Peterson Institute for International Economics

Policy Brief

NUMBER PB10-23 OCTOBER 2010

Prospects for Implementing the Korea-US Free Trade Agreement

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CURRENT STATUS OF THE KORUS FTA

The Korea-US Free Trade Agreement (KORUS FTA) was signed on June 30, 2007. Since then, the Korean National Assembly has vetted the agreement and the pact cleared a major legislative hurdle when the Foreign Affairs and Trade Committee approved it in April 2009; the full assembly has deferred final passage pending comparable action by the US Congress. In the United States, the ratification process has not yet begun; neither President George W. Bush nor President Barack Obama has submitted implementing legislation to Congress.

Because the deal was signed just before the expiration of Trade Promotion Authority (TPA) on June 30, 2007, US implementing legislation still qualifies for "fast track" procedures even though the TPA has expired. Under fast track procedures, the president formally submits implementing legislation to Congress. In practice, the text of the bill is negotiated with congressional committees and not submitted until most disputed issues have been resolved.

President Obama has said that certain problems (mostly relating to autos and beef) need to be resolved before he moves forward with implementing legislation. At the Toronto G-20 Summit, Presidents Obama and Lee Myung Bak tasked their officials to find solutions by the Seoul G-20 Summit in November 2010, so that ratification could proceed soon after.

Assuming a deal is struck in Seoul or soon after, White House officials plan to table implementing legislation in early 2011. On that timetable, the agreement could enter into force in late 2011 or January 2012.

FLASHPOINTS IN THE US RATIFICATION DEBATE

Critics of the KORUS FTA in the United States cite numerous provisions of the pact that should be recast; most of their concerns echo complaints about other FTAs that previously passed congressional muster (e.g., investor-state dispute provisions and labor provisions) or provisions that eliminate over time high US tariffs protecting apparel and a few other industries. However, most attention has been directed at the provisions on autos and beef.

Autos. Auto issues have been a major stumbling block to congressional ratification of the KORUS FTA. Bilateral auto trade was valued at about $12 billion in 2008 and Korea had a $10 billion surplus. The KORUS FTA gives Korea a small price advantage over other importers as a result of the elimination of the 2.5 percent US auto tariff; sets a 10-year phaseout of the 25 percent US tariff on light trucks; and benefits US exporters by eliminating the 8 percent Korean auto tariff, which should help increase US exports of luxury vehicles.

The FTA has been opposed by Ford and Chrysler and the autoworkers union; General Motors (GM) has quietly supported the deal because of its stake in GM-Daewoo. The critics argue that trade should be more balanced and that the FTA needs to be rewritten to require Korea to eliminate nontariff barriers—e.g., discriminatory tax policies and fuel, emission, and safety standards—that they claim impede import and distribution of foreign cars in Korea.

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The call for more balanced trade amounts to a managed trade manifesto that is seductive in political terms and irrational in economic terms. The list of identified obstacles is more substantive and has been the focus of attention of trade officials seeking to fulfill the presidential mandate from the Toronto G-20 Summit.

What is likely to be included in a KORUS FTA reform package on autos? To their credit, US officials under both Presidents Bush and Obama have rejected the managed trade proposals. Instead, efforts have focused on improving transparency of Korean regulatory policies and the operation of dispute resolution procedures in the auto sector. Trade officials have looked at the Korea–European Union FTA for precedents that might improve upon similar KORUS FTA provisions. In addition, both governments have sought to encourage innovation in their auto industries and joint ventures, which would spur investment and employment in both countries. One example is the LG Chem investment in Michigan that President Obama helped launch in July 2010. LG is investing $300 million in the plant, which will produce electric batteries for US-produced hybrid cars starting in 2012.

Beef. The KORUS FTA phases out the 40 percent Korean tariff; however, sanitary restrictions still bar US exports of cattle over 30 months old. Resolution of the beef issue is significant for two reasons: to increase US exports to Korea and to set a precedent for resolving similar problems with other countries, especially Japan.

US beef exports are well below their peak level before shipments were banned in December 2003 due to concerns about bovine spongiform encephalopathy (BSE) contamination. Pursuant to World Organization for Animal Health (OIE) rulings in 2008, Korea subsequently committed to fully open its market over time.

Currently, US beef exporters face two problems. The smaller issue is the resolution of the remaining Korean import ban that affects a very small share of potential US shipments; in this matter, US and Korean officials are likely to set out a specific schedule for monitoring beef production and trade and removing import restrictions consistent with OIE guidelines. The larger problem is that the long hiatus from the Korean beef market during the BSE crisis has allowed Australian suppliers to gain a dominant share of the Korean import market. US beef producers will find it difficult to dislodge their Australian competitors—especially once Australia concludes its own FTA with Korea in the near future.

WILL CONGRESS RATIFY THE KORUS FTA?

Conventional wisdom posits that once a bill is tabled, Congress cannot say "no" to an important ally—especially now, given sensitive developments on the Korean peninsula. Nonetheless, the vote will likely be close, since Democratic leaders will "excuse" as many of their members as possible from voting "yes" while still allowing passage of the bill. President Obama and his allies in Congress do not want to take the blame for a foreign policy or security crisis that could unfold if the FTA is rejected. But passage will require a large majority of Republican votes and a significant minority of Democratic votes, just as with almost every FTA since the North American Free Trade Agreement (NAFTA).

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However, three "wild cards" are affecting congressional action on trade legislation in 2011: composition of the new Congress after the November 2010 election; White House strategy regarding the other FTAs with Colombia and Panama, which also await congressional action; and legislation targeting Chinese currency manipulation as a countervailable subsidy.

Republicans will make large gains in both houses of Congress and could take control of the House. Republican control of the Senate is also possible but less likely given the ascent of anti-establishment candidates in recent Republican primary elections. How these events affect trade votes is harder to assess, since newly elected members in both parties may tend to take more protectionist positions than their predecessors. Over the past two decades, the US trade debate has become more ideological, and both the right and left wings of the political spectrum have a protectionist bias.

If the Republicans gain control of the House, their leaders are likely to push for ratification of the KORUS FTA (and perhaps all three FTAs at the same time; see below). The leadership will have to pressure the right wing of the Republican Party, since most Democrats will oppose, as they did in the 2005 vote on the Central America FTA (CAFTA). In this scenario, the national security rationale will loom large in the debate and will probably be decisive in securing support among otherwise protectionist members.

Implementing the KORUS FTA is important to help maintain the credibility of other US trade initiatives that seek to boost US exports, constrain Chinese economic influence in the Asia-Pacific region, and advance overall US foreign policy and security interests.

Will the Obama administration submit legislation only for the KORUS FTA, or will it try to "kill three birds with one stone" by linking FTAs with Korea, Colombia, and Panama into an omnibus implementing bill? The rationale for linking the three pacts is that members don't want to vote three times on trade bills, so it is better to do them all together in a single bill. This strategy would probably mute a lot of the criticism from specific manufacturing firms about the KORUS FTA, since those firms benefit from the other pacts. Labor unions would continue to oppose all three FTAs—but members representing labor constituencies were never going to vote for these trade deals anyway.

However, the Colombia FTA no longer qualifies for fast track. Speaker Nancy Pelosi and the House Democrats changed a House rule in April 2008 nullifying the pact's eligibility. Therefore, from a parliamentary perspective, it is unclear how a "3 in 1" bill would be handled.

If Democrats maintain control of the House, they will probably want to continue to defer action on the Colombia FTA. This strategy would provide time to press for more policy and judicial reforms in Colombia; it would also partially compensate labor constituencies for moving forward with the KORUS FTA.

If Republicans gain control, however, the "3 in 1" strategy could be revived. House Democrats may prefer to accept one trade vote on FTAs if the China currency bill proceeds down a parallel legislative track, and thus they may passively accept House action that essentially annuls the 2008 rule change.

The third wild card is what happens to the China currency bill in the next Congress. The bill passed by the House Ways and Means Committee on September 24, 2010, will probably not make it through the full Congress this year. Whether a similar bill is revived in the next Congress depends on Chinese policy changes and US electoral results. That said, the odds are good that a China bill will be tabled early in 2011 because members from both parties want to counter the implicit subsidization of Chinese exports resulting from the persistent undervaluation of the renminbi—and they see draft legislation as a useful prod for Chinese policy reform. Big business will oppose this legislative effort, but I doubt they would divert substantial lobbying efforts on priority tax matters to actively block a bill—especially if the "3 in 1" strategy unfolds.

WHY WILL CONGRESS ACT?

There are three main reasons why the Obama administration decided to accelerate efforts to resolve the impasse over the KORUS FTA despite the continued opposition of labor unions, Ford and Chrysler, and leading congressional Democrats. All derive from actions taken by other countries that could adversely affect US commercial and security interests in the Asia-Pacific region.

The first reason is to demonstrate support for a strong ally facing North Korean aggression. When the KORUS FTA was negotiated, the main concern related to North Korea was whether goods produced in the Kaesong Industrial Complex would be eligible for FTA preferences. Since then, however, North Korea has taken a number of provocative actions—especially testing nuclear devices and launching offensive missiles—that underscore the importance of a strong and durable alliance between the United States and South Korea. Neither country wants to let a few provisions in a major trade agreement create friction in a strategically important bilateral alliance. That's the reason why Secretary Hillary Clinton is now a strong advocate within the Obama administration for the KORUS FTA despite earlier reservations voiced during the 2008 election campaign.

The second reason is to secure a level playing field for US exporters in the Korean market. Korea has concluded or is negotiating FTAs with most of its major trading partners; by definition these deals discriminate against US exporters and investors. Korean FTAs in force or under negotiation cover more than 50 percent of Korea's merchandise trade, and that ratio will exceed 70 percent if talks with China begin as expected in 2011.

The imminent signing of the Korea–European Union FTA, an agreement modeled on and largely comparable to the KORUS FTA, increases the urgency of congressional action on the KORUS FTA since US and EU exports compete for sales in the Korean market. The Korea–European Union FTA is scheduled to be signed on October 6, 2010 and to enter into force on July 1, 2011, at which time European firms will benefit from tariff preferences in the Korean market largely comparable to those that had been expected to have been already available to US firms.

The third reason relates to the ability of US officials to advance US economic interests through an effective trade policy. The long delay in ratifying the KORUS FTA sends a signal to US trading partners that US officials don't have the requisite political support to follow through on agreements reached at the trade negotiating table. Such concerns do not prevent them from negotiating with the United States, but foreign officials are inclined not to put their best cards on the table for fear that they will have to renegotiate the deal to assuage a skeptical Congress.

Implementing the KORUS FTA is thus important to help maintain the credibility of other US trade initiatives—including the Doha Round of multilateral trade negotiations in the World Trade Organization and the Trans-Pacific Partnership talks—that seek to boost US exports, constrain Chinese economic influence in the Asia-Pacific region, and advance overall US foreign policy and security interests.