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The Korea-US Free Trade Agreement: A Summary Assessment

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The Korea–United States Free Trade Agreement (KORUS FTA) is a historic accord that should enhance bilateral economic relations and reinforce our longstanding partnership on political and security matters. Like any negotiated deal, the KORUS FTA is not the optimal result for either country, but it provides substantial benefits that make Korea and the United States considerably better off than they would be in the absence of the pact.

The FTA should reinforce the already substantial commercial ties between the United States and Korea. The US-Korea pact covers more trade than any other US trade agreement except the North American Free Trade Agreement (NAFTA). In 2006 bilateral merchandise trade exceeded $75 billion, with US exports of $30.8 billion and imports from Korea of $44.7 billion. Over the past five years, however, the growth in US-Korea trade has been sluggish; total two-way trade has grown at an average annual rate of only less than 7 percent. Indeed, for the past few years, Korean exports to the United States have been flat while US exports to Korea have grown only modestly (see table 1).[1]

In economic terms, the FTA is important because it opens up substantial new opportunities for bilateral trade and investment in goods and services. At the same time, it is controversial because the reforms required by the KORUS FTA will increase competition for Korean and American firms, workers, and farmers and thus will require adjustment. Both countries will benefit: Even though economic models yield sometimes widely differing results, the published forecasts of the welfare gains from the FTA all are positive (see Kiyota and Stern 2007). As a practical matter, however, the size of the gains for each country will depend importantly on how government policies and firm strategies respond to the new competitive environment.

Like other FTAs, the KORUS FTA also serves important foreign policy interests. In particular, it is part of each country's strategic response both to the challenges to security and stability on the Korean peninsula and to evolving economic integration arrangements in East Asia. For the United States, it is critically important to have a strong economic and political alliance with South Korea. The ongoing challenges posed by the North Korean regime should make that point self-evident.

For the same reason, it is important for the United States to participate in and help shape the course of economic integration in East Asia. The region is the hotbed of regional trading arrangements, with a variety of pacts differing in scope and coverage linking the economies of the Association of South East Asian Nations (ASEAN) with large industrial producers in China, Japan, and Korea. These initiatives are driven by the growing role of China in the regional and world economy. Not surprisingly, they reflect Chinese political as well as economic interests in its neighborhood, and Korean and Japanese attempts to emulate and compete with their new number one trading partner.[2] The United States is engaged to a limited extent in this process of integration through its FTA with Singapore and its network of consultative accords with the ASEAN. For the United States, the KORUS FTA is a way to buttress recent sluggish trade, counter discrimination against US exporters resulting from other pacts to which the United States is not a party, and signal continuing US engagement in a region critical for US economic and political security.

1. US-Korea trade growth has been overshadowed by each country's soaring trade with China, which has become Korea's leading trading partner.

2. China surpassed the United States as Korea's top trading partner in 2004 and became Japan's leading partner in the first half of 2007.

Table 1 US-Korea merchandise trade, 2001–06
(millions of dollars)

Year	US exports to Korea	US imports from Korea	US trade balance
2001	20,899	34,917	–14,018
2002	21,151	35,284	–14,133
2003	22,525	36,929	–14,404
2004	24,995	45,064	–20,069
2005	26,210	43,155	–16,945
2006	30,794	44,714	–13,920

Note: Data report domestic exports and imports for consumption.
Source: USITC Interactive Tariff and Trade Dataweb.

In this policy brief, I assess what the agreement achieved and its implications for evolving trade relations in the Asia-Pacific region. I conclude with a brief comment on the impending ratification debate in the US Congress.

ASSESSING THE KORUS FTA: KEY POINTS

The outcome of the KORUS FTA negotiations was predictable and as predicted (see Schott, Bradford, and Moll 2006). The agreement is comprehensive in scope, with calibrated exceptions made in a respectful bow to political reality. Each side was sensitive to the priority concerns of the other. Compromises were reached on several important political issues, including autos, rice, and treatment of production from the Kaesong Industrial Complex in North Korea.

Highlights of the deal have been summarized in the "fact sheets" posted by both governments. Most tariffs on bilateral trade will be removed within three years, which is significant even though average tariffs are relatively low, because bilateral trade is so large. Even in agriculture, where Korean trade barriers are much higher, many tariffs will be phased out over time and many quotas will be expanded; only rice will be exempted from some degree of liberalization. The impact of these bilateral preferences will depend, of course, on (1) what happens in the Doha Round and how quickly such multilateral liberalization is implemented (since liberalization on a most favored nation basis would dilute the relative value of the FTA tariff preferences), and (2) the evolution of other FTAs among Asia-Pacific countries.

The following subsections provide a broad brush analysis of key aspects of the FTA. I focus my comments on autos, agriculture, services, and the Kaesong Industrial Complex, since these areas are receiving the most scrutiny in the public debate in both countries.

Automotive Trade

Any assessment of the impact of the FTA on manufactures must start with autos. The automotive industry is an important producer and employer in both Korea and the United States. Korean production has grown steadily since 2001, from 2.95 million vehicles to 3.7 million in 2005 (of which about 70 percent were exported).[3] Over the same period, US production has hovered around 12 million vehicles (despite increased volumes by foreign companies producing in the United States) but has weakened somewhat since the second half of 2006. In contrast, US auto sales have remained relatively firm: During January–July 2007, total US auto sales were running at an annual rate of 16.3 million (down 3.2 percent from the same period in 2006).[4] Demand in the Korean market is down sharply from earlier this decade.[5]

In 2006 Korea exported about 700,000 cars to the United States; US car exports to Korea totaled about 4,500. In addition, auto companies have substantial investments in each other's market. Hyundai produced almost 300,000 cars in its new US plant (and Kia is building a US facility with similar capacity); the General Motors joint venture in Korea (GM Daewoo Auto and Technology) had domestic sales and exports of more than 1.1 million cars and accounted for about 12 percent of Korean car sales.[6]

The auto sector accounts for about 9 percent of total manufacturing employment in each country and auto unions in both countries have criticized the FTA. In 2004, Korean auto companies employed almost 250,000 workers. Korean union officials voice concerns that cost pressures are leading Korean automakers to produce abroad, including in the US market—though their criticism has been relatively muted because of Korea's booming exports.

Auto production in the United States employed 1.1

3. In 2005 Korean auto exports (defined broadly as Harmonized Schedule [HS] 87) were valued at $37.5 billion; sales to the US market accounted for 28 percent of Korean exports, the European Union–15 took 22 percent, and China took 9 percent.

4. According to Ward's AutoInfoBank, the US "Big 3" sales were down almost 9 percent in 2007 compared with that in 2006, while sales of Asian and European cars recorded modest increases.

5. Sales in the Korean market averaged 1.1 million vehicles annually in 2004–06, down more than 20 percent from the previous three-year average sales.

6. In 2002 General Motors bought a controlling share of Daewoo Motor and established GM Daewoo Auto and Technology in collaboration with Suzuki, Shanghai Automotive Industry Corporation, and Daewoo creditors.

million workers (250,210 in assembly; 175,600 in auto bodies; and 667,720 in parts) out of total 2006 US manufacturing employment of 14.2 million. However, in the auto sector, as in manufacturing more broadly, US employment is down from levels a decade earlier. Total US manufacturing jobs in 2006 were down about 18 percent and those in the US auto sector were down about 17 percent since 2000. New US plants recently built by Hyundai and Kia, which project combined production of about 600,000 cars by the end of this decade, will provide some modest relief. The US employment data, coupled with stagnant real wages for the past decade, explain to some extent why US autoworkers have become increasingly restive toward new free trade initiatives in general and the KORUS FTA in particular. In that regard, however, Hufbauer and Schott (2005) found that the wage premium paid to unionized auto workers—the amount they earn in excess of the average for manufacturing workers—was compressed largely as a result of US *nonunion* auto plants. Many of those plants are foreign "transplants."

The auto sector accounts for a large segment of bilateral trade and a large share of the US trade deficit with Korea. That deficit, along with a checkered history of attempts to remove Korean trade barriers pursuant to bilateral understandings on autos, has led auto unions and two car companies, Chrysler and Ford, to oppose the KORUS FTA.

Two-way trade is substantial; in 2006, Korea-US auto trade totaled $11.6 billion or about 15 percent of bilateral merchandise trade. Korean car exports to the United States were valued at about $10.9 billion; by contrast, US exports to Korea totaled only $730 million, mostly auto parts such as gear boxes and air bags.[7] Autos accounted for 24 percent of total US imports from Korea in 2006.

The disparity in bilateral trade flows in this sector has provoked heated concerns that continue to echo in the congressional debate on the KORUS FTA—including a demand issued in March 2007 that the pact include quantitative indicators to ensure increased US exports to Korea (see *Inside US Trade*, March 9, 2007, 16). To some US observers, the disparity in the volume of Korean exports to the US market compared with US exports to Korea (about 150 to 1) is prima facie evidence of discrimination.[8] They remain skeptical that the KORUS FTA will provide meaningful market access for US exporters, given the limited results from attempts over the past two decades to break down barriers to the Korean auto market, including through two US-Korea memoranda of understanding on autos in the 1990s. They conclude that US sales will not increase significantly, and therefore the United States should not remove its remaining trade restrictions affecting Korean shipments to the US market.

The KORUS FTA provisions on autos were a high priority for both countries. For Korean firms, the primary objective was to secure the immediate elimination of the small US tariff on passenger vehicles (2.5 percent). For the United States, the goal was to remove obstacles to market access in Korea, in particular the 8 percent Korean tariff, higher taxes on cars with larger engines, and regulations that favor incumbent producers.

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The FTA outcome on autos makes both sides better off than they would be in the absence of the bilateral deal. The FTA removes tariffs immediately for most classes of cars and phases out over a decade the 25 percent US light truck tariff (a vestige of the 1963 "Chicken War" retaliation against Europe!).[9]

The light truck tariff is a major aberration in the US industrial tariff schedule whose original justification has long since expired. Light trucks receive import protection higher than most other US products, including most textiles and apparel. This segment of the market generated substantial profits in past years for the Big 3, but Big 3 sales have slumped sharply in 2007. Concern about cutting the US light truck tariff reflects in part the Big 3's increased sensitivity to import competition in the face of this market weakness. Note, however, that the FTA tariff cuts would be phased in over nine years, meaning that in 2014 the US industry would still be protected by a double digit tariff.

Besides the tariff cuts, the FTA substantially reduces the burdens related to tax and regulatory policies. FTA provisions provide greater transparency and access to the regulatory process and a dispute resolution procedure to encourage compliance (with recourse to a snapback of the 2.5 percent US car tariff

7. Data cover HS chapter 87 as reported in the USITC Dataweb.

8. However, the vigorous growth in Korean auto exports also suggests that Korean products are becoming increasingly competitive in world markets.

9. Currently, Korea does not export light trucks to the United States but hopes to begin competing against Japanese producers once the tariff cuts are implemented.

Table 2 Breakdown on quantities of Korean auto production and shipment, 2005

Type of auto vehicle	Production quantity	Domestic shipments	Export shipments
Passenger car (light)	159,943	46,528	110,192
Passenger car (small)	1,159,512	210,200	950,729
Passenger car (medium)	591,964	225,072	366,095
Passenger car (large)	282,398	139,272	148,560
Passenger car (multiutility vehicle)	1,161,911	291,296	880,416
Total	3,355,728	912,368	2,455,992

Source: Korea National Statistical Office.

if rights are violated).[10] The pact also establishes an "Autos Working Group" that will monitor and provide comments on new draft regulations in Korea.[11] FTA investment provisions also provide general protections for US investors in Korea, who should face fewer problems in establishing joint ventures or other investments in the Korean auto sector than General Motors endured when it purchased a controlling share of Daewoo Motors in 2002. The pact goes beyond the World Trade Organization agreement on trade-related investment measures to bar performance requirements that require the transfer of technology (which could be of increasing importance given the industry focus on new hybrid fuels and engine technologies).

Will the FTA allow US auto exporters to compete more effectively in the Korean market? Chrysler and Ford express skepticism, given past experience, that FTA provisions that promise greater transparency and access to regulatory agencies will remove the discriminatory treatment evidenced in the past administration of Korea's regulatory policies affecting the auto sector. They argue that Korean tariff and nontariff barriers have restricted the supply of imported large vehicles—which traditionally have higher profit margins—to reserve a large share of that segment of the market for domestic producers.[12] Whether due to aggressive pricing or to nontariff trade barriers or other factors, a surprisingly high percentage of Korean production of larger cars is sold in the domestic market rather than exported, and these are the cars that compete most directly with imports. According to 2005 data reported by the Korea National Statistical Office (see table 2), Korean production of medium and large passenger cars, comparable in engine size to most imports, is only a quarter of total national production of passenger cars, but more than 40 percent of that production is sold in Korea (compared with less than 20 percent of light and small cars or 25 percent of multiutility vehicles). I suspect that such data explain only a small part of the story, and that lingering protectionism, relatively high tariffs and sales taxes, and high distribution and marketing costs, have all contributed to Korea's low import penetration in autos.

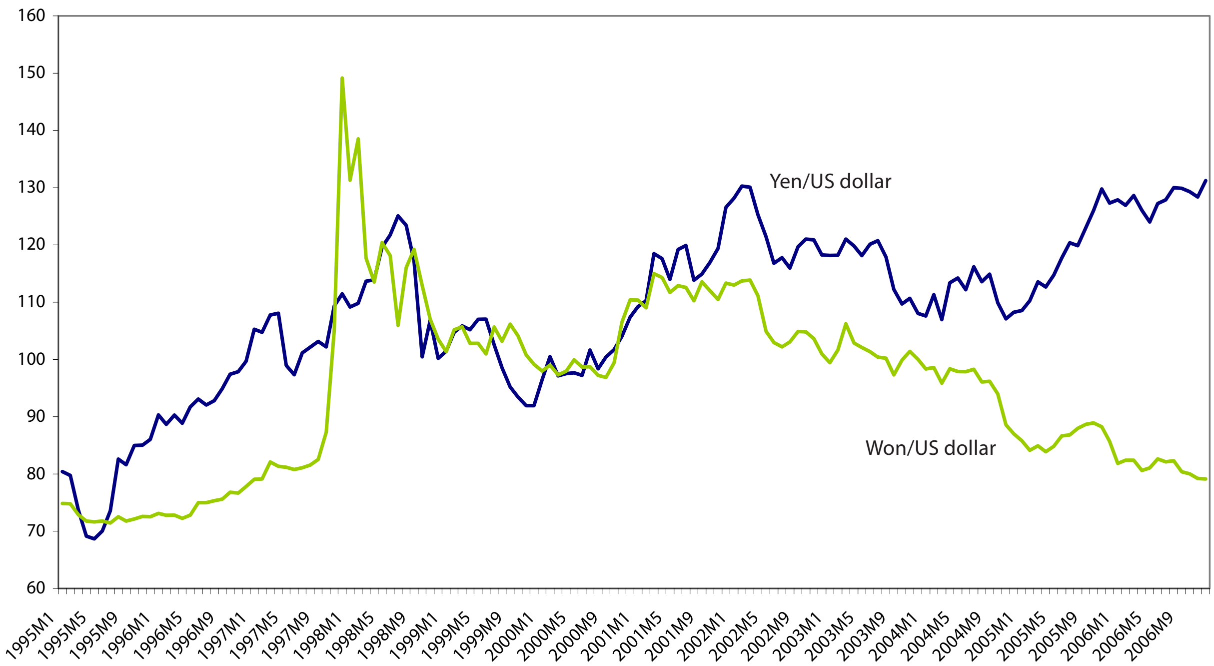
Why did Korea give such priority to eliminating the small US tariff, and why have these provisions provoked such criticism among labor unions in both countries? The answer to the first question seems to relate primarily to Japanese competition in the US market. Korean exporters have had to price aggressively in the US market to compete with Japanese-made cars to compensate for currency movements. As shown in figure 1, the won/dollar rate has appreciated markedly over the past few years while the yen has weakened against the dollar. Korean profit margins have been squeezed, with Hyundai reporting 2006 global profits down 35 percent due in large measure to the impact of the strong won (see "Won's Rise Makes Waves," *Wall Street Journal*, June 11, 2007). In these circumstances, while the swing in the won/dollar and yen/dollar rates swamps the impact of tariff reforms, the immediate 2.5 percent tariff reduction does provide a small cushion for Korean exporters in a highly competitive market. Such price competition is good for US consumers but adds further to the challenges facing the Big 3 American producers in their home market. More to

10. The light truck tariff was not included in this snapback clause. Korean officials argued that investors might defer placements in Korean firms if the tariff cuts could be reversed.

11. For a summary of these provisions, see United States Trade Representative (USTR), "Fact Sheet on Auto-related provisions in the US-Korea Free Trade Agreement," April 3, 2007. Available at the USTR's website, www.ustr.gov.

12. To be sure, there is nothing wrong with using tax policy to promote socially desirable objectives such as pollution control and public safety, provided the measures are applied in a nondiscriminatory fashion.

Figure 1 Real exchange rate vis-à-vis US dollar (2000 = 100)



Note: Downward movements in the lines reflect real appreciation.

the point, the price competition will continue to sharpen, with or without the FTA, as companies try to increase or at least maintain market share. The US tariff concessions to Korea will not change the competitive conditions in the US market to any appreciable extent.

Are the auto provisions of the KORUS FTA "unbalanced?" In terms of the requirements to change existing policies, the answer is definitely yes. Korea is required to lower its barriers to trade and investment much more than the United States.

Claims that the pact is "unbalanced" because the *balance of trade* is one-sided reflect confused economics and confuse the policy debate. The real issue is whether tariff liberalization and regulatory reform in Korea will create new export opportunities for US automakers. The 8 percent tariff advantage alone should help. US exporters will have a significant tariff preference in competition with Japanese and German cars for Korean customers, at least until the EU-Korea FTA and the Doha Round results are concluded and fully implemented.[13] The scope and pace of those reforms do not provide ironclad guarantees of increased US sales to Korea but the cost advantage alone should generate sharply higher demand for US-made autos. Indeed, anecdotal reports about changes already taking place in the Korean market in anticipation of the FTA—including price discounting by imported car dealers—suggest the pact could promote a narrowing of the price differentials between domestic and foreign cars, at least for models of similar size and engine displacement.

In sum, protectionist pressures in the United States arise due to competition both between US and foreign firms and between US unionized and nonunionized plants. US union opposition is in large measure a reaction to the long-term decline in employment and stagnant real wages, as well as new competition in the US market from foreign "transplants," including most recently Korean automakers such as Hyundai and Kia. General Motors is doing very well in the Korean market, and US-based exporters can expect a sharp increase in sales to Korea from their current anemic levels—but the US industry won't strengthen very much based on this export growth.

In terms of what should be done to restore the health of the US auto industry, FTAs have positive, albeit limited, medicinal powers. Curing the US industry's chronic problems, particularly those related to healthcare and pension costs, require domestic policy reforms that should be urgently addressed by the US Congress. In other words, the most important benefits for the

13. The European Union opened FTA negotiations with Korea in May 2007. EU Trade Commissioner Peter Mandelson is seeking a deal comparable to the KORUS FTA; talks are projected to be completed by early 2008.

US auto industry would not come from increased access to the Korean market, but from homegrown reforms introduced in response to competitive challenges in the US market.

Agriculture

Agriculture accounts for only 3 percent of bilateral trade but is a crucial component of each country's trade politics. Indeed, political consideration of a prospective negotiation was repeatedly postponed because of concern that agriculture writ large would not be covered by the pact. So it is noteworthy that the pact covers almost all agricultural trade between the two countries, even if the liberalization schedule is protracted and in some cases incomplete for some sensitive products. It also is noteworthy that the United States agreed to exempt rice from Korea's commitments. In some areas, the FTA will generate new competition for Korean farmers; in some areas, the new competition will be with farmers from other countries that export to Korea under existing FTAs (e.g., Chile and, in the near future, the European Union and Australia).

The FTA outcome on autos makes both sides better off than they would be in the absence of the bilateral deal.

In the agricultural negotiations, the most important issue for Korea was rice and the most important issue for the United States was—and still is—beef. The exemption of rice was an important political gesture but did not change the economics of the FTA very much. As a practical matter, full liberalization of rice trade was never in the cards—the most that could have been achieved in the negotiations would have been a minor increase in the tariff rate quota that would have accommodated incremental US sales in the Korean market. Thus, the political benefit of excluding rice far outweighed the trade effect.

On beef, the FTA phases out Korean tariffs over 15 years. However, the FTA does not cover the main barrier to the Korean market—the ban on US imports imposed for health reasons since December 2003 in response to the discovery of a bovine spongiform encephalopathy (BSE)–infected cow (and partially lifted this year).[14] With the determination issued in May 2007 by the World Organization for Animal Health (OIE) that the United States is a "controlled risk" country, there is now an expectation that Korean regulators will be able to renew certification of US beef products. Indeed, Korean Deputy Prime Minister Kwon Okyu commented after the OIE ruling that regulatory proceedings in Korea could lead to the removal of the import ban within a few months.[15] As Senate Finance Committee Chairman Max Baucus (D-MT) has repeatedly warned, the US Congress is unlikely to consider ratification of the pact until the Korean beef ban is fully resolved.

FTA tariff reforms should provide immediate benefits for a broad range of US farm exports, including wheat and corn, soybeans for crushing, wine and bourbon whiskey, frozen concentrated orange juice, frozen french fries, and most fresh vegetables and tree nuts (the main exceptions are carrots, broccoli, cauliflower, and peas with a 5-year tariff phaseout and shelled walnuts with a 6-year tariff phaseout). For products such as fish, butter, cheese, food whey, barley, and corn starch, Korean imports will continue to be regulated by tariff-rate quotas for a period of 10 to 15 years. In the interim, however, the quotas will be expanded and the overquota tariff surcharge reduced until the protection is eliminated. Combined, these products account for a substantial share of US farm exports to Korea (see table 3).

A number of important products will be subject to partial liberalization. Seasonal restrictions on navel oranges will remain (except for small annual quota increases) but out-of-season tariffs will be phased out over seven years—given the different growing seasons, US exporters of oranges should benefit significantly from this new access during Korea's off season. The high tariffs on mandarin oranges and Fuji apples will be eliminated over 15 and 20 years, respectively. Overall, the FTA should spur significant growth in US agricultural exports to Korea: Again, the largest gain could well accrue from regulatory actions on beef not directly covered by the FTA obligations.

In sum, the FTA liberalization of farm trade predominantly benefits US agricultural exporters.[16] Korean officials acknowledged that the pact will adversely affect some segments of its agrarian economy—particularly beef, pork, mandarin oranges, and beans—and proffered new adjustment assistance and compensation programs to mitigate the adjustment burdens for those Korean farmers.[17]

14. Before the BSE-related ban in late 2003, US beef exports to Korea (HS chapter 2) were valued at $915 million and represented one-third of total US farm exports to Korea in 2003.

15. However, concerns by Korean regulators about the reliability of US monitoring of beef exports have resurfaced due to the recent spate of mistakes in which certain boned beef still proscribed by Korean health authorities was included in US shipments to Korea. These US production/shipping errors could delay and possibly hamper the resolution of the beef problem.

16. However, given the large Korean-American community, Korean officials also predict an increase in specialty food exports to serve the ethnic market in the United States.

17. See, for example, "Domestic Compensation Measures in light of the Conclusion of KORUS FTA," statement by Korean Deputy Prime Minister and Minister of Finance and Economy Kwon Okyu on behalf of other Korean ministers issued after the conclusion of the FTA talks on April 2, 2007. Available at the Ministry of Finance and Economy's website, www.english.mofe.go.kr (accessed on August 7, 2007).

Table 3 US exports to Korea in selected agricultural products (thousands of dollars)

HTS 2 digit code	HTS 4 digit code	HTS 10 digit code	Description	2005	2006
02			**Meat and edible offal meat**	**193,704**	**273,894**
	0201		Meat of bovine animals, fresh or chilled	0	288
	0202		Meat of bovine animals, frozen	0	160
	0203		Meat of swine (pork), fresh, chilled, or frozen	133,549	203,613
		0203194000	Meat of swine, nesoi, except processed, fresh, or chilled	25,243	34,741
		0203192000	Meat of swine, nesoi, processed, fresh, or chilled	242	1,468
		0203292000	Meat of swine, nesoi, processed or frozen	2,101	6,053
		0203294000	Meat of swine, nesoi, except processed or frozen	88,287	141,309
	0207		Meat and edible offal of poultry (chickens, ducks, geese, turkeys, and guineas), fresh, chilled, or frozen	42,612	51,899
03			**Fish and crustaceans, mollusks, and other aquatic invertebrates**	**390,537**	**404,912**
	0301		Fish, live	1,599	1,461
	0302		Fish, fresh or chilled, excluding fish fillets and other fish meat without bones; fish livers and roes, chilled	2,666	5,736
	0303		Fish, frozen, excluding fish fillets and other fish meat without bones; fish livers and roes, frozen	217,819	230,571
		0303804050	Alaska pollock (Theragra Chalcogramma) roe, frozen	145,442	142,940
	0304		Fish fillets and other fish meat (minced or not), fresh, chilled, or frozen	149,277	143,188
04			**Dairy produce; birds' eggs; natural honey; and edible products of animal origin, nesoi**	**47,366**	**51,856**
	0401		Milk and cream, not concentrated nor containing added sweetening	52	16
	0402		Milk and cream, concentrated or containing added sweetening	1,189	1,618
	0403		Buttermilk, curded milk and cream, yogurt, kephir, etc., flavored or not, etc., or containing added fruit or cocoa	2,224	1,515
	0404		Whey and other products consisting of natural milk constituents nesoi, concentrated or sweetened or not	17,654	22,445
	0405		Butter and other fats and oils derived from milk	236	382
	0406		Cheese and curd	22,477	22,400
07			**Edible vegetables and certain roots and tubers**	**15,782**	**19,432**
	0701		Potatoes (other than sweet potatoes), fresh or chilled	605	1,485
	0709		Vegetables nesoi, fresh or chilled	8,699	7,925
	0710		Vegetables (uncooked or cooked by steam or boiling water), frozen	2,118	2,696
08			**Edible fruit and nuts: Peel of citrus fruits or melons**	**187,080**	**210,923**
	0802		Nuts nesoi, fresh or dried	52,723	67,865
	0805		Citrus fruit, fresh or dried	113,277	111,903
		0805100020	Oranges, Temple, fresh or dried	15,049	24,622
		0805100040	Oranges, nesoi, fresh or dried	82,992	35,640
	0806		Grapes, fresh or dried	7,391	8,442

(table continues next page)

Table 3 US exports to Korea in selected agricultural products (thousands of dollars) *(continued)*

HTS 2 digit code	HTS 4 digit code	HTS 10 digit code	Description	2005	2006
10			**Cereals**	**429,075**	**944,504**
	1001		Wheat and meslin	181,132	188,276
	1005		Corn (maize)	239,378	723,334
12			**Oil seeds and oleaginous fruits: Miscellaneous grains, seeds, and fruits; industrial or medicinal plants; and straw and fodder**	**322,586**	**267,181**
	1201		Soybeans, broken or not	199,406	113,068
20			**Preparations of vegetables, fruit, nuts, or other parts of plants**	**99,473**	**101,023**
	2009		Fruit juices not fortified with vitamins or minerals (including grape must) and vegetable juices, unfermented and not containing added spirits, containing added sweetening or not	30,514	31,554
		2009110020	Orange juice, unfermented, frozen, in containers each holding less than 0.946 liter	1,896	2,463
		2009110040	Orange juice, unfermented, frozen, in containers each holding 0.946 liter or more but not more than 3.785 liters	24	613
		2009110060	Orange juice, unfermented, frozen, in containers of more than 3.785 liters	8,312	5,331
		2009904000	Mixtures of fruit juices, unfermented	5,597	8,100
22			**Beverages, spirits, and vinegar**	**36,229**	**36,241**
	2202		Waters, including mineral waters and aerated waters, containing added sweetening or flavored, and other nonalcoholic beverages nesoi	15,102	13,547
	2204		Wine of fresh grapes, including fortified wines; grape must have an alcoholic strength by volume exceeding 0.5 percent volume, nesoi	10,018	11,138
Total agriculture exports[a]				**2,107,676**	**2,795,231**

nesoi = not elsewhere specified or included.

a. Agriculture is defined as HS 1-24 in HS 2 digit code.

Source: USITC Interactive Tariff and Trade Dataweb (accessed on May 30, 2007).

Services

Increased trade and investment in services, coupled with regulatory reform of Korean service industries, were a priority objective of both countries. For the United States, FTA provisions on trade and investment in financial services, express delivery, and professional services (such as legal and accounting services), create significant new business opportunities. Insurance companies, in particular, will benefit from broad ranging rights of establishment as well as increased cross-border trade in a wide range of insurance products. The FTA also bars customs duties on electronic commerce and lifts investment restrictions in Korean telecommunications companies. In addition, Korea further liberalized or locked in changes in broadcasting and cable quotas undertaken just before the formal negotiations began.

All these Korean "concessions" are good news for the Korean economy and for Korean companies and workers. Indeed, the services provisions of the KORUS FTA could well be the most important aspect of the deal for Korea. By committing to greater transparency of administrative and regulatory procedures and by removing obstacles to investment and the provision of services (where restrictions often raise production and distribution costs for producers of goods and services alike), the Korean government will help promote a more conducive environment for investment from both domestic and foreign sources. The ancillary benefits of the required investment and regulatory reforms, as well as the increased productivity of service industries, should accrue across the Korean economy. In this regard, the KORUS FTA can help address one of the key challenges facing the Korean economy recently highlighted by the Organization for Economic Cooperation and Development (OECD 2007): the gap between Korea and the best performing countries due to Korea's low level of productivity growth.

The FTA is deficient, however, in its lack of obligations regarding the movement of natural persons. This shortcoming is the fault of the US negotiators whose hands were tied by a congressional mandate that "immigration" issues broadly defined could not be discussed in the context of a trade pact. As a result, the FTA does not expand the H-1B visas for Korean nationals, despite the inherent need of many US firms for qualified workers. However, the United States and Korea have been discussing, in parallel with the KORUS FTA, the inclusion of Korea in the US visa waiver program, with the expectation that the administration will qualify Korea for this preferential treatment in the very near future.

Kaesong Industrial Complex

Each country started the negotiations in a position diametrically opposed to the other: Korea wanted goods produced in the Kaesong Industrial Complex in North Korea to be fully eligible for FTA preferences; and the United States wanted no benefits from the FTA to accrue to the regime of Kim Jong-Il. Nonetheless, the two partners shared a common objective of promoting cooperation on security issues in Northeast Asia and encouraging the process of policy reform in North Korea.

A year ago, I suggested to both governments that they establish "procedures in the FTA itself for updating the pact if and when the reunification process advances" (Schott, Bradford, and Moll 2006, 15).[18] In the course of the talks, the two sides bridged their differences in Annex 22-C on "outward processing zones" (OPZs) on the Korean peninsula. The agreement does *not* accord trade preferences to goods produced in the Kaesong Industrial Complex, but it does create a process for future consideration of such a development, if the economic and political situation on the Korean peninsula changes as desired by both FTA partners.

To that end, the FTA establishes a committee to (1) identify geographic areas that *may be* designated OPZs; and (2) develop criteria for evaluating whether goods produced in OPZs *may* be considered eligible for FTA preferences. The criteria *must* include environmental and labor standards and practices and take account of how the standards and practices compare with (1) those in the local economy, and (2) relevant international norms [emphasis added]. Committee decisions regarding OPZ designations and FTA eligibility are not self-executing. Extension of FTA preferences to new areas (OPZs) would require amendments to the agreement. For the United States, such an amendment would have to be ratified by the Congress and implemented through new legislation. The Chairman of the House Ways and Means Trade Subcommittee, Sander Levin (D-MI), argued in early June that these procedures would not be consistent with the obligations on labor standards that the United States Trade Representative (USTR) committed to include in every FTA. However, the FTA preferences can only be applied to OPZs if the KORUS FTA is amended, and Congress is unlikely to approve such changes if the labor conditions do not comport with international norms. I suspect that Congressman Levin's concern will be addressed through clarifying language in FTA implementing legislation.

Trade is not a top priority for the Democratic leadership in Congress; however several trade initiatives and trade preference programs require legislative action—including renewal of the Trade Adjustment Assistance (TAA) program.

IMPLICATIONS FOR TRADE RELATIONS IN THE ASIA-PACIFIC REGION

The conclusion of the FTA also has profound implications for the trade relations that Korea and the United States have with other countries. As noted earlier, the European Union already has sought to emulate the KORUS FTA with its own bilateral pact. The KORUS FTA accelerated the preparations and launch in May 2007 of new free trade negotiations between the European Union and Korea. European exports to East Asia have revived in the past two years, but risk being sideswiped by the new preferences accorded by bilateral and regional trade deals to which Europe is not a party, just like the concerns that are addressed in the United States. European officials have emulated US initiatives in Asia, and recently launched talks with not only Korea, but also with ASEAN and India. Like US-Korea trade, autos are a main component of EU-Korea

18. Graham (2007) made a similar recommendation in his analysis of historical precedents for including special export zones in trade agreements.

trade. EU officials covet the new access promised US exporters in the KORUS FTA; indeed, if US ratification of that pact is delayed, EU exporters could gain preferential access to the Korean market over their US and Japanese competitors.

Under these circumstances, Japan could be prompted to follow suit—even though the outcome of the July 2007 Upper House election seems to presage a go-slow approach to Japanese agricultural reform that such agreements would likely require. Nonetheless, if and when the EU and US FTAs with Korea enter into force, Japanese officials will be hard pressed not to revive the long-stalled free trade talks between Korea and Japan, and also will have to seriously consider FTA talks with the United States and/or the European Union.

As with Korea, the idea of an FTA with the United States has been vetted for a long time in Japan but was shelved due to domestic resistance to agricultural and regulatory reforms. The topic was discussed in bilateral talks between President Bush and Prime Minister Abe in late April, but preparations for FTA talks were deferred due to internal resistance from the Ministry of Agriculture and well-founded concerns about the upcoming Upper House elections. Like Korea, Japan has a broad economic and foreign policy agenda that could be served by a closer partnership with the United States, especially at a time when the global trade talks face an uncertain outcome and when competition from China is moving up the value-added chain. That said, without a renewal of US trade promotion authority (TPA), we may not see any new FTA negotiations involving the United States in the near term.

The Bush administration needs to respond constructively to Democratic concerns about the FTA and the competitiveness of the US auto industry. In return Speaker Pelosi should encourage Chairman Rangel to negotiate a legislative compromise.

Could the KORUS FTA be a building block toward a broader Asia-Pacific trade accord? The answer is possibly but not quickly. The Asia-Pacific region is home to a variety of trade agreements which differ widely in terms of quality and participation. Various proposals are now being vetted in an effort to harmonize existing arrangements; some would also extend membership to other Asia-Pacific partners. All the models that have been suggested—whether it is ASEAN-10 plus 1, ASEAN-10 plus 3, ASEAN-10 plus 6, or the Free Trade Area of the Asia-Pacific (FTAAP)—have at their core the ASEAN, and ASEAN is not well integrated itself. Moreover, the basic underlying economic conditions are so different in so many countries that developing a consensus will be laborious. Regional integration thus will be an evolutionary process with competing models of engagement.

PROSPECTS FOR CONGRESSIONAL RATIFICATION OF THE KORUS FTA

The conclusion of the KORUS FTA negotiations in early April 2007 took place while another set of high stakes trade negotiations—those between leaders in the US Congress and the Bush administration—were still being contested. At issue in the domestic talks was nothing less than "A New Trade Policy for America" and the start of a process to restore bipartisan support in the Congress for US trade initiatives after a decade of fractious partisanship by the Republican majority that controlled both the House of Representatives and the Senate until January 2007.

The Congress-administration negotiation progressed in fits and starts. A deal was finally struck on May 10, 2007, covering labor, environment, intellectual property, government procurement, national security issues relating to port management and services, investment, and support and training for domestic workers (see Destler 2007). In essence, it is a domestic political deal in which congressional Democrats (led by House Ways and Means Committee Chairman Charles Rangel [D-NY] and endorsed by Speaker of the House Nancy Pelosi [D-CA]) and the Bush administration (represented by USTR Susan Schwab and Treasury Secretary Henry Paulson) reconfirm that all FTAs signed by June 30, 2007 (meaning Peru, Panama, Colombia, and Korea) qualify for the "fast track," implementing procedures afforded by the TPA of the Trade Act of 2002, and commit to support ratification of trade agreements that reflect the agreed changes in US trade negotiating objectives. For Korea (and Colombia), however, the calculus is a little more complicated, since the House Ways and Means Committee called for additional changes in those countries' policies beyond the areas delineated in the pact.[19] Underscoring that point, Speaker Pelosi, House Majority Leader Steny Hoyer (D-MD), Ways and Means Chairman Rangel, and Trade Subcommittee Chairman Levin reiterated on June 29, 2007,

19. While not a part of the agreement, the House Ways and Means Committee issued a cover note to their announcement of the pact that listed additional concerns regarding Korean trade and regulatory barriers, particularly in the auto sector, which "will have to be addressed."

that "we cannot support the KFTA as currently negotiated."[20]

The KORUS FTA was signed on June 30, 2007, after the issues covered in the bipartisan agreement were incorporated into the FTA text. The US International Trade Commission (USITC) is now conducting the required analysis of the pact; once the USITC report is submitted, the formal legislative process can begin. However, public debate over the FTA has been underway in both countries for quite some time, and critics have been quick to voice concerns. Congress is now hearing the "squeaky wheels," especially from Detroit. Some feel disadvantaged by the KORUS FTA; others seem to be opposing the trade deal in order to leverage changes in domestic policies of beneficial interest to their industry. Such critiques are not uncommon at this stage of the legislative process before proponents begin to lobby specific legislation. But the situation is more complex and uncertain than in the past due to the change in congressional leadership and to the bipartisan pact between the Congress and the Bush administration.

As with other FTAs—including NAFTA—debated by the Congress, the economic case for the KORUS FTA will be convincing but not necessarily politically compelling. Increased trade and investment generated by a bilateral pact, even with a major trading partner, is not that important for the $13 trillion US economy. Most major US trade initiatives have been sold to the Congress on foreign policy grounds; indeed, NAFTA seemed headed for defeat until then General Colin Powell convincingly argued that the trade deal would contribute to greater political and economic stability throughout Central America and thus greater security at the long US border with Mexico. After that testimony, the NAFTA passed the House by a vote of 234 to 200.

I expect a similar dynamic to drive the ratification debate on the KORUS FTA. The economic benefits of the pact will be weighed against the adjustment costs. Proponents also will argue that the deal is needed to counter the discrimination that US exporters and investors face due to trade agreements between Korea and other countries and to ensure that the growing wave of bilateral and regional arrangements among East Asian countries continues to include the United States. The prospective conclusion of the EU-Korea FTA in early 2008 will reinforce this argument: If Congress defers action on the KORUS FTA, the US auto industry (among others) will suffer as its European competitors get preferences in the Korean market. Ultimately, however, the Congress will likely support the KORUS FTA because of its strategic importance—in particular the durability of the US-Korea alliance over the past half century and our mutual interest in reinforcing it, our common objectives in promoting peace and prosperity on the Korean peninsula, and the breadth of the US commitment to the East Asian region.

When will the Congress vote on implementing legislation for the KORUS FTA? There is no clear timetable. Under TPA, a vote could occur soon after submission of the requisite economic impact analysis by the USITC in late September 2007 or be deferred for a substantial period of time; the "fast track" procedures only require an expeditious vote without amendment once implementing legislation is tabled. Given the economic and political reasons cited above, Congress should expedite ratification, so the pact can enter into force by January 2009.

That said, the current session of Congress (through the 2008 presidential election) has an unusually large number of prospective trade votes on its legislative calendar. Trade is not a top priority for the Democratic leadership in Congress; however several trade initiatives and trade preference programs *require* legislative action—including renewal of the Trade Adjustment Assistance (TAA) program. The FTAs with Peru, Panama, Colombia, and Korea will compete with those trade issues and other legislation—including a new farm bill—for congressional attention.[21] Extending TPA in its current form is highly unlikely in this Congress, though a short-term extension of TPA solely for the Doha Round is possible if those talks make substantial progress later this year.

The stakes—in terms of both US economic and security interests in East Asia—are too great, and the costs too high, to reject the pact or defer a decision.

Speaker Pelosi's June 29, 2007 statement—which specifically targeted the pact's auto provisions—presents a significant obstacle to congressional ratification of the KORUS FTA. The Bush administration needs a substantial minority of Democratic members to support implementing legislation for the KORUS FTA and risks losing those votes if it ignores the Speaker's position. However, acceding to the Speaker's demands also risks failure; Korea would certainly demand changes in other FTA

20. The statement specifically noted problems with the pact's auto provisions. See, Speaker Nancy Pelosi, press release, June 29, 2007. Available at the Speaker of the House's website, www.speaker.gov (accessed July 16, 2007).

21. My best guess is that the Peru and Panama FTAs will be approved in early fall 2007 based on changes made to the pacts pursuant to the terms set by the Congress-administration arrangement. A vote on Colombia will likely be postponed until new programs by the Uribe government make progress in dealing with the paramilitary scandals.

provisions benefiting US interests and the entire deal could quickly unravel.[22]

How can this dilemma be overcome? Changing the substantive provisions of the FTA's auto chapter won't work and isn't justified in any event. As noted earlier, the Democratic critique of these provisions is not convincing. But the Bush administration needs to respond constructively to Democratic concerns about the FTA and the competitiveness of the US auto industry. For example, federal programs could assist the companies in complying with new fuel economy standards and financing their "legacy" pension and healthcare costs. In return Speaker Pelosi should encourage Chairman Rangel to negotiate a legislative compromise. Such a deal should focus on domestic measures that would help US automakers compete at home and abroad but also—for political reasons—may have to augment the FTA's auto safeguard provision (which seeks to ensure that commitments to reduce nontariff barriers to auto trade will be faithfully enforced). If Chairman Rangel can pull the two sides together, as he did with great skill and patience to produce the May 10, 2007 accord, then ratification of the KORUS FTA could proceed in late 2007 or early 2008 (with a vote possibly delayed until after the Michigan primary election in February 2008).[23]

22. Korean officials were upset that they had to reopen the FTA text just days before the signing deadline to accommodate additional provisions required by the May 10, 2007, Congress-administration deal.

23. Again this timetable assumes the resolution of the beef issue; if problems persist, ratification will be postponed.

The ratification debate in Congress will be contentious. In the end, however, I am confident that the KORUS FTA will be approved. The stakes—in terms of both US economic and security interests in East Asia—are too great, and the costs too high, to reject the pact or defer a decision.

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