U.S.-ROK ECONOMIC RELATIONS LEFT UNCERTAIN AMID LEADERSHIP CHANGES

INTRODUCTION

While the other parts of this book bring China fully into the coverage—diplomacy, national identities, and sanctions—here we narrow the focus on U.S.-ROK relations with an eye to the current uncertainty about the future of the KORUS FTA, the five-year old bilateral trade agreement. Donald Trump has assumed the presidency critical of trade imbalances in goods, including assertions about the negative impact of the FTA with South Korea. It appears that the U.S. side will insist on renegotiating the agreement. In order to assess what this could mean, we take a close look at what the impact of KORUS has been and at how the debate in Washington has been unfolding under Trump's watch. The three chapters were written in the early spring of 2017; so they could capture only the initial impact of Trump at a time when South Korean leadership was paralyzed between impeachment and the election of a new president without any serious bilateral engagement over economic issues. Yet, as tensions over economics are expected to rise, our objective is to inform the discussion with relevant economic background and with awareness of what Trump has been saying and how it may shape the political debate.

The following chapters all seek to improve our understanding of what KORUS is and what its impact has been. They make sure to distinguish trade in goods, where the growth in trade has widened the deficit in South Korea's favor, and trade in services, which has expanded in favor of the U.S. side. Efforts are made to explain what causes trade deficits, attentive to macroeconomics and the distinction between final goods and inputs that originate in other countries. Links between economics and security are taken into account. In each case, there is an attempt to grasp the reasoning behind the policies Trump appears intent on pursuing and the logic of economic or strategic analysis. The reader will find both overlap and complementarity across this set of chapters.

As for what to expect, one prospect is minor adjustments without damaging the positive essence of KORUS, another is bypassing the United States in pursuit of regionalism that might draw Japan and South Korea together in a multilateral context, and a third is to address U.S. concerns through mostly unilateral enforcement measures as well as a serious rethinking of bilateral trade ties. All of the authors are concerned about myths distorting what economists understand about trade and abuse of security ties to affect trade ties. It is early to grasp how the U.S. review of trade policy will unfold as well as how Trump and Moon Jae-in will refocus the bilateral relationship from the time they meet in June 2017.

TOWARD A BETTER UNDERSTANDING OF KORUS FTA: SUH JIN KYO

Suh Jin Kyo observes that Trump has threatened to terminate KORUS, which, Trump claims, has been devastating for the American economy, unless Korea gives the United States better terms. Given Trump's talk also of linking security and economic concerns and demand that South Korea pay for THAAD, Suh warns of a backlash that could trigger latent anti-Americanism, adding that neither side should want severe trade frictions to undercut or even signal discord in the U.S.-Korea strategic alliance. After all, the motives behind the U.S. effort to sign the trade deal were predominantly political and strategic, which reflects the changing geopolitical environment in Northeast Asia, Suh further argues.

Trump is seemingly against KORUS, calling it a "horrible deal" that has left America "destroyed." This gross oversimplification of the impact of KORUS is indicative of his administration's lack of understanding of data used in creating trade policy. Contrary to what Trump has stated, U.S. FTAs are not the main cause of job losses, especially in manufacturing. Persistent U.S. trade deficits do not reflect recent FTAs. The U.S. has had continuous annual trade deficits since 1976. If one only looked at trade in goods, as Trump has consistently done, it is apparent that the deficit with Korea has increased in the years since KORUS was implemented. In 2016, U.S. goods exports to Korea were $42.4 billion, a decrease of 6.3 percent ($2.8 billion) from pre-KORUS levels, while goods imports from Korea were $70.5 billion, an increase of 22.4 percent ($12.9 billion). Yet, trade surpluses or deficits are not reflective of the fairness of a trade deal. Bilateral deficits tend to be connected more with a country's macroeconomic characteristics than unfair trade practices. 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, concludes Suh warily.

Suh is positive about what KORUS has accomplished as the centerpiece of U.S.-ROK trade and economic relations since it went into effect on March 15, 2012. Six rounds of tariff cuts have occurred, resulting in the elimination of 92 percent of South Korean tariff lines and 93 percent of U.S. ones. Trade in goods and services has risen from $129.2 billion in 2011 to $145.3 billion in 2016—almost five times as fast as the U.S. growth rate in goods and service trade to the world over the same period. KORUS has benefitted both economies during a slowdown in global trade. The United States runs huge surpluses in services—particularly in education, banking, and intellectual property. This includes travel (for all purposes including education) services, and fees for the use of intellectual property rights.

While the service surplus with Korea ($10.7 billion in 2016) is overshadowed by a larger goods deficit, it has doubled over the past decade and is an important sector where the United States could keep making crucial gains, given its highly skilled and educated workforce. The content of imports from Korea is no less important than their monetary value. Most U.S. goods imports from Korea are not final goods but industrial supplies and capital goods, which can help U.S. companies raise their international competitiveness. The main import categories in 2016 were: industrial supplies and capital goods ($30.0 billion, 42.6 percent of total goods imports) and automotive vehicles, parts, and engines ($25.1 billion, 35.6 percent). South Korea is also the fifth fastest growing source of FDI in the United States; investment doubled between 2011 and 2015, directly creating 45,100 jobs. The deficit would be further reduced if FDI were taken into consideration. South Korea's goods imports from the world fell 22.5 percent from $524.4 billion to $406 billion since 2011. However, its imports from the United States grew 3.3 percent. Moreover, adjusting the trade balance to account for the value-added content of exports would cut the U.S. trade deficit with Korea by roughly 60 percent. Bilateral trade deficits have to take into consideration how global supply chains affect bilateral trade, Suh observes.

The goods and services trade deficit with South Korea was only $17 billion, much less than the $28 billion goods trade deficit often referenced by the Trump administration.

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 South Korea, Suh adds. A distorted trade picture can inflame bilateral relations, while raising anti-trade sentiment at a time when protectionist pressures are already rising. All outstanding issues—including specific market access concessions, rules of origin, financial services, even regulatory transparency and regulatory overreach—can be fully and effectively discussed within the current framework of the agreement. This calls for modifying, not ending KORUS.

TRUMP, U.S.-ROK ECONOMIC RELATIONS, AND ASIAN REGIONALISM: CLAUDE BARFIELD

Claude Barfield outlines the main tenets and priorities visible at the outset of the Trump administration's trade policies. He first comments on the organizational structure for developing and executing trade policies: who is in charge and what their roles are so far as we know. He also describes the administration's initial actions, the implications of the new U.S. trade agenda for Asia, with particular attention to Japan and Korea, and options for an East Asian response to Trump's decision to withdraw from the TPP. Barfield urges the remaining nations (TPP-11) to recreate the provisions without the United States. He concludes that it would be hard to overestimate the upheaval promised by Trump during the presidential campaign—and reiterated by the new president and his trade counselors since taking office—referring to a seminal document published during the fall campaign by incoming Commerce Secretary Wilbur Ross and trade advisor Peter Navarro.

Much of the underlying analysis by Ross, Navarro, and also Steve Bannon—and certainly Trump himself—is deeply flawed and contested by almost every economics professional, argues Barfield. The Trump team finds two underlying sources of U.S. economic decline: persistent trade deficits and the rise of offshoring of jobs by unpatriotic U.S. corporations. It judges good or bad trade deals on the basis of whether they are followed by an increase (bad) or decrease (good) in the bilateral trade deficit (likewise with an existing trade surplus). Trump and his trade advisers strongly believe the United States is surrounded by nations who "game the system" and cheat with abandon. They plan to try to negotiate policies that will (in their faulty view) decrease the U.S. trade deficit, introduce unilateral actions against allegedly unfair trade practices, and renegotiate and/or withdraw from existing FTAs (and the WTO) if trading partners prove to be recalcitrant.

As for KORUS, there are lingering complaints from key U.S. business sectors that could form the basis for a Trump administration push for changes. These include issues related to pharmaceutical regulations and to the establishment of an independent review mechanism for pricing; greater liberalization for legal services; problems with implementing data transfer liberalization; and transparency and procedural clarity by Korean regulators, particularly the Fair Trade Commission on competition policy matters. Most of the issues that surfaced during the Obama administration could be handled without provoking a real crisis in U.S.-Korean trade. What is unclear, however, is how many of the new Trump policy demands that emerged during the campaign and since, will be carried over into any negotiations to update KORUS FTA, observes Barfield.

On Asian regionalism, Barfield argues that Asian nations should not remain supine and reactive. Specifically, TPP-11 nations will be in a much strong negotiating position if they find common cause in a revamped TPP than if they only face the United States one-on-one.

Moreover, given increasingly fraught security conditions in Northeast Asia, it is imperative that Korea and Japan pursue closer relations. Since a bilateral FTA is politically difficult for both nations, as with TPP, Korean membership in a TPP-11 would finesse the political snares while achieving the same result. Already the other eleven TPP members have largely changed their law and practices in preparation for the once-projected TPP entry. Barfield doubts that RCEP will succeed as a Chinese-led Asian economic architecture. India is opposed and plays an increasing role. No matter how weak their unity, ASEAN nations have always been fiercely protective of an ASEAN-centric regional future. At some point, should the Chinese push too hard, there will be an inevitable backlash, Barfield anticipates, adding that, despite Xi Jinping's effusions about global markets and multilateralism, Beijing is by no means ready for an economic leadership role. With Trump and Xi abnegating leadership, the best hope, readers are told, is for Seoul and Tokyo to cast bygones aside for regionalism.

A U.S. PERSPECTIVE ON BILATERAL ECONOMIC RELATIONS: MARK MANYIN, BROCK WILLIAMS

Manyin and Williams find the Trump administration signaling two potential paradigm shifts that could lead to greater tension in the U.S.-ROK economic relationship. First is the president's negative view of existing U.S. trade policy and willingness to at least threaten the use of measures infrequently deployed to correct its "failures." Second, Trump has signaled a willingness to use U.S. security relationships to influence economic relations and vice versa. The likelihood of this succeeding may depend on at least four factors: North Korea policy coordination, alliance relations, consultations over how best to approach China, and the U.S. and Trump's popularity among South Koreans. Elevation of North Korea to a top-tier foreign policy issue, combined with the greater probability of tensions over North Korea policy, and the administration's inclination to explicitly use economic and security issues to increase bargaining leverage could mean that significant tension over economic issues is more likely to occur than at any time in the past decade. This is the warning offered by the two authors as they anticipate tough negotiations.

The two authors find that those supporting the KORUS FTA agreement note that U.S. exports of certain products with tariff reductions under KORUS have risen considerably as have U.S. services exports, while those opposed to the agreement note that the bilateral trade deficit with South Korea has more than doubled since the agreement has been in effect. In its first Trade Policy Agenda, issued in March 2017, the Trump administration, which has sharply criticized prior U.S. trade policies and trade agreements, in particular highlighted the bilateral trade deficit with South Korea. Yet, the authors point to drivers of the overall fall in U.S. goods exports since 2011 as a $1.1 billion decline in ferrous scrap exports and a $1 billion decline in corn exports, partly reflecting lower commodity prices over the period. Overall exports to South Korea were also likely depressed by the country's economic slowdown as evidenced by a similar drop in South Korea's imports from its other top trading partners. As for rising U.S. imports, the authors point to autos and auto parts accounting for a large share, increasing by roughly $9 billion, or nearly 70 percent of the $13 billion increase in overall goods imports from South Korea. However, one should be cautious in attributing this increase solely to the FTA, they add. For example, auto imports grew by approximately 15 percent each year from 2012 to 2015, before the United States made any reduction to its 2.5

percent auto tariff, and the bilateral trade deficit with South Korea would have been even larger without the agreement in place, they note. Moreover, the value of South Korean FDI in the United States increased from $19.9 to $40.1 billion, more than doubling. Thus, trade issues defy recent simplifications.

Although the general perception from the business community is that market access in South Korea has improved significantly on a number of fronts, U.S. firms have raised complaints over South Korea's implementation of its FTA commitments, Manyin and Williams add. For example, the Korean Customs Service reportedly required particularly onerous origin verifications on a variety of U.S. exports. Vestiges of a regulatory system with an inherent, if sometimes subtle, bias toward the protection of businesses, are cited in instances that suggest South Korea has not lived up to the spirit of the agreement. Most likely to be used to address such concerns are enhanced enforcement activities, involving mostly unilateral steps, avoiding the need for lengthy and challenging negotiations. These may include bringing more cases against South Korea in the WTO, potentially utilizing the dispute-settlement mechanisms of the KORUS FTA, or making greater use of U.S. anti-dumping and countervailing duty (AD/CVD) and other trade remedy laws. A protracted effort in foreign exchange markets to resist the won's appreciation would almost surely result in increased engagement by the Treasury Department and stronger actions by the Trump administration. Yet, were South Korea to take a proactive step to increase the transparency of its transactions on foreign exchange markets, a long-standing complaint of the Treasury Department, it could potentially help diffuse concerns.

Unless South Korea's domestic economy picks up steam, trade negotiations appear unlikely to have a major impact. Indeed, a broader challenge to focusing so heavily on this single metric in trade relations is that even if the administration's investigation unveils and new negotiations address remaining barriers to competition in the South Korean market, if the trade deficit persists, such negotiations could be deemed a failure even if they have positive benefits in both countries, as many argue the KORUS has had.

The shift from TPP to bilateral negotiations changes the venue for future U.S.-South Korea trade discussions. South Korea had repeatedly expressed interest in joining the TPP and, arguably, was the most likely new candidate for membership due to its comparable FTA with the United States. The Obama administration welcomed its interest, while also using the possibility of entry as leverage to push South Korea to resolve outstanding bilateral frictions. Now that bilateral talks are expected, four areas may be covered: the trade deficit, currency issues, KORUS FTA modifications, and trade enforcement. Besides, Trump has appeared to go beyond the subtle interplay between economics and security by explicitly arguing that the two should be used to extract gains for the United States.

The likelihood of the Trump administration tying commitments in either the trade or security realm to concessions in the other and of such an approach succeeding may depend on at least four factors: the level of U.S.-ROK coordination over North Korea policy, alliance relations, consultations over how best to approach China, and U.S. and Trump's popularity among South Koreans. A lot of factors enter the overall picture in the Manyin-Williams analysis of what to expect as talk of U.S.-ROK trade ties goes forward.