, Singapore, Vietnam, and the United States) announced the broad outline of an ambitious, 21st-century TPP agreement. Soon thereafter, the original 9 countries were joined by Japan, Canada and Mexico, thus making a 12-nation TPP bloc, accounting for 40% of the world GDP, compared to only 25% for the 27-nation European Union GDP. TPP is designed for more than traditional FTAs, since it will include not just such traditional core FTA issues as reducing or eliminating tariffs and rules on intellectual property, labor and environment. TPP also aims to make the regulatory systems of member countries more compatible with global standards, to address trade and investment in innovative products and services, and to ensure state-owned enterprises compete fairly with private companies. Since TPP is more than FTAs, it is possible that Korea might also join it in the future. Among the 12-country TPP negotiation bloc, 6 countries (Australia, Canada, Chile, Mexico, Peru and Singapore) have already concluded FTAs with the United States.

TPP is a key element of the Obama Administration strategy to promote U.S. exports vigorously, and, at the same time, to make U.S. engagement in the Asia-Pacific region a top priority. TPP is important because the U.S. now exports more to Pacific Rim countries than to Europe. TPP also promises something truly revolutionary: persuading Asian governments to accept new rules for state-owned enterprises, a hallmark of Asian-style capitalism. TPP can accelerate the movement of the global center of economic gravity from the Atlantic Ocean to the Pacific. It is also a test for the new U.S. strategy of coping with China's rise by "pivoting" American foreign and economic policy more towards Asia.

While the U.S. government hopes to complete the broad outlines of a final TPP agreement by the end of 2012, there are formidable barriers to a final deal. Critics in the countries negotiating TPP with the United States suspect that the United States is using the TPP to impose on TPP partner countries its own expansive intellectual property regulations related to copyrights and patents. Within the Unites States also, there is significant opposition to TPP among agricultural and automobile sectors.

The decision by former Prime Minster Yoshihiko Noda for Japan to join the TPP negotiations is considered especially significant in making TPP a truly Pan-Pacific movement. Japan's new interest in TPP stems from three factors. First is the fear generated in Japan by the new KORUS FTA, which can make Japan's export industry less competitive in the U.S. market vis-à-vis its Korean rival. Second, the absence of China in TPP can create a strategic environment, where China would see Japan as a formidable neighbor that cannot be pushed around easily. Third is the declining clout of Japanese agricultural interests long opposed to any form of free trade agreements. Agriculture now accounts for less than 1.5% of Japan's GDP, and the public opinion poll indicates that the majority of Japanese want to join the TPP negotiations.

After Japan decided to join the TPP negotiations, both Canada and Mexico also joined the TPP talks. KORUS has also induced China to seek more aggressively a Korea-China or even Korea-China-Japan FTA in order not to be left behind. Thus, KORUS is not just a trade-enhancing mechanism between the two countries of the United States and Korea, but also it has become a geo-political catalyst for the United States to leverage its influence in the increasingly important Asia-Pacific theatre.

Notes:

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