Asia’s mighty trading giants, which have for years benefited from the seemingly inexhaustible US appetite for their exports, have now run headlong into US President Donald Trump’s fierce insistence that the terms of America’s trade with them has been fundamentally unfair. That clash, which could yet lead to trade wars, could upend the global order that has prevailed for decades.
Saving KORUS from Trump
By Byung-il Choi

Nowhere have the implications of Donald Trump’s presidency on US relations with allies been more fraught than in South Korea. Despite the imperatives of the North Korean nuclear crisis in 2017 and early 2018, the new US administration pressed Seoul hard to renegotiate their free trade agreement — even threatening to scrap the deal in the midst of the nuclear crisis.

That left the administration of President Moon Jae-in to engage in an extremely delicate balancing act. Byung-il Choi outlines how the talks unfolded and why the outcome has left so many in South Korea uncertain about Trump’s approach to trade — and to Washington’s allies.

DESPITE THE STRONG trade headwinds coming from US President Donald Trump, somehow the Korea-US Free Trade Agreement (KORUS) seems to have survived. In late March 2018, Seoul and Washington announced that they had reached an agreement in principle to amend the deal but the cost of saving it from the unconventional Trump was not small. In fact, the deal is not yet complete — not because of legal scrubbing, a routine last-mile process in trade negotiations, but because of Trump himself. A few days after the official announcement that a deal in principle had been struck, Trump said that he would hold the agreement until after a deal was made with North Korea. So, whither KORUS?

WHY AMEND KORUS?
Renegotiating the free trade agreement was not something the South Korean government wanted to do. The idea came from Trump. As an underdog presidential candidate, Trump criticized all previous trade agreements as “horrible,” generating terrible pain for American workers. In his categorical rejection of existing trade agreements, Trump made it clear that KORUS, which was once praised as the biggest US trade pact since the North American Free Trade Agreement (NAFTA) and an exemplary case of a win-win trade accord, would be up for renegotiation if he were elected.

But renegotiating KORUS was not something new. It had happened before. Under strong pressure from the US, the agreement was effectively re-negotiated even before it went into force. Then-US President Barack Obama criticized KORUS as “unfair” during his presidential campaign, citing South Korea’s lopsided trade surplus in the auto sector. The agreement, signed by Obama’s Republican predecessor, could not clear the final step of ratification in the US Congress. With the arrival of Obama, KORUS would not see the light of day without renegotiations on autos. Hence, the South Korean side was forced to sit down with the US once again. As a result, the phase-out of tariffs was renegotiated in favor of Washington.

While the renegotiation over autos paved the way for congressional ratification, the fate of KORUS also was seriously contested in Seoul. Ironically, it was the current South Korean ruling party that vehemently opposed the agreement, with current President Moon Jae-in at the forefront of that opposition. In the heated presidential race of 2012, Moon, as the candidate from the opposition party, was openly critical of KORUS. Some members of the National Assembly from his party even stormed the US Embassy in Seoul to deliver a letter of opposition to the agreement.

On the left side of the political spectrum in South Korea, opposition to KORUS was seen as defiance of American neoliberalism. Opponents of the agreement viewed the launching of KORUS by left-leaning President Roh Moo-hyun as both a mystery and a betrayal. Throughout the process, South Korean negotiators were constantly hounded by demonstrators. Angry and wearing red headbands, they seemed to be everywhere. They travelled to all the negotiating venues, both inside and outside of South Korea. Mainly composed of farmers, members of labor unions and representatives of anti-American NGOs, the demonstrators shouted such slogans as “KORUS is a recipe for disaster! KORUS kills farmers and workers! Korea will become the colony of the US!”

The road toward completion of the agreement was long and winding. The KORUS talks began in early 2006, and an agreement was signed by the two countries in 2007, but they could not get to the implementation stage. It took a right-leaning South Korean government to renegotiate the auto sector before KORUS became effective on March 15, 2012. In other words it took almost five years after the initial agreement to see the agreement enter into force. In light of this turbulent and treacherous history, KORUS always represented a delicate balance of interests between Seoul and Washington, and within South Korea itself.

SMART POLITICS, BAD ECONOMICS
KORUS ran into unexpected turmoil again in 2017 as Trump ramped up pressure to renegotiate the agreement again, calling it a “job killer.” Despite the president’s criticisms, in the five years since KORUS came into effect, it has been widely seen as mutually beneficial. Under it, trade and investment flows between South Korea and the US have been on the rise. The US market share in South Korea increased from 8.3 percent in 2012 to 10.6 percent in 2016, while the South Korean trade deficit with the US improved from 2.6 percent in 2012 to 3.2 percent in 2016.

Like any trade agreement, KORUS has not been free from disputes. With regard to issues such as rules of origin and the service sectors, Washington has raised concerns, whereas Seoul has sought to strengthen the investor-state dispute settlement procedure. These points of discord, however, could be addressed in the context of the implementation of KORUS, not as roadblocks that called for renegotiations.

As for the widening of the US trade deficit with South Korea under KORUS, the mainstream view is that this was not related to any defect in the agreement, but rather to the prevailing macroeconomic situation in the two countries. The strong recovery of the US economy, in contrast to the sluggish performance of the South Korean economy, has been cited as the main reason the US trade deficit with South Korea has widened.
According to a report by the US International Trade Commission (ITC), “The US trade deficit against Korea in 2015 was recorded at US$28.3 billion, much less than the estimated deficit without the FTA.” The ITC estimated that the US trade deficit was reduced by as much as US$15.8 billion because of KORUS.

Trump’s view on KORUS was markedly different from this consensus among trade experts. He argued that the growing US trade deficit was simply a sign of unfair trade practices. In particular, he pointed at the auto sector. According to the US, from 2011 to 2016, the US trade deficit in goods with South Korea more than doubled, rising from US$13.2 billion to US$27.6 billion. During the same period, the US deficit in the auto sector alone rose to US$24 billion, an increase of 77 percent since 2011, accounting for nearly 90 percent of the total deficit in 2016.

If Trump intended to flag this number to show something flawed in KORUS, he was wrong. South Korea’s automobile exports to the US started to receive the FTA preferences only from 2011. Until 2015, the US maintained its import tariffs on autos (2.5 percent) from South Korea. In other words, South Korean autos did not receive any reduction in tariffs from KORUS from 2011 to 2016. In contrast, US auto imports into South Korea enjoyed the FTA preferences (the elimination of the 8 percent tariff on imported autos) from 2012. Hence, the increasing US deficit in the auto sector during the period 2011 to 2016 reflected fundamental market forces—the strong economic recovery in the US and the competitiveness of South Korean autos. Trump’s pressure on South Korea to renegotiate KORUS on the grounds of a growing trade deficit in the auto sector can’t survive the scrutiny of economic logic. If he were a student of Economics 101, he would be given a failing grade. Anyone could see that his pursuit of a renegotiation of KORUS was politically motivated.

THE NEW NORMAL OF TRADE POLITICS: TRUMP VERSUS MOON

Trump withdrew the US from the Trans-Pacific Partnership (TPP) trade accord in his first week as president. He also demanded to renegotiate NAFTA, blaming it for trade deficits and job dislocations. Renegotiating KORUS was part of Trump’s new mantra of “Buy American, Hire American.” Trump understands only one word: deficit. And he speaks of only one solution: reduction.

Considering his track record and ideological inclination, President Moon may have welcomed the demand from Trump to renegotiate KORUS. For him, it could have offered a golden opportunity to rectify any flaws in the agreement that he himself strongly objected to as a presidential candidate. Moreover, the US pressure could provide an opportunity to play to his political base. Curiously enough, Moon’s new government, which came to power following the candlelight vigils that led to the impeachment of President Park Geun-hye, chose not to play head-to-head. As a result, renegotiating KORUS was chased by Washington, but avoided by Seoul.

From the US viewpoint, bringing the unwilling South Korean side to the negotiating table was a priority. Throughout the summer of 2017, Moon’s government was reluctant to agree to a renegotiation of KORUS, arguing that the agreement was “win-win” and “balanced.” Moon changed his mind after Trump threatened to terminate KORUS in September 2017.

Bringing the South Korean side to the negotiating table was one thing, but concluding the negotiations in favor of the US was another. The US was fully aware of the fear factor for South Korea: agriculture. The South Korean government was deeply concerned that the renegotiations might open this political Pandora’s Box. That was precisely the reason behind Moon’s unwillingness to renegotiate the deal in the first place.

From the start, South Korea’s leverage was weak, and it got weaker as Trump threatened to terminate KORUS. Many saw this hardball approach by the US president as unexpected from the country’s closest ally, especially when South Korea was under the intensifying security threat from North Korea’s nuclear adventurism.

WHEN TRADE MEETS SECURITY

While renegotiations were underway, Trump announced plans to impose 25 percent tariffs on imports of steel and 10 percent on aluminum from all over the world on the grounds of national security, invoking Section 232 of the 1962 Trade Expansion Act. The European Union, Canada, Mexico, South Korea and Japan, all allies of the US, were included in the hit list, along with China and other countries. The Trade Expansion Act of 1962, with its Section 232 (Security Exception), is a legacy of the Cold War. But even during the Cold War, Section 232 was rarely used against non-allies. South Korea shipped 3.6 million tons of steel products to the US last year, making it the third-largest steel exporter behind Canada and Brazil. When announcing the steel tariffs, Trump also sent an open invitation to bilateral negotiations, which Seoul quickly accepted.

The essence of the deal, as announced in late March 2018, was to exchange concessions on autos for concessions on steel, according to the South Korean government. Seoul made concessions on autos in KORUS in order to receive an exemption from the 25 percent tariff on steel exports to the US. In the context of KORUS, US automakers would be allowed to export 50,000 vehicles to South Korea that do not comply with South Korean safety regulations. This number doubles the figure previously agreed under KORUS. These vehicles do not meet US safety standards and would be treated as such. South Korea also agreed to delay the phase-out of the 25 percent US tariff on South Korean pickup trucks until 2041, 20 years later than permitted under KORUS.

The two countries also agreed to hold additional talks to amend South Korea’s pharmaceutical pricing system. No new concessions were made regarding South Korea’s agriculture markets, designated by Seoul as a non-starter in the trade talks. It is noteworthy that the American agricultural sector did not want to push the South Korean side hard to further open up. American farm products were already enjoying increasing sales in the South Korean market. In particular, the case of American beef was extraordinary: American beef occupied the largest import share.
of the South Korean market, a sharp break from the days of massive protests in 2008 against US beef imports. Too much pushing could backfire, the US side must have thought.

The scope of the amendments to KORUS was less than expected. This was in large part due to the US negotiating strategy. Washington allocated more resources to the renegotiation of NAFTA. Despite strong pressure, Canada and Mexico proved tough negotiators, much to the dismay of Trump. Unlike South Korea, which negotiated for an early exit from the Section 232 tariffs on steel, Canada and Mexico did not opt for such an exit and refused to link the issue with the NAFTA renegotiations. In return for its concessions on KORUS, South Korea was granted a quota on steel imports that would be exempt from the new tariffs. Under the arrangement, South Korea will be allowed to export to the US a volume of steel equivalent to 70 percent of the average of South Korea’s exports to the US over the last three years — free of the tariffs.

As it turns out, Washington linked other issues to the KORUS talks. The US disclosed that a side agreement on currencies was also negotiated. While the South Korean government flatly denied such a deal, it came to be known that government officials from Seoul and Washington had been negotiating on the issue of suspected South Korean currency manipulation. Seoul should have rejected such negotiations on two grounds. First, unlike the US dollar and the euro, the Korean won does not have the privileged status of a key global currency. Second, South Korea’s trade dependency ranks among the highest in the world. Combining these two factors, it should be clear that stabilizing the value of its currency is an utmost policy priority for South Korea. Any foreign attempt to label this as currency manipulation should be rejected. Somehow, Seoul was trapped in the strategic big picture of the US.

OPENING PANDORAS BOX

Conventional wisdom has it that trade disputes among allies should not be politicized. Only in those with non-allies do security concerns often override trade issues. In some high profile cases, security has been offered as excuse for trade sanctions. In trade disputes among allies, however, there has traditionally been confidence and trust among policymakers that the security of allies would not be impaired, even when trade disputes became too serious to be resolved. The renegotiation process of KORUS amply demonstrated that under Trump, this conventional firewall between trade and security among allies no longer exists.

The arrival of President Trump has seen Section 232 be brought back from the dead. It now appears the US intends to invoke the “Security Exception” of Section 232 to change the rules-based global trading system. When he announced new tariffs on steel and aluminum, Trump indicated a willingness by the US to negotiate bilaterally with countries on the hit list. By invoking Section 232, the US is threatening to raise tariffs above the bound level the US has committed to through the World Trade Organization (WTO). The US, the architect and largest stakeholder of the rules-based multilateral trading system, has turned inward, as the slogan “America First” suggests. Under Trump, the US will seek to pursue its domestic interests, including the sectoral interests of declining, so-called Rust Belt industries disadvantaged by international competition at the expense of established global norms. Trump does not seem intent on preserving the interests of alliances. He threatened to terminate NAFTA and KORUS, unless they were renegotiated and amended on terms favorable to US domestic interests. Trump’s perception of allies was revealed when he said: “We are going to charge countries that take advantage of the US, some of them are our so-called allies, but they're not allies on trade.”

THE FUTURE OF KORUS AND THE ‘TRUMP RISK’

Perhaps the best thing South Korea achieved from the negotiations with the US was to save KORUS. After the announcement of the agreement, Seoul was busy touting the outcome as a South Korean victory. The consensus among trade experts was radically different. The 20-year delay in the elimination of the US tariffs on South Korean pickup trucks was not taken lightly. Under the original KORUS, the US tariff was supposed to be eliminated in 2021. No major auto exporting countries have negotiated such a preferential deal. (In the TPP, Japan got 30 years to eliminate the US tariff on trucks.)

Pickup trucks are the most lucrative segment of the US auto market. At 25 percent, the US import tariff is virtually prohibitive, giving the Big Three US automakers virtual dominance of this highly profitable market. Under the original KORUS, South Korean auto companies could have exported pickup trucks to the US without any tariffs within a few years. Now, under the amended KORUS, such a possibility is long gone. The only commercially viable option for South Korean auto companies would be to produce vehicles in the US. That would mean a high-paying job creation opportunity in South Korea is gone.

In return for concessions in the auto sector, Seoul got an exemption from the 25 percent tariff on steel under Section 232. Deeper scrutiny reveals a plethora of puzzles. A lion’s share of South Korean steel is already under punitive trade remedy measures imposed by the US, which means South Korean exporters are experiencing severe problems in the US. If the quota is to be agreed, existing trade remedies should have been suspended. At the least, a US guarantee for a sunset clause for the existing trade remedies should have been secured. Somehow, Seoul failed to obtain this minimum level of assurance.

What is more, Seoul opted for an early exit from the Section 232 steel tariffs by agreeing to a quota. Quotas are prohibited under the WTO, an organization that the US championed to create and strengthen. Now, the US has demanded a quota to reduce South Korea’s steel exports to the US in the name of security concerns. As the biggest beneficiary of the rules-based trade system, South Korea could have joined with the EU, Japan and other major countries to criticize and oppose the dangers of Trump’s use of Section 232. Instead, South Korea chose another option. This could create an unfortunate precedent for future trade problems with Trump.

The most worrisome is the possibility of future applications of Section 232. Steel may be only the beginning. Trump toyed with the idea of 25 percent tariffs on auto imports. He ordered a Section 232 investigation into autos and auto parts. In renegotiating KORUS, Seoul should have adopted strategic foresight in addressing this future possibility. If something similar to steel takes place, all the preferential tariffs in autos and auto parts as agreed in the KORUS renegotiations will prove useless. It seems that KORUS, despite having been renegotiated and amended, will have to live with the unconventional and unpredictable Trump. Ironically, the amendments do little or nothing to reduce uncertainty and risk.

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