Free Trade Bulletin
HERBERT A. STIEFEL CENTER FOR TRADE POLICY STUDIES

CATO INSTITUTE

June 13, 2019 | Number 73

Trump's First Trade Deal

The Slightly Revised Korea-U.S. Free Trade Agreement

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While the renegotiation of the North American Free Trade Agreement has received far more attention, a lesser-known U.S. trade deal has also been reworked. In April of 2017, President Trump proclaimed his displeasure with the Korea-U.S. Free Trade Agreement (commonly referred to as "KORUS"), stating, "It was a Hillary Clinton disaster, a deal that should've never been made."[1] Trump said he had told the South Koreans, "We'll either terminate or negotiate. We may terminate."[2] This set the wheels in motion for a relatively low-profile trade renegotiation that became Trump's first trade deal.

The renegotiation of KORUS provides a useful example of Trump's trade dealmaking in practice. As we will show below, the renegotiation made only minor changes to the agreement and could be taken to mean that the reality of Trump's trade policy may not always match the rhetoric. However, the administration's concerns about trade with Korea have always been less prominent than its concerns about trade with other trading partners, so the conclusion of the KORUS talks with only small changes may simply be a reflection of the administration's focus on other areas of trade policy rather than an indication of its general approach to trade policy.

THE ORIGINAL KORUS

The original KORUS grew out of bilateral consultations that began in late 2004, although the idea of a trade agreement between the two countries had been floated as early as the 1980s. A deal was concluded in April 2007, revised the next month to reflect demands from Congressional Democrats, and signed by the parties on June 30, 2007.[3] Important features of the agreement were a phase-in period for the removal of most tariffs on bilateral trade, with autos and agriculture the most noteworthy areas of liberalization; a reduction in the burden of various Korean tax and regulatory policies; and the opening up of certain Korean services markets.[4]

The initial version of the deal faced several hurdles with domestic ratification. Although Korea had significantly opened its agricultural market as part of the negotiations, Korean restrictions on U.S. beef imports had not been fully resolved. Max Baucus, a powerful farm-state senator, objected to the deal until that issue was fixed. The U.S. auto industry also had concerns about the new competition it would face from its Korean counterparts. Finally, presidential elections in Korea led to delays in consideration of the deal, and then came the 2008 U.S. presidential election and the financial crisis. These issues held up ratification for the remainder of the Bush administration and a couple of years into Obama's first term.[5]

In December 2010, the two parties agreed to a set of minor changes: U.S. tariff cuts on cars and light trucks were delayed for a few years, and Korea made changes to certain regulatory policies that would help U.S. carmakers with access to the Korean market.[6] These changes paved the way for ratification in both Korea and the United States, and the agreement entered into force on March 15, 2012.[7]

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TIMELINE OF THE KORUS RENEGOTIATION

President Trump and his Korean counterpart, Moon Jae-in, first spoke about a KORUS renegotiation during the June 2017 U.S.-Korea Summit. Soon after, U.S. Trade Representative Robert Lighthizer requested convening a special session of the KORUS Joint Committee.[8] The special session was held in August but failed to reach a resolution. At that point, press reports suggested that Trump was hinting at a possible U.S. withdrawal from the agreement.[9] However, after another meeting in October, the two sides agreed to start the process of amending the agreement.[10]

The two countries held the first round of talks on possible amendments in early January 2018, focusing on automotive trade and the further opening of Korea's agricultural market.[11] The second round of talks began at the end of that month, occurring just a week after Trump had announced safeguard tariffs that would affect Korean washing machines and solar panels.[12] During this tense second round, the United States continued to push for changes concerning the sale of autos in Korea. Meanwhile, Korea made detailed suggestions to reform the investor-state dispute settlement (ISDS) mechanism and raised concerns about the safeguard tariffs on washing machines and solar panels.[13]

The third round of talks, held in March, coincided with the Trump administration's announcement of sweeping new tariffs on steel under Section 232 of the Trade Expansion Act of 1962. Korea negotiated an exemption from the tariffs in exchange for agreeing to limit steel exports to the United States. The two sides also discussed further opening the Korean market to U.S. pharmaceuticals. Both governments seemed to take a more diplomatic approach to these talks in order to avoid adding complications to the upcoming inter-Korea and U.S.–North Korea summit.[14] On March 28, Korea and the United States released a joint statement announcing that they had "reached an agreement in principle on the general terms of amendments and modifications to the United States–Republic of Korea Free Trade Agreement."[15] The two parties signed the renegotiated trade deal on September 24, 2018.[16]

Shortly thereafter, Korea completed its domestic procedure to effectuate the amended KORUS, and on December 7, 2018, the National Assembly ratified the agreement, voting 180–5 in support of the deal, with 19 abstentions.[17] Although the Koreans had hinted that they would demand an exemption from the Trump administration's possible Section 232 tariffs on all automobiles in exchange for their approval of the new KORUS, the legislation was finalized without addressing this issue.[18] Meanwhile, no congressional vote was required in the United States because of the limited scope of the revisions and the absence of changes to any U.S. statutes.

Upon exchanging written notifications that each country had completed its respective legal requirements and procedures, the new KORUS entered into force on January 1, 2019.[19]

MAJOR CHANGES TO KORUS

KORUS 2.0 is mostly just a tweak of the original KORUS, but it contains a few noteworthy changes. Some issues were addressed as modifications to the original KORUS, while others that were not covered in the original were negotiated as side agreements secured by exchanges of letters between the parties. Changes demanded by the United States included steel export restrictions, a larger quota for U.S. cars exported to Korea that meet U.S. emissions and safety standards instead of Korea's idiosyncratic rules, an extension of the duration of the U.S. 25 percent tariffs on imported pickup trucks, changes to rules on Korean medicine pricing, and new procedures for Korean customs inspections. There were also several Korean demands that resulted in changes to the investor-state dispute settlement and trade defense mechanism procedures, as well as rules of origin requirements for certain textile products.

Voluntary Export Restraint on Steel from Korea

Regarding the side deals, the biggest (and most negative) economic impact will arise from the export restrictions on Korean steel. Pursuant to these restrictions, Korea will cap steel exports to the United States at 70 percent of the average volume from the past three years on a product-by-product basis.[20] This was done in exchange for an indefinite exemption from the Trump administration's Section 232 national security tariffs on steel. These quotas will lead to some degree of price increase for U.S. consumers, with the amount of the increase dependent on how the measures are implemented, among other factors.

In anticipation of the quotas, larger Korean steel producers had already been looking to other markets, such as India, for their exports, and some of Korea's smaller steel producers, such as Seah Steel and Husteel, have considered moving more production to the United States to circumvent the quotas altogether.[21]

This outcome is troubling because it takes trade policy back to the 1980s and utilizes a tool that operates outside current international rules. Tying unrelated national security issues to pressure Korea into concessions signals a new approach to trade negotiations that we are likely to see more of from the Trump administration.

Increased Export Quotas and Expansion of Eco-Credits for U.S. Autos

Under the original KORUS, U.S.-based auto manufacturers can export up to 25,000 vehicles (per manufacturer per year) to Korea that will be deemed compliant with Korean safety standards as long as they meet U.S. standards. As part of the renegotiation, the annual quota has now been increased to 50,000 vehicles per manufacturer.[22] On its face, this appears to be a good market-opening provision and a positive development for increasing U.S. access to the Korean market. However, the real economic value is unclear. In 2017, U.S. passenger vehicle and light truck exports to Korea totaled only 52,687 units; to put this figure in perspective, Canada is the leading destination for U.S. auto exports, with 917,669 units, and China is second at 262,527 units.[23] Furthermore, Ford and General Motors each shipped fewer than 10,000 vehicles to Korea in 2017.[24] Given the low volume of U.S. auto exports to Korea, increasing the quota will probably not have much impact.

In addition, most U.S. automobiles will be exempt from Korea's stricter CO_2 emission requirements. In order to achieve this, the cap on eco-credits that U.S. manufacturers can use to "pay" for increased CO_2 emissions will be raised to match the discrepancy between the U.S. and Korean emission standards.[25] In addition, Korea will continue to provide leniency on both fuel economy and greenhouse gas emissions regulations for small-volume U.S.-vehicle manufacturers that sell small quantities of cars to Korea. As with the increased quota for autos meeting U.S. safety standards, given the low level of U.S. exports to Korea, this change is likely to have a minimal effect on trade.

Phaseout of Tariffs on Light Trucks from Korea

While the auto provisions noted above could open Korea's market a bit to U.S. exports, on trucks the Trump administration has moved in the direction of greater protectionism. Korea agreed to a U.S. demand to extend a 25 percent U.S. tariff on light-truck imports until 2041 (the tariff was supposed to be phased out by 2021 under the original KORUS). Because Korea does not currently export trucks to the United States, this will have no immediate impact on the market. However, the change could delay any future export plans Korean truck producers may have pursued. Ambassador Lighthizer has said, "The Koreans don't ship trucks to the United States right now and the reason they don't is because of this tariff," and, "They were going to start next year—we would have seen massive truck shipments. So, that's put off for two decades."[26] Along the same lines, in a study published in June 2018, the U.S. International Trade Commission estimated that the extension of the duties "could avoid an increase of 59,000 units in light truck imports" and "7,600 units in medium/heavy truck imports from Korea" over the 20-year extension period.[27] Although the actual plans of Korean automakers were unclear, the tariff extension certainly limits their options for producing trucks for the U.S. market and keeps imported light trucks out of reach to U.S. consumers for another 20 years.[28]

Korean Medicine Pricing

The Pharmaceutical Research and Manufacturers of America has long complained about how Korea's national health insurance pricing entities—the Health Insurance Review and Assessment Service and the National Health Insurance Corporation—have priced imported drugs at below-market prices.[29] In this regard, the association has claimed that "Korea's pricing policies severely devalue U.S. intellectual property and favor Korea's own pharmaceutical industry at the expense of U.S. companies."[30] According to the U.S. Trade Representative's Office, as part of the KORUS renegotiation, "Within 2018, Korea will amend its Premium Pricing Policy for Global Innovative Drugs to make it consistent with Korea's commitments under KORUS to ensure non-discriminatory and fair treatment for U.S. pharmaceutical exports."[31] In essence, the amended KORUS was supposed to ensure that Korea bring its pharmaceutical policies in line with what was originally agreed. Korea made the amendments as scheduled, but criticism of the new rules has emerged from both domestic and foreign pharmaceutical companies, and the policy may continue to be contested.[32]

Korean Customs Procedures

Another KORUS change targets red tape involving customs procedures. Korean customs, as compared to U.S. customs, traditionally demands more detailed documentation, a practice that acts as a nontariff barrier to trade. Whereas U.S. Customs and Border Protection places scrutiny primarily on Tier 1 suppliers (direct suppliers to original equipment manufacturers) as long as certificates exist for producers farther down the supply chain, the Korean Customs Service often demands significantly more documentation, even from suppliers as far removed as the Tier 3 level (suppliers of raw material).[33] The KORUS renegotiation has produced a list of eight principles designed to reduce this customs slowdown and calls for the creation of a working group to monitor these issues.[34]

Other Notable Changes and Omissions

Although the majority of KORUS 2.0 amendments were designed to satisfy U.S. demands, three smaller changes were made at the request of Korea. First, the investor-state dispute mechanism has been revised in minor ways and largely resembles the rules in the Comprehensive and Progressive Agreement for Trans-Pacific Partnership. ISDS is an arbitration process that allows foreign investors to bring claims against governments before an ad hoc panel. Some Korean officials are dissatisfied with the burden this system has placed on their government. As of this year, Korea is facing a number of ISDS claims that put it at risk of upward of $50 billion in damages. Korea lost its first ISDS case this year against Iran's Dayyani Group, after which the Korean government was required to pay 73 billion *won* (approximately $64 million).[35] This, among other factors, has reduced Korea's support for ISDS and led it to seek revisions.

Second, the KORUS amendments also seek to promote transparency in antidumping and countervailing duty proceedings.[36] The renegotiated terms are a direct response to the frequent use of this type of import restriction by the United States. While this change may not do much to curtail U.S. recourse to these trade remedies, improving transparency in the process is a net positive result.

Third, Korea asked for modifications to rules-of-origin requirements for three product categories of textile inputs that are not available in either Korea or the United States and thus have to come from other countries.[37] This change was requested because the current "yarn-forward" rules only allow a textile product to qualify for a free-trade agreement's lower tariffs if it is made of yarns and fabrics from one of the free-trade-agreement parties. The United States favors yarn-forward rules in its trade agreements because they restrict inputs from other countries.[38] The United States agreed to expedite its domestic commercial-availability review process, agreeing to make rule changes in the Specific Rules of Origin for Textile and Apparel Goods (Annex 4-A) if it is determined that commercial availability does not exist. This would be a welcome development in relaxing stringent yarn-forward rules that impede the most efficient ways of manufacturing textiles and clothing.

Finally, and notably, the agreement lacks provisions addressing currency manipulation, which the United States has sought in other recent trade negotiations. Initially, it appeared that the United States was pushing for KORUS provisions similar to those agreed to in a side letter to the Comprehensive and Progressive Agreement for Trans Pacific Partnership, which the United States helped negotiate but from which it later withdrew.[39] The Trump administration was later able to include currency provisions in the renegotiated North American Free Trade Agreement, known as the United States-Mexico-Canada Agreement, which has not yet been ratified by Congress.[40] In spite of early talk about a KORUS currency chapter,[41] the final renegotiated KORUS says nothing about currency issues. However, Korea has stated that it will begin disclosing its foreign exchange transactions.

CONCLUSION

Overall, the KORUS renegotiation is a minor tweak to the U.S.-Korea trade relationship rather than the wholesale revolution that Trump and his trade advisers portray it to be. That is probably for the best. However, concerns about KORUS have been less prominent for the Trump administration than concerns about other trade relationships in which the United States may take more aggressive actions. The escalating U.S.-China trade conflict, the administration's persistent use of various unilateral tariffs, and its blocking of nominations to the World Trade Organization's highest court are taking center stage. The resolution of these hot-button issues will reveal more about whether the administration can figure out a way to put together a coherent trade strategy that does not unravel decades of trade liberalization.

NOTES

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