



September 15, 2017

U.S.-South Korea (KORUS) FTA

Overview

The U.S.-South Korea (KORUS) free trade agreement (FTA) has been a central component of bilateral economic engagement since entering into force in March 2012. The agreement reduces and eliminates tariff and non-tariff barriers between the two parties on manufactured goods, agricultural products, and services; provides rules and disciplines on investment, intellectual property rights (IPR) and other issues; commits both countries to maintain certain worker and environmental standards; and provides mechanisms for resolving disputes. The KORUS FTA is the second largest U.S. FTA by trade flows after the North American Free Trade Agreement (NAFTA). It is also among the most recently negotiated and arguably has the most extensive commitments of any U.S. FTA in effect.

The United States and South Korea, allies since 1953, negotiated KORUS both to deepen and enhance economic ties and to strengthen a critical alliance relationship. The Trump Administration is reviewing KORUS and considering revisions. While the agreement may not have altered either country's fundamental strategic interests in the region, analysts contend that U.S. withdrawal from the pact, as also contemplated by President Trump, could harm U.S. credibility at a time when the alliance requires close coordination in the face of North Korean threats.

The Bush Administration signed the KORUS FTA in 2007, but the agreement was not submitted to Congress until 2011 under the Obama Administration. This followed further negotiations and an exchange of letters that in effect modified some provisions of the initial agreement, such as the auto provisions, to address congressional concerns. In the interim, the European Union (EU) negotiated and implemented in 2011 its own FTA with South Korea, which is a member of 15 FTAs in total.

Views on the KORUS FTA and its outcomes to date are mixed. Proponents argue KORUS has enhanced trade, competition and consumer choice in both countries, increased U.S. IPR protection in South Korea, and improved transparency in South Korea's regulatory process. They also contend that lower import restrictions in South Korea have increased U.S. exports of certain products and services. Others argue that the agreement's impact is disappointing, pointing to an increase in the U.S. trade deficit with South Korea since KORUS became effective. Some U.S. stakeholders also raise concerns regarding South Korea's implementation of the agreement, including challenges with customs verifications needed to take advantage of the FTA's tariff benefits.

Potential Renegotiation

President Trump has repeatedly criticized the agreement and the U.S. bilateral trade deficit, and argued for a

KORUS renegotiation. In response to these concerns, the United States Trade Representative (USTR) requested a special session of the KORUS Joint Committee to discuss implementation and potential modifications. The first meeting of this special session convened on August 22, 2017, but no official outcomes were announced, and there was reportedly disagreement as to next steps. South Korea requested a joint economic study to examine the impact of the agreement on both countries before discussing any changes to the agreement. President Trump has also considered unilateral U.S. withdrawal from KORUS. The FTA text allows for the agreement to terminate 180 days after notification is given by either party after which tariffs, now nearly eliminated, could return to World Trade Organization (WTO) most-favored nation (MFN) levels. These average 3.5% in the United States and 16.5% in South Korea. There is no recent precedent of U.S. FTA termination and there are legal questions over the President's authority to terminate the agreement, particularly the domestic laws implementing the agreement.

[Any] changes affecting the United States resulting from the work of [the KORUS] Joint Committee cannot take effect unless either the President exercises his authorities as delegated by Congress or Congress makes changes to U.S. statutes...Congress expects to be consulted in the exercise of [delegated] authorities.

House Ways and Means and Senate Finance
Committee Leaders, July 17, 2017

Congress would play a major role in any potential renegotiation of KORUS, but it has not yet been notified by the Administration of its intent to begin formal negotiations. Such notification is necessary if legislation implementing negotiated changes is to receive expedited treatment under Trade Promotion Authority.

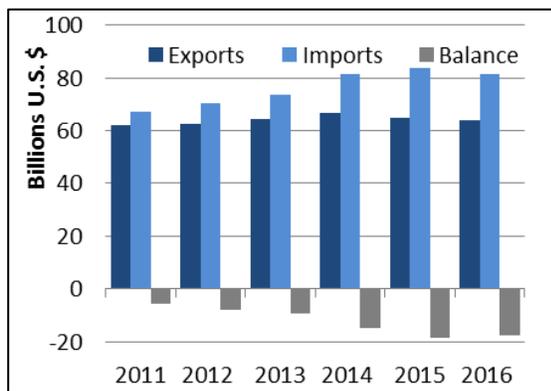
Trade and Investment Patterns

South Korea is the seventh largest U.S. trading partner with total trade (goods and services) in 2016 of \$166 billion (\$73.7 billion exports and \$92.7 billion imports). From 2011, the year before KORUS took effect, to 2016, bilateral trade increased by 13%. U.S. imports increased by 22% for goods and 13% for services, while exports decreased by 6% for goods and increased by 26% for services. The total U.S. trade deficit with South Korea increased from \$5.4 billion to \$17.6 billion during this period (**Figure 1**), which represents 3.5% of the global U.S. trade deficit in 2016. During the same period, the stock of U.S. foreign direct investment (FDI) to South Korea grew from \$28 billion to \$39 billion, while South Korean FDI in the United States grew from \$20 billion to \$41 billion.

It is difficult to determine the extent to which the trade agreement affected these patterns due to the myriad factors

that simultaneously influence trade and investment flows. South Korea's rate of economic growth has slowed since KORUS took effect, which may explain the drop in goods imports from the United States; imports from China and Japan were also flat or fell from 2011 to 2016. The U.S. International Trade Commission estimates that the bilateral trade deficit would have been larger without the KORUS FTA. South Korean imports from the EU, however, increased by 9% from 2011 to 2016, which has led to questions over how the EU and U.S. FTAs differ. The two FTAs generally have similar tariff reductions, especially on major products like motor vehicles, suggesting other factors such as consumer preferences may have played a larger role in the different outcomes.

Figure 1. U.S. Total Trade with South Korea



Source: Bureau of Economic Analysis.

Selected Key Sectors and Provisions

Agriculture

Agricultural products are an area of U.S. comparative advantage—the United States ran a \$5.7 billion agricultural trade surplus with South Korea in 2016. South Korea's agriculture sector is highly protected—MFN agricultural tariffs average 57%—but through KORUS, South Korea immediately granted duty-free status to almost two-thirds of U.S. agricultural exports. Tariffs and import quotas on most other agricultural goods will be phased out by 2021. One of the most significant market access gains for U.S. producers is South Korea's elimination of its 40% tariff on beef over 15 years. Rice, however, was excluded at Seoul's insistence. Despite export gains from 2011 to 2016 in sectors with large tariff reductions like beef (\$365 million increase), tree nuts (\$113 million increase), and fruits (\$154 million increase), overall U.S. agriculture exports to South Korea have decreased, due largely to a major decline in the value of corn exports (\$1 billion decrease), which partly reflects a drop in commodity prices.

Motor Vehicles

U.S. and South Korean producers compete intensely in the motor vehicle and parts sector and such imports account for one-third of U.S. goods imports from South Korea. South Korean manufacturers operate a number of production plants in the United States while a General Motors subsidiary (formerly Daewoo) is one of South Korea's largest motor vehicle producers. Auto trade was among the most contentious issues in the KORUS FTA, but all three U.S. automakers ultimately supported the agreement. The agreement eliminated the 2.5% U.S. auto import tariff in 2016, but maintains the 25% U.S. light truck tariff until

2018 and eliminates it by 2021. South Korea's 8% auto import tariff was reduced to 4% immediately and eliminated in 2016, and its 10% light truck tariff was immediately eliminated. Under KORUS, tariffs on virtually all auto parts immediately dropped to zero. KORUS also permits each U.S.-based producer to export 25,000 cars directly to South Korea under U.S. rather than South Korean safety standards. From 2011 to 2016, U.S. auto and parts exports doubled to \$2.2 billion, but are still much smaller than U.S. imports which increased by 75% to \$21 billion, generating an \$18.8 billion deficit in the sector.

Services

Services trade was a priority in the KORUS FTA talks as the U.S. side sought greater market access for its highly competitive services firms, and South Korea hoped to improve productivity in a sector that lags behind its manufacturers. Commitments are on a "negative list" basis; i.e., all service sectors are covered except those specifically exempted. Provisions prohibit discriminatory treatment, local presence requirements, and market access limitations, and require certain steps in the regulatory process. Industry-specific commitments include the gradual, partial opening of South Korea's legal services sector; a financial services chapter that includes a novel provision allowing data flow transfers; and an annex on express delivery. Since 2011, the U.S. bilateral trade surplus in services trade has grown from \$6.9 billion to over \$10 billion, with major growth in exports of travel (+\$2.6 billion) and charges for use of intellectual property (+\$1.3 billion).

Issues for Congress

KORUS and the Alliance. Tensions over trade issues could influence the Korean public's perception of U.S. motives and commitment to South Korea. What is the most productive way to address trade concerns without damaging vital U.S. national security interests?

Trade Agreements and Trade Deficits. The Trump Administration has made bilateral trade balances a key metric of the success of U.S. FTAs, yet most economists argue other factors largely determine trade outcomes. What metrics are appropriate to evaluate U.S. FTAs? Has KORUS, which has lowered reciprocal trade barriers, achieved its goals to date?

Potential Renegotiation. Some U.S. exporters take issue with South Korea's KORUS implementation, but most business groups stress the FTA's benefits, argue against withdrawal, and urge caution in renegotiation. However, KORUS was signed ten years ago and the United States has negotiated newer provisions, such as in the Trans-Pacific Partnership (TPP), to address new congressional trade negotiating objectives on issues such as digital trade and state-owned enterprises. What are the costs and benefits of renegotiating KORUS; what should the U.S. seek through such talks; and what role should Congress play?

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