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KORUS FTA 2.0: Assessing the Changes

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On December 3, 2010, the United States and South Korea agreed to incremental changes to the Korea-US Free Trade Agreement (KORUS FTA) that was signed in June 2007 but not ratified by the US Congress or the Korean National Assembly. Most of the changes affect bilateral trade in autos and light trucks; other minor changes involve pharmaceutical patents, US pork exports, and US visas.

In economic terms, the overall impact of the new deal differs little from the old deal. Changes in the tariff schedules reduce the overall benefits of the trade pact but not by very much. Immediate tariff cuts on autos and light trucks have been deferred a few years, but changes in Korea's regulatory policies and procedures on autos should help mitigate existing problems and preclude the introduction of new nontariff barriers to US exports to Korea.

In political terms, the new deal is far superior because it has elicited new support from US industry and two important labor unions that greatly increases prospects for Congressional ratification. If the KORUS FTA is approved by Congress in the first half of 2011, the pact could enter into force by January 1, 2012.

THE AUTO PACKAGE

The new agreement slows down tariff liberalization and speeds up regulatory reforms affecting auto emissions, fuel economy, and safety standards. It also establishes a new auto-specific safeguard procedure that can be invoked by either country in the event of harmful import surges.

Under the new agreement the US car tariff, currently 2.5 percent, will be maintained for four years (i.e., until January 2016) and then eliminated. In turn, Korea slowed its own tariff reform. Instead of being eliminated immediately, the 8 percent Korean car tariff will be reduced to 4 percent upon entry into force of the pact and then eliminated at the same time as the US car tariff. Note that Korea agreed in its FTA with the European Union to phase out its tariff on large engine cars within three years; thus, if the KORUS FTA enters into force on January 1, 2012, US car exporters will have a small tariff advantage over European exporters (4 percent versus 5.3 percent) in the first year and then will face a small disadvantage until January 2016. The exception to this general pattern is electric cars and plug-in hybrids; instead of a 10-year tariff phase-out, tariffs on these vehicles will now be phased out in five years.

In addition, the US tariff on light trucks, which has been 25 percent since the infamous 1963 US-Europe chicken war, will be maintained for seven years (until 2019) and then phased out over the next three years. Originally, the light truck tariff was to be phased out in 10 equal annual increments. In this case, however, Korea did not slow its own tariff reform; the 10 percent Korean truck tariff will be eliminated upon entry into force of the agreement.

Do these changes in tariff reforms make much of a difference? Probably not—and definitely not if the Doha Round agreement concludes and begins to cut most-favored nation (MFN) tariffs starting in January 2013, the likely start date if a WTO deal is reached by early 2012. In that case, the US car tariff would decline from 2.5 percent to 1.9 percent in six annual increments of 0.1 percent starting in January 2014. Similarly, US light truck tariffs would be phased down from 25 percent to 6.1 percent in 2019. So for light trucks, the

US MFN tariff would be lower than the KORUS preferential tariff beginning in January 2014.

The more valuable changes in the auto provisions involve Korean regulatory policies. Three commitments bear mention. First, Korea agreed that US imports would comply with fuel economy and emissions standards if the cars do not exceed 119 percent of current Korean emissions limits. This "leniency rate" applies to each US manufacturer that sold no more than 4,500 units in the 2009 base year; it thus covers GM, Ford, and Chrysler. As a practical matter, emissions standards are being upgraded in each country. Korea's fuel efficiency standard will require automakers to reduce greenhouse gas emissions to 140 grams per kilometer and improve fuel economy to 17 kilometers per liter by 2015, which translates into an effective standard of 40 miles per gallon. By contrast, the United States will require automakers to achieve 36 miles per gallon by 2016. These standards are for fleet averages. The new agreement recognizes that cars imported into Korea generally are larger and less fuel efficient than the subcompact vehicles that dominate Korean domestic car sales and that fleet averaging requirements favor Korean producers. The leniency rate effectively remedies that discrimination until the new regulations are fully implemented in 2015.

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Second, Korea agreed to recognize and/or accept US safety regulations for imported US cars if the number imported does not exceed 25,000 vehicles per automaker. This limit has been increased from 6,500 units in the original pact. Since annual US exports to Korea from all companies have averaged 5,000 to 7,000 cars, this new regulation effectively grants mutual recognition to US standards even if US shipments from each automaker increase fourfold. This provision should fully accommodate the likely growth in US car exports for the foreseeable future.

Third, Korea committed to making its regulatory process more transparent to ensure that new regulations do not create unnecessary barriers to trade. In addition, Korea agreed to give auto companies 12 months to comply with significant regulatory changes before new requirements become effective.

Finally, the new accord creates special auto safeguard provisions, which allow the United States or Korea to impose temporary protection to counter import surges. This new auto safeguard supplements the general safeguards provisions in the KORUS FTA, which expire 10 years after the entry into force of the agreement. The special auto provision allows each country to impose safeguard measures "for 10 years beyond the full elimination of tariffs for each Korean auto product" (White House 2010). In other words, until January 2026 for cars and January 2032 for light trucks. It is highly unlikely that this mechanism would be used, however, since Korean automakers already are sourcing a greater share of their US sales from US-based assembly plants. Nonetheless, the US auto industry regards these provisions as insurance against market disruption; the Koreans agreed since the insurance premium is minimal.

OTHER CHANGES

Trade negotiations are an exercise in "give and take," so it was not surprising that Korean officials sought changes in the KORUS FTA to compensate for the new auto provisions demanded by US officials. In addition to the short delay in cutting Korean car tariffs, three changes were chalked up on the Korean side of the ledger. Here again the changes have scant impact on bilateral trade.

First, the 25 percent Korean tariff on imports of a major category of US frozen pork will be phased out by January 2016 instead of January 2014. Despite the delay, US pork producers still come out well ahead as a result of the agreement.

Second, the applicability of US L-1 visas for intracompany transfers of Korean professionals working in the United States will be extended to five years. Currently L-1 visas are valid for either one or three years (with the possibility of extensions), depending on whether the worker is with an established Korean subsidiary in the United States or is setting up a new office (Inside US Trade 2010, p. 14).

Third, the United States agreed to extend the grace period before Korea has to implement a pharmaceutical "patent linkage" system under which regulators investigate patent infringement claims before granting marketing approval for generic drugs. The KORUS FTA obligations in this area were maintained but Korea was given three years instead of 18 months to adopt a patent linkage regime.

THE BOTTOM LINE

On balance, KORUS FTA 2.0 is almost as good as the original, and some provisions are notable improvements. The original deal should have been ratified years ago but faced significant resistance primarily from Ford, Chrysler, the United Auto Workers, and their congressional representatives. President

Obama accepted much of their critique and committed to "level the playing field for US auto manufacturers and workers" (White House 2010).

The agreement should also have positive knock-on effects on the awakening global trade talks and on negotiations for a Trans-Pacific Partnership.

Most of the auto changes focus on protecting the US market from imported automobiles for a few extra years. What this likely means for US companies and workers is less pressure from Korean imports and more competition from Korean cars produced in US plants. The new pact also rectifies several problems regarding Korean regulatory policies that had not been fully remedied in the original agreement. Combining the regulatory reforms and the Korean tariff cuts, US exporters should be able to sell more cars to Korea—though they will no longer benefit from immediate elimination of the Korean car tariff and they will now face tougher competition from European firms benefiting from the EU-Korea FTA starting in July 2011.

Like most political compromises, the new trade pact took two steps forward and one step back. Overall, however, the KORUS FTA still provides big net gains for both sides. US-Korean trade in goods and services should expand significantly. The US International Trade Commission estimated in 2007 that the KORUS FTA would increase annual bilateral trade by more than $20 billion—and the new provisions should not diminish that positive outlook. The agreement should also have positive knock-on effects on the awakening global trade talks and on negotiations for a Trans-Pacific Partnership (which Korea may now consider joining later next year). And perhaps most importantly, the deal helps reconfirm and reinforce the strategic alliance between the United States and Korea that has been a crucial part of our bilateral relations for the past 60 years. While the fits and starts of the negotiating process were messy, if the new deal leads to Congressional ratification next summer, as is now expected, then it will be well worth the effort.

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