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Response to Sang-yirl Nam (KISDI): Economic Issues and Implications of Freeing Korea-U.S. Trade in the Automobile Sector: Potential Impact of KORUS FTA

Thank you for coming, and thank you to the Korea Economic Institute (KEI) for inviting me to participate in this Seminar on the likely impact of the KORUS FTA on the global automotive industry.

In his speech to the Detroit Economic Club on Monday, Gary Shapiro, President of the Consumer Electronics Association, argued that UAW opposition to the KORUS FTA was "contrary to the best course of action for America's economy and our future…What America hears is that Detroit needs special help and can't compete in the free market." Shapiro went on to challenge the Big 3 automakers to "move quicker" in integrating personal electronics technology into their vehicles, and claimed that U.S. auto producers had "missed the iPod craze, leaving it to aftermarket firms to meet the demand."

The UAW takes this type of criticism seriously, and I take it a bit personally, if for no other reason than I'm woefully inadequate in keeping up with my daughter's use of iPods, text messages, and knowledge of teenage pop music. But it's a bit of stretch to argue that the Big 3's inefficiency at bringing the tunes of Hannah Montana to a new generation of American drivers is a contributing factor to the competitiveness or un-competitiveness of U.S.-made vehicles *vis a vis* Korean-made cars and trucks.

But Shapiro does do us a favor by raising the economic concept of "competitiveness", or in the words of Professor Nam, of "competitive advantage or disadvantage". He also raises the question of positive policy measures to help the U.S. automotive industry and whether they should take place within the context of international trade agreements such as the KORUS FTA.

This is similar to Jeffrey Schott's argument that: "There is little that joint U.S. and Korean initiatives can do to improve the competitiveness of Ford, Chrysler, and GM in the U.S. market; the companies and unions will have to work together, though changes in U.S. policies could provide a more conducive environment for investment in new product development and worker retraining." UAW believes, by contrast, that there are things that Korea and the U.S. can jointly do, or more importantly, not do, to improve the competitiveness of the U.S. automotive sector. One thing would be to not approve the KORUS FTA in the form it was negotiated by the Bush and Roh administrations.

Professor Nam is correct when he points out the "US side argues that there exist unfair sentiment and regulations against imported automobiles in Korea." The UAW does not believe that this KORUS FTA adequately addresses the unfair structural competitive advantages enjoyed by Korean automotive producers.

I would like to return for a moment to Professor Nam's use of the notion of "competitive advantage". Unlike the Consumer Electronics Association that evaluates the trade deal in terms of whether it makes U.S. companies more competitive versus Korean firms, Nam appears to prefer to use the term in a purely nationalist context—would the KORUS FTA make one or both countries better off, and if so, by how much? In his exhaustive compilation of auto trade numbers, for example, only countries, not auto producers or classes, are "identified as major players in the world market".

The UAW, by contrast, analyzes the potential impact of the KORUS FTA on the auto sector from a different conception of "competitiveness"—from a conception of class—are workers made better or worse off relative to the multinational auto companies under the FTA? It is a slightly different question of whether the KORUS FTA would make American auto workers more, or less, competitive with autoworkers in Korea, China, Europe or elsewhere.

By most measures of international productivity, U.S. auto workers rank high among the work forces in the world—U.S. workers can compete on the basis of labor productivity. Unfortunately, the auto provisions of the KORUS FTA are structured to promote wage competition, rather than competition based on productivity and economic efficiency.

This is also a much different question from asking whether the United States or American auto companies would be made better or worse off relative to Korea and Korean auto makers. The belief of both the UAW and the Korean Metalworkers' Union (KMWU) is that the FTA would make auto workers in both countries worse off. We have issued joint declarations opposing it, and are undertaking an international mobilization effort to defeat the KORUS FTA, the Korea-Canada FTA, and the Korea-European Union FTA.

Shapiro can stand in Detroit and argue that KORUS would be great for the 2,000 electronics companies he represents, while ignoring the thousands of U.S. electronics jobs lost over the past two decades, as those very same companies moved production to low-wage havens around the world. If lowering wages and benefits to the lowest possible level is what is meant by creating a “competitive advantage”, we may want to pass on the so-called “benefits” of the FTA.

By competitive advantage, do we mean that the U.S. auto companies would somehow be advantaged in competition with Korean, Japanese, or other auto companies? If so, why are Ford and Chrysler opposing the KORUS FTA, and GM remaining “neutral”? GM’s public position can perhaps be explained by the fact that it owns Daewoo Motors, and is quite “competitive”, even against Hyundai, in producing cars in Korea.

In fact, GM and Ford are quite competitive in producing and selling cars in Europe, Russia, Latin America, and elsewhere around the world. What is it about Korea, which has the lowest auto import penetration ratio of any auto producing nation in the world that makes it so difficult for autos made elsewhere to be exported and sold there? Would the KORUS FTA make it any easier to overcome these obstacles or competitive disadvantages?

But let us now turn to the specific use of the notion of competitive advantage in Professor Nam’s paper. He provides his definition of “Revealed Comparative Advantage (RCA) Index” [RCAij=(Xij/XWij)/(Xi/XW)], plugs in the global trade figures, and calculates that Korea’s exports of autos to the U.S. divided by Korea’s exports of autos to the world; all divided by the ratio of Korea’s aggregate exports to the U.S. to Korea’s aggregate exports from the world, is greater than one. Thus, Korea has, by definition, a “comparative advantage” over the U.S. in producing and trading autos. This is just a mathematical way of saying that relative market conditions are such that more cars made in Korea are exported to and sold in the U.S., than are all other products made in Korea and exported and sold in the U.S. This is hardly surprising given that 80% of the U.S. trade deficit with Korea is in auto products.

But what does this definitional notion of “comparative advantage” really mean? What does it tell us? If one defines A/B=C, where C equals “comparative advantage”, plugs in the export and import numbers, one can logically calculate a numerical value of C. This is precisely what Professor Nam does in his paper—nothing more, nothing less. Nam acknowledges that his paper does <u>not</u> provide “an empirical statistical model but a mathematical calculation model that is heavily dependant upon some parameters, for example, elasticity of substitution between domestic goods and imports, which is difficult to estimate and is assumed.” Historical empirical evidence would suggest that elasticity of substitution between Korean autos and imported autos for Korean consumers is quite low.

But having “demonstrated” that Korea has a comparative advantage in auto production, Nam leaves his readers to conclude that any free-trade regime that leads to Korea producing all the cars in Korea, and the U.S. producing, um, let’s say, iPods in China???, must be a good thing. Generate a huge and growing auto trade deficit with Korea? It’s a good thing. Lower working class living standards of manufacturing workers? Wonderful! Make it easier for global auto producers, both Korean and American, to move more and more production to China where wages are low and unions non-existent? Fantastic!

In the conclusion to his paper, Professor Nam writes: “The emerging Chinese and Indian markets will be not only an opportunity but also a threat. Cooperation based on complementarity between Korea and the US will maximize the opportunity but minimize the threat.” The American and Korean labor movements see the KORUS FTA as potentially increasing the threat of lower living standards of workers in both countries, rather than any kind of opportunity.

The earlier speakers laid out much of empirical evidence on U.S.-Korea auto trade, but let me share a few additional figures: Motor vehicle production in Korea reached 4.1 million in 2007, up from 2.9 million in 2001. The top three auto producers in Korea were Hyundai, Kia, and GM-Daewoo, followed by Ssangyong and Samsung. Motor vehicle exports from Korea reached 2.8 million in 2007, up from 1.5 million in 2001. In 2007, the import community sold 53,390 cars in Korea. Ford, Chrysler, and GM (excluding Daewoo) sold fewer than 10,000 vehicles in Korea last year.

Thus, the U.S. bilateral auto trade deficit with Korea exceeded $10 billion in 2007, despite the significant change in the value of the U.S. dollar. The U.S. International Trade Commission (ITC) estimates that the KORUS FTA would add another $1 to $1.3 billion to the annual U.S. auto trade deficit with Korea.

My colleague on this panel, Jeffrey Schott, argues that these trade statistics do not necessarily reflect an unfair trading situation or a failure to enforce trade rules and standards: “The FTA critics…cloak these concerns in a rhetorical charge that is politically seductive, citing the wide disparity in the number of cars imported in each country (700,000 U.S. imports of Korean cars versus 5,000 Korean imports of U.S. cars in 2006) as <u>de facto</u> evidence of unfair trading conditions.” We respectfully disagree.

Historically, Korea has kept its market closed to U.S. built automotive products, through a combination of tariff and non-tariff barriers. Despite previous agreements and memoranda of understanding with Korea to eliminate its barriers, the Korean market remains essentially closed to any significant import competition. Professor Nam does not address the question of Non-Tariff Barriers (NTB’s), and how they may affect the elasticity of substitution.

The proposed KORUS FTA will increase access by Korean automotive producers to the U.S. market, while allowing Korea to keep its market closed to U.S. built vehicles and auto parts. Similar to the NAFTA experience, the net result will be a surge of automobile imports from Korea and the loss of thousands of additional auto jobs in the U.S.

Under the proposed KORUS FTA, the U.S. would be immediately required to eliminate its 2.5% tariff on the vast majority of Korean-produced vehicles and auto parts. In addition, the 25% U.S. tariff on light trucks would be phased out over ten years. It will be relatively easy for Korean automakers to ramp up Korean production for export to the U.S.

Some KORUS FTA proponents argue that there is no reason to fear a surge of auto imports from Korea because Korean companies will be sourcing their vehicles from facilities located in the United States. But the very existence of the U.S. auto tariffs has created an incentive for Korean companies to locate production facilities in this country. If these tariffs are removed, we can expect to see Korean companies abandoning plans for future automotive investment in the U.S. In fact, immediately following the announcement of the trade deal in April, Hyundai announced its intention to study plans to export pick-ups to the U.S.

The KORUS FTA contains no guarantees or mechanisms for the U.S. to gain greater access to the Korean auto market, and allows Korea to continue the discriminatory taxes and other non-tariff barriers that it has used to keep its market closed. The so-called special auto dispute resolution process is structured in a manner that would make it extremely difficult for the U.S. to prevail in any case against Korean non-tariff barriers. The “snapback” provision does not even apply to the light truck tariff.

Thus, the UAW and the KMWU oppose the passage of the KORUS FTA. Thank you for your attention.