Is the Korea-U.S. FTA Really So Bad for the U.S. Economy?

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It is likely that the five-year-old Korea-US free trade agreement (FTA), also referred to as the KORUS, will be officially renegotiated sooner or later as U.S. President Donald Trump and South Korean President Moon Jae-in have reaffirmed that economic cooperation and sustainable trade are an important pillar of their alliance and agreed to expedite talks on the bilateral FTA during President Trump's visit to Seoul. In fact, Washington has initiated talks to revise the agreement when United States Trade Representative (USTR) Robert Lighthizer raised in July the issue of removing barriers to U.S. trade. In particular, President Trump has threatened to terminate the KORUS, which he claims has been devastating for the American economy, unless Korea concedes better terms to the United States, citing how the termination process of the agreement is simpler than for the NAFTA. Is the KORUS a horrible and unacceptable deal for the U.S., as Mr. Trump claims? Is the Korus really bad for the U.S. economy?

If one only looks at trade in goods, as President Trump has consistently done, it is apparent that the United States' deficit with Korea has increased in the years since the KORUS came into effect in 2012. In 2016,

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the U.S. exported $42.7 billion in goods to Korea, a decrease of 5.6 percent from the pre-KORUS level, while the U.S. imported $70.4 billion, an increase of 22.2 percent, totaling a $27.7 billion deficit. As a result, United States' trade deficit with Korea has doubled from 2011 to 2016. Not all American industries have, however, suffered from the KORUS. The U.S. services sector enjoys a $10.1 billion trade surplus with Korea. U.S. exports of services to Korea amounted to $21.1 billion in 2016, while importing only $11.0 billion. This services trade surplus increased $3.2 billion between 2011 and 2016, an increase of 45.5 percent, which indicates a huge potential for further growth in services trade greater than goods trade.

Korean automotive exports to the U.S. are often cited as one of the key driving forces behind the growing U.S. trade deficit with Korea. The auto sector's trade deficit is $24 billion, which is equivalent to 86 percent of the entire goods trade deficit, according to the USTR. However, this could be more rationally explained by Korean consumers' lack of interest in American vehicles rather than tariff or non-tariff barriers. The automotive tariffs for both countries were eliminated on January 1, 2016, though the U.S. still retains some tariffs on trucks. Thus, the KORUS is not to blame for an increase in U.S. automotive imports from Korea.

In absolute terms, the U.S. trade deficit with Korea is dwarfed by its deficits with other countries such as China, Germany, Mexico, and Japan. The largest is with China, accounting for more than 60 percent of the overall U.S. trade deficit in goods and services. In 2016, the U.S. $310 billion trade deficit with China was largely driven by $480 billion of imports. The second largest deficit is with Germany ($68 billion), the third is with Mexico ($62 billion), and the fourth is with Japan ($56 billion). At $17 billion, the U.S. goods and services trade deficit with Korea is only 3.5 percent of its total trade deficit, or 5.5 percent of the trade deficit with China and 25 percent of that with Germany. If the Trump administration is serious about reducing the overall U.S. trade deficit, it must focus its attention on China, Germany, Mexico or Japan, not Korea.

The KORUS includes an investment chapter that is designed to facilitate bilateral investment between the two countries. FDI has significantly expanded under the KORUS, contributing to the direct and indirect creation of jobs. South Korea's FDI in the United States sharply increased from $15.7 billion in 2010 to $40.1 billion in 2015. U.S. investment in South Korea also increased from $26.2 billion in 2010 to $34.6 billion in 2015. Since 2014, inbound FDI from Korea has exceeded outbound FDI to Korea, making the United States a net beneficiary of FDI. Moreover, Korea is the fifth-fastest growing source of FDI to the United States, with investment doubling between 2011 and 2015 and directly creating 45,100 jobs.

Furthermore, the USITC has pointed out that the KORUS had a significant positive effect on U.S. bilateral trade balances, and that without the KORUS, the deficit with Korea would have been $15.8 billion higher.[1] The growth rate of South Korea's imports from the United States supports the USITC estimates. Since the KORUS, South Korean real GDP has only grown on average 2.8 percent annually, largely slowing due to the impact of the global economic downturn on its export-oriented economy. Accordingly, Korea's goods and services imports from the world fell 25.4 percent from $648.9 billion to $484.2 billion since 2011. However, Korea's imports from the United States grew 3.3 percent from $61.9 billion to $63.9 billion over the same period.

In sum, the KORUS has contributed to the expansion of new trade opportunities for both parties. Both trade and investment are now substantially larger than before the KORUS. Overall, goods and services trade has risen from $129.2 billion in 2011 to $145.31 billion in 2016. This is almost five times as fast as the U.S. growth rate in goods and service trade to the world over the same period. The annual growth rate of the U.S. trade in goods and services with Korea between 2011 and 2016 was 2.4 percent while the figures with NAFTA and the rest of world were 0.4 percent and 0.5 percent, respectively. Clearly, the KORUS has benefited both economies during a slowdown in global trade.

However, the White House seems to consider trade deficits as impeding economic growth and prefers taking a bilateral approach to trade imbalances. In particular, President Trump seems to think that the KORUS has led to a decline in U.S. exports to Korea, and the "flood" of Korean imports has resulted in U.S. trade deficits with Korea that equate to lost American jobs. This gross oversimplification of the impact of the KORUS is indicative of the Trump administration's lack of understanding of the data used in creating trade policy. Counter to what President Trump has stated, U.S. free trade agreements are not the main cause of job losses, especially in manufacturing. Many Americans are convinced that free trade has led to the decline in manufacturing jobs. However, manufacturing's share of U.S. employment has fallen steadily for over half a century, long before it started running trade deficits.[2] All industrialized countries, even those with large trade surpluses such as Germany and the Netherlands, have reported a similar trend.

[1] USITC (2016), Economic Impact of Trade Agreements Implemented Under Trade Authorities Procedures, 2016 Report. (June)

[2] Robert Z. Lawrence and Lawrence Edwards (2012), "Shattering the Myths About U.S. Trade Policy," *Harvard Business Review*. (March)

Misunderstanding trade deficits has fostered a number of myths about international trade and U.S. trade policies. Those myths have allowed trade deficits to be used to further anti-trade and anti-market positions, including industrial policy, and sanctions against "unfair" trading partners. However, fundamental economic principles backed by empirical data show that protectionism cannot cure the trade deficit.[3] Rather, increasing exports is the best means to reduce the trade deficit and boost employment in manufacturing. Making goods and services more attractive is of no use if U.S. companies cannot have access to foreign markets. Surely, securing promising foreign and global markets through FTAs is a useful way of increasing exports.

Renegotiating or reforming the KORUS FTA could be a difficult process for both governments. Officials under the new Moon Jae-in government would be very sensitive to new U.S. demands and pressure, which might provoke an anti-American backlash in South Korea. President Moon could face severe political pressure domestically to stand apart from the United States and draw closer to China or even to North Korea. In such a situation, President Moon might not have the necessary room to make a compromise to benefit both countries. Moreover, given the current tensions in the Korean Peninsula, neither side should want severe trade frictions to undercut or even signal discord in the U.S.-Korea strategic alliance. Thus, renegotiating the KORUS demands very careful attention, especially in terms of approaching the negotiating framework.

[3] Fewer imports would mean fewer dollars flowing into international currency markets, raising the value of the dollar relative to other currencies. The stronger dollar would make U.S. exports more expensive for foreign consumers and imports more attractive to the United States. Then, exports would fall and imports would rise until the trade balance matched the savings and investment balance.