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Withdrawing from KORUS: an own goal for the United States by Troy Stangarone

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No trade agreement is without its imperfections. NAFTA, as President Donald Trump has pointed out, is in need of updating. However, political realities in negotiating countries mean that certain sectors maintain some level of protection. The US-Korea FTA, or KORUS FTA, is no exception. When the agreement was originally negotiated, South Korea excluded rice from the agreement, while the United States maintained restrictions on inland water shipping established under the Jones Act. Politics in both countries necessitated that the restrictions remain place. With the KORUS FTA now five years old, Trump has said that the agreement should either be renegotiated or the United States should withdraw. However, withdrawing from the KORUS FTA would only increase the US trade deficit with South Korea.

The standard by which to judge a free trade agreement is not whether it is a perfect agreement, but whether both countries sufficiently benefit from it. For KORUS FTA, the answer is clearly yes.

This may not be obvious for the United States. Critics rightly point out that the US trade deficit in goods has grown from $12.4 billion to $28.1 billion since the agreement came into effect. They also argue that the agreement has cost the United States nearly 95,000 jobs. However, only looking at trade in goods gives a distorted picture of the agreement and leaves out both trade in services and new foreign direct investment (FDI) by South Korean firms in the United States – two areas where the US benefits greatly from the agreement.

A focus on the bilateral goods deficit assesses the KORUS FTA according to all US trade in goods with Korea rather than trade covered by the agreement. The FTA is still being implemented and some goods were already duty free when it was signed; as a result not all goods have benefited from the agreement. Since the KORUS FTA has come into effect, US exports of beneficiary goods have increased by 18 percent while non-beneficiary items have declined by 20 percent. The focus on goods trade also discounts the growth in exports of services to South Korea, which has grown from $16.7 billion to $21.6 billion and, perhaps more important, created a surplus of $10.7 billion in services for the US. At the same time, FDI from South Korea into the United States has doubled over the same period, helping to support 47,000 jobs that receive an average compensation in salary and benefits of $92,000.

Perhaps more compelling are the consequences of a US withdrawal from the KORUS FTA. The US International Trade Commission has determined that without KORUS, the US trade deficit with Korea would be $16 billion higher. In the absence of the FTA, US products would be at a disadvantage relative to those from competitors from the European Union, China, Australia, Canada, and others who have a free trade agreement with South Korea.

Consider US exports of beef. South Korea has an import tariff of 40 percent that the KORUS FTA requires be reduced in equal increments over 15 years. Now Korea imports over $1 billion in beef from the United States. The main competitor for US beef imports in the South Korean market is Australia. In the absence of KORUS, a significant portion of those exports would go to Australian ranchers because Australia has an FTA with Korea that is 2 years behind the US in the tariff phase-out. Other US products would also lose market share to competitors that have duty-free access in South Korea.

Even if withdrawal from the KORUS FTA was only a tactic to spur renegotiations, the United States would likely face losses. The United States negotiated KORUS prior to the EU negotiating its agreement with South Korea, but the EU agreement came into force first. As a result, EU pork producers have had an advantage over the United States.

If withdrawal isn't an option, are there benefits to renegotiation? Despite being the United States' most advanced FTA, there is room for improvement, specifically in adding new areas that would have been in the Trans-Pacific Partnership. Because of the importance of the digital economy to both countries, and areas such as intellectual property rights, this sector could be a win-win for both countries, but the US should not expect significant shifts in the trade deficit.

The US trade deficit with South Korea is driven more by structural issues in the South Korean economy than any flaws – real or perceived – in the KORUS FTA. To bring down the trade deficit, South Korea needs domestic reforms that address old-age poverty and the pension system, the high costs of education, and youth unemployment (among others) to increase domestic consumption, which would spur imports. Reforms that give South Koreans with more disposable income to spend on goods, including US imports, which would help reduce the US trade deficit. While these reforms would be beneficial to South Korea and boost economic growth, they are outside of the scope of the KORUS FTA.

Just as withdrawing from NAFTA would have been detrimental to agricultural districts around the United States, withdrawing from the KORUS FTA would most likely lead to an increased trade deficit through a reduction in US exports and a loss of high-paying jobs. It would also raise questions about the US commitment to South Korea at a time of growing concerns about North Korea. While there might be scope for upgrading provisions of the KORUS FTA, withdrawing from the KORUS FTA would not benefit the United States.

PacNet commentaries and responses represent the views of the respective authors. Alternative viewpoints are always welcomed and encouraged.

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