

The First Anniversary Evaluation of the Korea-U.S. FTA and Its Implications

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1. Introduction

Since it was signed in April of 2007, and after undergoing additional negotiations in 2011, the Korea-U.S. FTA finally came into effect as of March 15, 2012, with the completion of the ratification process in the two countries after six years since negotiations began. Some were hopeful while others remained concerned about

the KORUS FTA, as it is a high-level and comprehensive FTA that was signed with a mega-economic power. Accordingly, there had been many tough challenges in internal negotiations for the KORUS FTA to become effective. This paper aims to evaluate, however on a limited basis, the effect the KORUS FTA had on the trade and investment in the two countries as of its first anniversary.

2. Trade of goods

A. Goods

1) Changes in volume of trade since the KORUS FTA went into effect

Korea's trade with the U.S., in general, has increased substantially since 2010 after the financial crisis. Although it is still growing, the rate of growth is slowing. Korea's exports to the U.S. from March 2012, shortly after the KORUS FTA went into effect, until December, grew by 1.1% from the previous year, while the imports shrank by 7.7%. Such changes in trade must have been impacted not only by the KORUS FTA, but also by other various factors, such as the economic circumstances in each country and the fluctuations in foreign exchange rates. Accordingly, this paper examines the effects of the KORUS FTA by analyzing the changes in Korea's trade with the U.S. through various contributing factors. The analysis showed that, as a result of the KORUS FTA, Korea's exports to the U.S. grew by 12.7%, while the imports from the U.S. grew by 7.6% (See Table 1 below). This means that without the KORUS FTA, Korea's exports to the U.S., during the period from March 2012 until December 2012, would have decreased by 11.58% from the same period of the previous year. Also, the analysis showed that, while the customs tax reduction effect resulting from the KORUS FTA was 0.09%, the noncustoms tax effect was 12.6%, indicating that the overall improvements in the trading environment must have contributed more to the expansion in the exports compared to the immediate abolishment of customs taxes. In terms of industries, the customs tax effect was shown most notably in the auto parts industry while the noncustoms tax effect was noticeable in industries involved in chemicals, metals, and other machineries. The imports from the U.S. were reduced by 7.7% from the previous year since the KORUS FTA went into effect, but the KORUS FTA effect increased by 7.6% indicates that in reality, the imports owing to the KORUS FTA resulted in a net increase. Unlike the exports to the U.S., the imports from the U.S. showed a meaningful decrease because of the effects of foreign exchange, indicating that the U.S.'s relative rise in consumer prices had an adverse effect because, despite the continued rally of the Korean won, the U.S.'s real effective exchange rate rose while Korea's real effective exchange rate declined. With industries, the KORUS FTA import effect was most notable in the auto parts industry.

2) Analysis of export/import diversity and the rate of utilization after the KORUS FTA went into effect

After the KORUS FTA came into effect, it appears that Korea's export diversity has improved, with the number of products exported to the U.S. increased in 116 products, whereas products imported from the U.S. decreased in 21 products. The number of products exported increased in the areas of some chemical manufacturing industries and other manufacturing industries, while a substantial product change occurred in the imports of textile products and auto parts.

In terms of the rate of utilization of the KORUS FTA, the analysis shows that Korea's rate of import utilization was 52.9% from March to December 2012, which was higher than the export utilization

of 41.7%, demonstrating that the KORUS FTA¹ is better used in imports from the U.S. Table 1. Analysis of changes in trade between Korea and the U.S. (rate of change from the period between March 2011 and December 2011 to the same period in 2012)

(Unit: %)

Industries	Korea's Exports to the U.S.				Korea's Imports from the U.S.			
	Net Change	F/X Effect	KORUS FTA Effect		Net Change	F/X Effect	KORUS FTA Effect	
			Noncustoms tax effect	Customs tax effect				
Agriculture, fisheries, and mining	△8.40	-	-	-	△20.30	0.13	-	
Manufacturing	Textiles	△1.30	△0.01	0.00	△0.10	△10.30	△2.11	-
	Chemicals	5.00	-	75.46	0.00	0.30	0.00	-
	Metals	13.90	-	31.70	1.45	△8.20	△2.57	-
	Other machinery	12.10	0.01	58.36	0.19	△10.50	△1.57	-
	Electronics	△36.70	△0.01	-	0.94	4.40	△3.74	-
	Automobiles and parts	15.40	0.02	-	5.48	24.40	-	172.17
	Other manufacturing	3.40	-	-	0.27	△10.70	△1.68	15.17
Overall	1.10	-	12.59	0.09	△7.70	△1.51	7.57	

Note: - represents those that have no statistical meaning. The statistics for agriculture and fisheries is as of December 2012. The period of analysis is different from agriculture in the industry-by-industry analysis.

Source: Calculated by the author based on sources from Korea Customs and Trade Development Institute and other estimates.

Table 2. Rate of utilization of special customs tax treatment under the KORUS FTA

(Unit: million dollars, %)

Industries	Korea's Exports to the U.S.			Korea's Imports from the U.S.		
	Customs tax applied to amounts of import	Amounts of import available for application	Rate of utilization	Customs tax applied to amounts of import	Amounts of import available for application	Rate of utilization
Agriculture, fisheries, and mining	1,126	1,310	85.9	32	37	86.1
Manufacturing	9,282	18,372	50.5	11,424	27,464	41.6
Textiles	45	111	40.2	403	645	62.6
Chemicals	3,539	5,874	60.2	2,848	3,682	77.3
Metals	535	1,238	43.2	883	1,365	64.7
Other machinery	873	2,896	30.1	1,986	3,027	65.6
Electronics	42	143	29.4	162	319	50.9
Automobiles and parts	540	1,074	50.3	2,477	12,870	19.2
Other manufacturing	3,709	7,036	52.7	2,664	5,556	48.0
Overall industries	10,408	19,682	52.9	11,456	27,502	41.7

¹ The utilization rate is the percentage makeup of the amount of imports that has actually been subjected to the special customs tax treatment out of the amount of imports available for the special customs tax treatment.

Source: Calculated by the author based on sources from Korea Customs and Trade Development Institute and USITC (<http://dataweb.usitc.gov/>).

A profound examination shows that both countries have exhibited high rates of utilization in agriculture, fisheries, mining, and textile products, while imports in terms of automobiles and parts, and exports in terms of other machineries showed high utilization rates. On the other hand, chemical products, which are imported from the U.S. in large volumes, have a high utilization rate, whereas utilization by automobiles and parts, which are exported in large volumes to the U.S., exhibited a relatively low utilization rate. This means that when Korea's automobiles and parts are exported to the U.S., they do not sufficiently enjoy the price competitiveness resulting from the application of the special customs tax treatment.

B. Agriculture

After the KORUS FTA came into effect, the overall export of agriculture, livestock, and fisheries products to the U.S. has increased by 7.4% from the same period before, which was higher than the rate of export increase found in the rest of the world excluding the U.S.'s with 4.5%, but still less than the average rate of increase of 10.2% in the five years before the KORUS FTA came into effect. It is therefore difficult to conclude that the exports of agriculture and fisheries products to the U.S. have increased in particular as a result of the KORUS FTA. Imports of agriculture, livestock, and fisheries products from the U.S. have declined by 14.5% from the same period before, which is less than the rate of increase in imports from the world of 4.7% or the average change in imports from the U.S. in the past five years of 20%. At the end of the day, while the export of agriculture, livestock, and fisheries products to the U.S. has increased

somewhat since the KORUS FTA became effective, and while the imports have declined, when this is compared with the trends of export/import with the rest of the world, there is nothing in particular that could be specifically attributed to the effects of the KORUS FTA.

The changes in the producer price index for agriculture, livestock, and fisheries products around the time the KORUS FTA became effective was examined in order to determine the injuries to Korea as a result of this FTA. While the agricultural products are repeatedly fluctuating, they are showing some growth in terms of absolute numbers. Fishery products have declined somewhat and, in particular, the livestock products have demonstrated a distinct decline. This is not because of the sudden increase in the imports of livestock products, but rather as a result of over supply of the Korean livestock products.

C. Manufacturing

As price competitiveness in major manufacturing industries was secured when the KORUS FTA was signed, exports to the U.S. have increased.² It was expected that for the industries like automobile and auto parts, textiles, general machinery, etc., the price reductions following the abolishment of customs taxes would play a substantial positive factor in their entry into the U.S. market. It was assumed that for electronics and IT products, Korean parts would receive early market shares within the U.S. market, beating Japan and China, which are Korea's competitors, when the FTA came into effect. However, one year since the KORUS FTA came into effect, the industries that have shown a no-

² Korean government, "Easy Understanding Korea-U.S. FTA." (oneclick.law.go.kr/CSP/FIDownload.laf?flSeq=321732)

ticeable increase in their export and import were manufacturers of automobiles and trailers, while other major industries are yet to manifest distinct export/import increases. Upon factor-by-factor analysis, there appears to have been positive trade effects owing to the KORUS FTA.

The exports of automobiles and trailers to the U.S. grew by 20.3% since the FTA came into effect, and imports also grew by 24.4% from the same period of the previous year. What is notable about the exports of auto parts to the U.S. is that, not only have the exports of parts, which have reduced customs taxes because of the KORUS FTA, increased, but also have the exports of automobiles, for which there has been no change in customs tax rates, increased. It appears that not only has the 2.5% customs tax, which was imposed on auto parts, been immediately abolished with the KORUS FTA coming into effect, the U.S.'s imports of parts from Korea have also substantially increased as a result of the increase in local manufacturing of vehicles. In addition, the high utilization of relevant parts indicates that the lowered customs tax benefit is being well taken advantage of. All top four imports from the U.S. are automobiles, and these imports have grown as the customs tax rate, which was 8%, fell to 4%. On the other hand, the imports from the U.S. for auto parts have declined despite the relatively high rate of utilization. This appears to have been caused by the disruptions in production caused by the unstable labor relations in the Korean automotive industry in 2012 and the ensuing increase in the imports of vehicles.

3. Services

In terms of services under the KORUS FTA, Korea has agreed to maintain the level of

market opening as of the time when negotiations took place, while promising additional liberalization only in some areas including legal, accounting, telecommunications and broadcasting services. The additional areas of market opening were mostly agreed to be opened in phases or after certain preparatory periods so that Korean companies could prepare for them. The areas in which market opening was implemented pursuant to the provision of the KORUS FTA upon it coming into effect were legal services, accounting services, and broadcasting services.³ With the phase-one opening of Korea's legal market pursuant to the KORUS FTA, the number of American lawyers obtaining foreign legal consultant licenses and the openings of foreign legal consultancy offices by American law firms have increased, along with the structural changes in the Korean legal market in response to the market opening. In the area of accounting services, the phase-one market opening has been implemented pursuant to the already-implemented Certified Public Accountant Act and other relevant laws, and the phase-two market opening is scheduled to take place by the fifth anniversary of the KORUS FTA coming into effect.⁴ The phase-one market openings for legal and accounting services comprise of those services that had so far been already allowed in accordance with the needs of the Korean companies and their effects on the Korean market is expected to be minimal. The telecommunications service opening is still in the preparatory stage as an indirect investment by foreigners in facili-

³ Chae Wook *et al.* (2007), "The Direction and Things to Be Done in Korea's Trade Policies with the US under the KORUS FTA," KIEP Research Report, Vol. 07-06, pp.92-98.

⁴ A provision for implementing market opening in 2 phases has already be adopted in the Public Certified Accountant Act, but the actual implementation date will be in accordance with the agreement for market opening.

ty-based telecommunications businesses (not including KT and SKT) and would only be 100% allowed within two years of the KORUS FTA coming into effect. In broadcasting, only the relieving of the annual restrictions on the ratio of the programming of Korean content for each area (animation and movies) per channel for general cable TV operator · satellite TV operator · PP, and the expansion of content limit per station per quarter for foreign content of over-the-air TV operators · general cable TV operator · satellite TV operator · PP.

4. Investment

The U.S.'s investment in Korea have steadily grown since 2008 and has shown a more rapid increase since the KORUS FTA coming into effect, with the amount per investment also quickly rising. Also, while the ratio between the reported amount and the actually paid-in amount in 2012 has increased substantially from 2011, making it seem as though this was because of the improvements in the investment conditions owing to the KORUS FTA, it bears to look at the more long-term trends. In terms of types of investments, the Greenfield types, and in terms of form, investments based on long-term borrowing have increased.

In terms of Korea's investment in the U.S., the number of reports and newly established companies have decreased since 2007, while the amount of investments have been on the rise since 2005. Investments in the U.S. have markedly increased shortly before the KORUS FTA coming into effect in 2011 and then declined in 2012. Looking at this for investment purposes, while the promotion of exports or investment for entry into the local market for securing access to the U.S. market

has decreased, investment for resources development, or adoption of advanced technology for the embracement of positive factors that occur in the U.S. market, appear to have increased substantially. This shows that the preemptive new investments used to utilize the advantages within the U.S. market were active since the FTA came into effect.

In terms of the Investor-State Dispute provision, which was a major debating topic in relation to investment, it is too early to make any evaluation, as no relevant case has occurred during the one year since the KORUS FTA came into effect. The application for arbitration submitted to the International Center for Settlement of Investment Dispute by Lone Star against the Korean government in relation to the sale of Korea Exchange Bank in November 2012 is not directly related to the KORUS FTA as it was based on the Korea-Belgium BIT.

5. Implications

It appears that the KORUS FTA generally had positive effects on the trade of goods between the two countries and it is necessary to make follow-up measures for the enhancement of the rate of utilization and performance. In terms of the export and import effects of the KORUS FTA, the exports took up 12.7% while the imports took up 7.6%, indicating that it has played the role of a bedrock during the economic downturn. However, as the FTA's effects are not sufficiently expressed merely by virtue of becoming effective, efforts should be made to make more use of it. The factor-by-factor analysis shows that while the customs tax effect was notable in auto parts, the noncustoms effects are generally substantial. Accordingly, the continued cooperation between the two countries to

lower the nontariff barrier is essential for enhancing performance in the future.

The effects of the KORUS FTA and the rate of utilization by industries are different, so making industry-specific, tailored, follow-up measures is desirable. Within the manufacturing industry, the performance in textiles, electronics, and general machinery, fell somewhat short of expectations, but notable results were shown in auto parts, chemicals, and metals. Thus, making plans for publicizing and supporting for the improvement of the rate of utilization for each industry is necessary. In the area of agriculture, although no injuries caused by the FTA have been seen, it is necessary to closely monitor any future injuries.

As the performance of the KORUS FTA depends on the sustained growth caused by improvement in productivity, the focus should not be only on the export performance but, in the long-term, also on the advancement of system and policies in the service and investment areas, as well as on the creation of a

competitive environment. The additional opening of the service markets will be either implemented in phases, or are on temporary hold. So far, there has not been any distinct changes other than in the legal industry. However, in the advancement of a more full-fledged market opening, there needs to be an overall checkup of the readiness and support, so as to raise the effects of the KORUS FTA. Because it could not be said that the KORUS FTA had significant effect in terms of investment, efforts should be made to improve the investment environment for companies for sustained investment activities. As much as the KORUS FTA is an opportunity for Korea to raise its standards to the international level, the government should provide more support so that the competitiveness of Korean companies will be enhanced in diverse areas, including intellectual property. **KIEP**