

THE SOCIAL AND ECONOMIC IMPACT OF THE US-SOUTH KOREA FREE TRADE AGREEMENT (KORUS FTA)

**International Union, United Automobile, Aerospace & Agricultural
Implement Workers of America (UAW)
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After meeting with the South Korean President on June 30, 2010 in Toronto, President Obama announced his intention “to resolve the outstanding issues” surrounding the proposed U.S.-Korea Free Trade Agreement (KORUS FTA) before the next meeting of the G-20 in November in Seoul. The trade deal, which was negotiated and signed by President George W. Bush on April 1, 2007, would eliminate tariffs on the majority of industrial and service products, including automotive vehicles and parts. What follows is the UAW’s evaluation of the impact of the proposed KORUS FTA on U.S. exports and imports from Korea, and on the jobs, rights and living standards of workers in both countries. In public comments submitted to the USTR and Congress, the UAW has advanced a set of principles and suggested proposals for resolving what we see as the key problems with the proposed KORUS FTA.

Bilateral Trade Deficit and Employment

The KORUS FTA would be the most economically significant U.S. trade agreement since the North American Free Trade Agreement (NAFTA). Aggregate merchandise trade between the United States and Korea totaled \$67.8 billion in 2009 (down from \$82.2 billion in 2008 because of the global economic crisis). The content of that bilateral trade is extremely imbalanced, with U.S. imports from Korea exceeding exports by \$10.6 billion last year (\$13.4 billion in 2008). Despite hopes expressed by the administration that implementation of the proposed KORUS FTA would aid the effort to double U.S. exports globally over the next five years, the agreement in its current form fails to address the fundamental U.S.-Korea trade imbalance. This imbalance is the result of a mixture of tariff and non-tariff barriers, as well as the fact that Korea has strong national industrial and monetary policies designed to promote manufacturing exports and we do not.

While the International Trade Commission (ITC) has concluded that the impact of the KORUS FTA on U.S. employment would be “negligible or minimal,” our experience under the North American Free Trade Agreement (NAFTA) suggests otherwise. Like NAFTA, the KORUS FTA would eliminate tariffs on a wide range of industrial and agricultural products and modify “rule-of-origin” provisions. And as with NAFTA, the KORUS FTA has inadequate protections and enforcement mechanisms to enforce either the spirit or the letter of the law.

We know that that trade creates both winners and losers. In this case, the U.S. beneficiaries of the KORUS FTA will be the financial sector and large agricultural export companies. Neither of these sectors is likely to add many direct jobs in the U.S. The losers in the U.S. will include small businesses and workers in the already hard-hit manufacturing sector who would compete with cheaper Korean manufacturing exports. The losers in Korea will include Korean industrial workers, since KORUS eliminates existing disincentives for Korean manufacturers to use imported parts from lower-wage countries

NAFTA, too, was presented as a way to create U.S. and Mexican jobs through increased trade. Hufbauer and Schott (1993), for example, forecasted that U.S. exports to Mexico would increase by \$16.7 billion, imports would increase \$7.7 billion, and the trade balance would improve by \$9 billion. As a result, “a net total of 171,000 U.S. jobs would be created.” From 1993 to 2004, however, the U.S. trade deficit with our NAFTA partners actually increased by \$107.3 billion, and according to the Economic Policy Institute (Campbell, Faux, Salas, Scott, 2006), more than a million U.S. jobs were displaced by NAFTA. Similarly in Mexico, NAFTA failed to deliver the promised jobs bonanza, or to raise living standards for Mexican workers. According to a detailed study by the Carnegie Endowment for International Peace (Polaski et al, 2006), “NAFTA has produced a disappointingly small net gain in jobs in Mexico. Data limitations preclude an exact tally, but it is clear that jobs created in export manufacturing have barely kept pace with jobs lost in agriculture due to imports”. The NAFTA impact on wages on both sides of the border was even more disappointing, with losses in average wages in the U.S. (where jobs lost in manufacturing paid better, on average, than jobs created in services) and ambiguous results in Mexico, where wages for assembly jobs in the maquiladora sector were very low and export-oriented development did little to strengthen the country’s broader industrial sector (Campbell, Faux, Salas, Scott, 2006).

EPI economist Rob Scott estimates that the KORUS FTA would lead to the elimination of 159,000 American jobs. The implementation of the proposed KORUS FTA would thereby undermine efforts to generate job growth as the country struggles to emerge from the economic downturn.

Rule-of-Origin Provisions and “Duty Drawback”

Workers and their unions in Korea are opposed to the KORUS FTA, in part, because it would encourage Korean manufacturers to significantly increase the sourcing of production to low-wage nations of Asia, including China, which would result in the loss of Korean jobs and undermine living standards and working conditions. The UAW shares their concern, and views the agreement’s “rule-of-origin” and “duty drawback” provisions as highly problematic.

Under the “rule-of-origin” provisions of the proposed KORUS FTA, only 35 percent of the value of vehicle (road tractors, buses, cars, trucks, special purpose vehicles, and chassis fitted with engines) must be created in Korea or the United States in order to qualify for tariff-free treatment, using the adjusted value build-down method. Thus, Hyundai, for example, could source the production (and employment) of up to 65 percent of the value of its vehicles to China or elsewhere, import these parts and components back into South Korea for final assembly, and then export the finished vehicle to the United States duty-free. (By contrast, 55 percent of the value of vehicles must be of “domestic content” under the proposed EU-Korea FTA.) The KORUS FTA’s lax rule-of-origin provisions mean that it is effectively a free trade agreement not just with Korea, but with the entire region.

Compounding the problem, under the KORUS FTA as proposed, Korean assemblers will also be able to “draw back” (avoid) the Korean tariffs on imported parts and components, thereby giving them an additional cost advantage/incentive to outsource production and employment to China, Thailand, Malaysia, and other countries where wages are much lower than Korea and labor rights are weak or non-existent. Duty drawback is an inward processing scheme where duties paid on parts used for the production of a final product are refunded when the final product is exported. Currently, Korean vehicle exporters cannot draw back the duties they pay on imported parts; under the KORUS FTA, they will be able to do so on vehicles exported to the U.S.

In other words, under the KORUS FTA, not only would a vehicle with 65% non-Korean content be subject to no U.S. duties, the exporting manufacturer would be able to collect a refund for Korean duties paid on the non-Korean content.

Duty drawback was a significant issue in talks toward an EU-Korea FTA, and that proposed agreement includes safeguards in the event of a significant increase in foreign sourcing; no such safeguards are part of the KORUS FTA. Despite this, the Italian parliament earlier this month rejected the EU-Korea FTA, which will likely delay its passage for months, if not longer.

In the renegotiation of the automotive provisions of the KORUS FTA, it is critical to workers in both the U.S. and Korea that safeguards be incorporated to prevent a surge in outsourcing by Korean exporters. As the KORUS FTA now stands, the U.S. and Korea are effectively signing an automotive free trade agreement with the world.

Bilateral Automotive Trade

Our overall trade imbalance with Korea is largely the result of imbalanced automotive trade. The \$8.9 billion 2009 U.S. automotive trade deficit represented 70.1 percent of our merchandise trade deficit with Korea. So far this

year, the U.S. auto trade deficit with Korea (\$3.9 billion) is greater than our aggregate bilateral merchandise trade deficit (\$3.1 billion).

South Korea is the fifth largest producer and fourth largest exporter of motor vehicles in the world. In 2009, Korea produced 3.5 million motor vehicles and exported 61 percent of them (2.14 million units) to the rest of the world. At the same time, Korea's own auto market is virtually closed to foreign-made vehicles — imports made up just 4.4 percent of Korean auto sales in 2009. According to the U.S. Department of Commerce (Bureau of Census, ITC), the United States exported just 5,878 passenger vehicles to Korea, while importing 476,833 vehicles from Korea in 2009.

The International Trade Commission (ITC) estimates that the KORUS FTA would lead to an annual increase in automotive imports from South Korea of \$1.3 to \$1.7 billion (9-12%), while U.S. automotive exports would increase by \$300 to \$400 million, thereby increasing the auto trade deficit with Korea by \$1.0 to \$1.3 billion. (The ITC also asserts that 55-57% of the increase in imports would represent “diverted imports from other trading partners.” As the import share of the U.S. vehicle market is roughly 23%, that assertion is highly implausible.)

With the economic recovery flagging and the recovery of the domestic auto industry still fragile, an increase in our automotive trade imbalance is a matter of grave concern. It is vital that any trade agreement include industry safeguards — such as a predetermined “snap-back” of the auto tariff — that would apply automatically in the event of a significant increase in imports of Korean automotive products.

Implications for Domestic Auto Parts Production and Employment

Thirty-eight percent of the 2009 U.S. automotive trade deficit with Korea was in auto parts. The \$3.4 billion parts deficit last year was only slightly below 2008 levels (\$3.5 billion), and considerably above the deficit sustained in 2004 (\$1.4 billion). These auto parts deficit figures reflect the fact that while the Korean automakers (Hyundai and Kia) significantly increased the number of vehicles assembled in the U.S. over the second half of the decade, much of the value in those vehicles consisted of parts and components imported from their suppliers in Korea.

By immediately eliminating tariffs on imported parts and components, the KORUS FTA disincentivizes Hyundai and Kia from supplying their U.S. assembly plants locally, perpetuating a situation in which the U.S. and Canadian content of Hyundai-Kia vehicles assembled in the U.S. (currently around 40%) is far less than that of vehicles assembled by Japanese or U.S. manufacturers. .

Implications for U.S. Pickup Production and Employment

We are particularly concerned about the impact of the phase-out of the 25 percent tariff on pickup trucks on future U.S. production of small pickups. Although the U.S. market is currently dominated by full-size trucks, that may not be the case forever: in a world of volatile energy prices and heightened environmental concerns, it is possible (even likely) that consumer tastes will shift toward smaller, lighter trucks.

Because the domestic market for small pickups is currently limited, manufacturers are already reluctant to invest in U.S. production. However, small pickups are popular in east Asia, and are produced there in far greater numbers than anywhere else. The phase-out of the 25 percent truck tariff under the KORUS FTA could thus have a significant impact on automakers' U.S. investment plans. In the absence of the tariff, any future increase in U.S. demand for small pickups would likely be met by importing vehicles from a region where production is already established.

Although Korean automakers do not currently manufacture a pickup truck, they unquestionably have the capacity to quickly develop, produce and competitively export pickups, either directly or through an alliance (e.g., with GM, Renault-Nissan, or Mahindra, all of whom either control or are in the process of acquiring control of Korean automakers, and all of whom manufacture pickups).

Finally, we are concerned that the KORUS FTA will serve as a model for future FTAs with other Asian nations – particularly Thailand, which is the world's second largest producer of pickup trucks. This heightens the risk to domestic vehicle and parts production. This is no idle threat; on consecutive days in late August, Ford announced that it would not reconsider closing its Ranger pickup assembly plant in Minnesota, then announced that it would invest \$350 million to produce the next-generation Ranger in Thailand. The UAW believes that the 25 percent pickup truck tariff should continue to be negotiated with Korea and other countries at the World Trade Organization (WTO).

Implications for U.S. Small Car Production and Employment

The KORUS FTA as proposed also poses a threat to the nascent small car sector in the U.S. (e.g., the Aveo, slated for GM's Orion, MI plant). While the elimination of the 2.5 percent tariff in itself represents only a marginal change in relative costs, the ability to include a large portion (up to 65 percent) of Chinese parts in duty-free vehicles could provide a significant competitive advantage in a segment where low prices are important and small costs savings can be significant.

East Asia is already a top center for the engineering and production of these vehicles, and manufacturers making decisions on the next “increment” of small car production to serve the U.S. market could easily conclude that Korea offers cost savings that are much more assured once the KORUS FTA provisions lock in these advantages.

Non-Tariff Barriers

U.S. automotive exports to Korea will remain negligible until effective provisions are put in place to address non-tariff barriers in the Korean auto market. The ITC has acknowledged that the 1995 and 1998 memoranda of understanding (MOUs) between the United States and Korea, the stated goals of which were to increase market access and address non-tariff barriers in the Korean market, did not result in increased sales of U.S.-built vehicles. The automotive provisions of the KORUS FTA do not appreciably move beyond the language contained in the 1995 and 1998 MOUs, so it is highly unlikely that the proposed KORUS FTA would lead to more open, equitable and reciprocal market access by reducing or eliminating barriers and distortions that decrease market opportunities for U.S. exports.

There is no evidence that Korea has altered its historical use of non-tariff automotive barriers since signing the KORUS FTA over three years ago. In written Senate testimony submitted on September 24, 2008, Chrysler Vice President John Bozzella described several non-tariff barriers (NTBs) introduced by Korea *after* the KORUS FTA had been signed in April 2007. These included a proposal by the Korea Insurance Development Institute (KIDI) to reform its methodology for calculating automobile insurance rates that caused customers to pay higher auto insurance rates for driving imported vehicles; significant changes to Korea’s auto emissions testing/certification process that made importing more difficult; and unjustified and intimidating actions taken by the Korean Fair Trade Commission in December 2007 against the Korea Automobile Importers and Dealers Association (KAIDA), including a raid on the group’s offices and the seizure of documents. As these examples illustrate, NTBs are easy to create, and having effective detection and enforcement mechanisms is critical if a free trade deal is to be a *fair* trade deal.

Dispute Settlement Procedures

Bush Administration trade negotiators touted the dispute resolution provisions in the KORUS FTA as containing “an innovative process for settling disputes on auto-related measures.” The KORUS FTA does establish an Automotive Working Group, consisting of officials from both governments, to resolve disputes about auto trade. However, the panel’s charge is structured in such a way as to virtually preclude effective relief. To prevail in a dispute over non-tariff barriers,

for example, it would not be sufficient for the U.S. to show the existence of barriers to U.S. automotive exports. Instead, the U.S. would have to prove "non-conformity" with Korea's obligations under the trade agreement, which is unlikely given its vague provisions.

Even if the U.S. were able to prove non-conformity, it would also be required to demonstrate that U.S. manufacturers have suffered "injury" as a result. Experience shows this to be an impossible hurdle to overcome because Korea can always allege that other factors are holding down sales of U.S. automotive products. And even if the panel were to rule in favor of the U.S., the only relief provided is that the U.S. would be allowed to reinstate (i.e., "snap back") our former 2.5% tariff on autos and auto parts. This snap back provision does not apply to the 25 % pickup truck tariff, arguably the most important U.S. tariff concession under KORUS FTA as proposed.

Labor Rights in South Korea

The UAW has serious concerns regarding the effectiveness of the worker rights provisions of the proposed KORUS FTA in protecting basic international labor standards. Korean workers who attempt to exercise fundamental rights recognized by the ILO – freedom of association, freedom to organize and bargain collectively, and freedom from workplace discrimination – are routinely thwarted.

In particular, the Korean government is increasingly using section 314 of the Korean Penal Code to bring "obstruction of business" charges against workers and union officials for engaging in legitimate union activity. Violations of section 314 include up to five years in prison and very steep criminal fines. Employers use the government's prosecution of workers under section 314 to justify firing workers, and use the threat of enormous compensation claims to intimidate workers and their unions into forgoing their rights. Between January 1, 2008 and October 28, 2009, 334 workers were in Korean prisons on obstruction of business charges, 82 of them during a single dispute at Ssangyong Motors. As of April 2010, damages claims against trade unions and individual union members totaled over \$40 million. The ILO's Committee on Freedom of Association in July 2008 and again in November 2009, in case number 2602, called on the Korean government to amend section 314 "to bring it into conformity with freedom of association principles."

The growing use of "irregular" or "precarious" workers to circumvent Korean labor laws is also a concern. These workers, who now make up more than half the total workforce in Korea, are not afforded the same legal rights to organize and bargain collectively as regular workers.

Exchange Rates and Currency Manipulation

U.S. manufacturers are justifiably concerned about the undervalued South Korean currency. In its September 2010 assessment, the International Monetary Fund (IMF) concluded that the Korean won was being kept undervalued: “Despite the 22 percent appreciation between March 2009 and June 2010, the real effective exchange rate remains undervalued according to IMF’s Consultative Group on Exchange Rate issues. The exchange rate should be allowed to fully reflect supply and demand conditions in the foreign exchange markets, with interventions being strictly limited to smoothing operations.”

Conclusion

The UAW is not opposed in principle to a trade agreement with Korea. The KORUS FTA negotiated and signed on April 2007, should be rejected because it fails to achieve the overall trade negotiating objectives of the United States. In particular:

- The KORUS FTA would have an adverse impact on U.S. economic growth, living standards and employment.
- The KORUS FTA would allow tariff evasion by non-signatory countries through duty drawback schemes; coupled with lax rules of origin, this would harm both Korean and U.S. workers by encouraging outsourcing to lower-wage countries in the region.
- The KORUS FTA would not lead to more open, equitable, and reciprocal access to the Korean market because it fails to effectively address non-tariff barriers and does not provide effective dispute settlement mechanisms.
- The KORUS FTA would not promote respect for worker rights consistent with core labor standards of the ILO.

For these reasons, the UAW calls on the Obama Administration to fundamentally renegotiate the auto provisions of the trade deal with Korea before it is granted any additional access to our market.

APPENDIX 1

U.S. Merchandise Trade World and South Korea: 2004-2010

	2004	2005	2006	2007	2008	2009	2009 (1st Half)	2010 (1st Half)
US MERCHANDISE TRADE								
WORLD								
IMPORTS:	\$1,472,926	\$1,674,514	\$1,861,380	\$1,964,922	\$2,117,245	\$1,562,549	\$722.1	\$916.4
EXPORTS:	\$807,536	\$892,512	\$1,023,109	\$1,149,340	\$1,276,994	\$1,045,575	\$503.8	\$617.6
BALANCE:	-\$665,390	-\$782,002	-\$838,271	-\$815,582	-\$840,251	-\$516,974	-\$218.3	-\$298.8
SOUTH KOREA								
IMPORTS:	\$46,168	\$43,779	\$45,804	\$47,566	\$48,069	\$39,235	\$19,219	\$22,339
EXPORTS:	\$26,412	\$27,670	\$32,442	\$34,703	\$34,669	\$26,640	\$12,573	\$19,244
BALANCE:	-\$19,756	-\$16,109	-\$13,362	-\$12,863	-\$13,400	-\$12,595	-\$6,646	-\$3,095

Between 2004 and 2008, the overall U.S. merchandise trade deficit increased 26.3 percent from \$655 billion to \$840 billion. With the economic crisis, which led to a collapse of global trade, the U.S. merchandise trade deficit fell \$323 billion, to a level of \$517 billion in 2009. Through the first six months of 2010, however, the U.S. merchandise trade deficit increased 37 percent over the corresponding period of 2009. Thus, while the 2009 U.S. trade imbalance improved due to cyclical economic reasons, our structural trade problems remain, and once U.S. consumer demand recovers we will again experience acceleration in the growth of the trade deficit. Further, the impact of the economic stimulus on consumer demand and domestic job growth was diluted by the disproportionate consumption of foreign goods and services.

U.S. Global Automotive Trade 2004-2010

	2004	2005	2006	2007	2008	2009	2009 (1st Half)	2010 (1st Half)
U.S. GLOBAL AUTO TRADE								
IMPORTS:								
Passenger Cars	\$122,267	\$123,394	\$135,509	\$133,859	\$125,606	\$81,073	\$30,682	\$43,448
Trucks, Buses, SPV	\$21,183	\$22,944	\$24,657	\$23,099	\$15,876	\$11,577	\$5,177	\$6,060
Parts	\$82,694	\$90,831	\$94,002	\$88,605	\$91,318	\$65,810	\$27,803	\$37,022
Total	\$226,144	\$237,169	\$254,168	\$245,563	\$232,800	\$158,460	\$63,662	\$86,530
EXPORTS:								
Passenger Cars	\$24,609	\$30,493	\$33,978	\$43,743	\$49,569	\$27,501	\$11,558	\$15,156
Trucks, Buses, SPV	\$12,702	\$14,813	\$16,985	\$19,459	\$19,246	\$14,503	\$6,124	\$7,803
Parts	\$52,649	\$54,662	\$58,214	\$61,419	\$57,394	\$42,924	\$18,259	\$23,835
Total	\$89,960	\$99,968	\$109,177	\$124,621	\$126,209	\$84,928	\$35,941	\$46,794
BALANCE:								
Passenger Cars	-\$97,658	-\$92,901	-\$101,531	-\$90,116	-\$76,037	-\$53,572	-\$19,124	-\$28,292
Trucks, Buses, SPV	-\$8,481	-\$8,131	-\$7,672	-\$3,640	\$3,370	\$2,926	\$947	\$1,743
Parts	-\$30,045	-\$36,169	-\$35,788	-\$27,186	-\$33,924	-\$22,886	-\$9,544	-\$13,187
Total	-\$136,184	-\$137,201	-\$144,991	-\$120,942	-\$106,591	-\$73,532	-\$27,721	-\$39,736

U.S. automotive trade has followed a similar pattern in recent years. The overall U.S. auto trade deficit increased modestly from 2004 (\$136 billion) to 2006 (\$145 billion), before decreasing to \$73.5 billion in 2009. The U.S. continued to endure large bilateral auto trade deficits with many nations, including Japan (\$32.8 billion), Mexico (\$23.4 billion), Germany (\$10.2 billion), and South Korea (\$7.9 billion). The U.S. auto trade deficit is up 43.3 percent in the first half of 2010, as compared to the same period in 2009.

U.S. –South Korea Automotive Trade 2004-2010

	2004	2005	2006	2007	2008	2009	2009 (1st Half)	2010 (1st Half)
U.S. SOUTH KOREA AUTO TRADE								
IMPORTS:								
Passenger Cars	\$10,044	\$8,765	\$8,695	\$8,235	\$7,414	\$5,696	\$2,850	\$2,345
Trucks, Buses, SPV	\$0	\$1	\$2	\$0	\$3	\$0	\$0	\$0
Parts	\$1,861	\$2,671	\$3,672	\$3,077	\$3,897	\$3,714	\$1,088	\$1,909
Total Imports	\$11,905	\$11,437	\$12,369	\$11,312	\$11,314	\$9,410	\$3,938	\$4,254
EXPORTS:								
Passenger Cars	\$48	\$115	\$149	\$345	\$370	\$161	\$63	\$148
Trucks, Buses, SPV	\$13	\$17	\$22	\$60	\$69	\$16	\$6	\$12
Parts	\$458	\$560	\$579	\$533	\$416	\$315	\$124	\$174
Total Exports	\$519	\$692	\$750	\$938	\$855	\$492	\$193	\$334
BALANCE:								
Passenger Cars	-\$9,996	-\$8,650	-\$8,546	-\$7,890	-\$7,044	-\$5,535	-\$2,787	-\$2,197
Trucks, Buses, SPV	\$13	\$16	\$20	\$60	\$66	\$16	\$6	\$12
Parts	-\$1,403	-\$2,111	-\$3,093	-\$2,544	-\$3,481	-\$3,399	-\$964	-\$1,735
Auto Trade Balance	-\$11,386	-\$10,745	-\$11,619	-\$10,374	-\$10,459	-\$8,918	-\$3,745	-\$3,920
Hyundai-Kia Imports and Sales			2006	2007	2008	2009		
Hyundai-Kia U.S. Car Sales			488,971	444,191	493,239	461,131		
HK U.S. Car Sales: Imports			325,096	318,875	349,587	347,641		
% of U.S. HK Car Sales as Imports			66.5%	71.8%	70.9%	75.4%		
Hyundai-Kia U.S. Light Truck Sales			257,592	314,824	254,545	229,041		
HK U.S. Light Truck Sales: Imports			230,355	226,158	175,500	156,609		
% of U.S. HK LT Sales as Imports			89.4%	71.8%	68.9%	68.4%		

In contrast to overall U.S. automotive trade, the U.S. bilateral auto trade deficit with South Korea remained relatively constant from 2004 to 2006, and declined less drastically over the 2006 to 2009 period). A significant share of the U.S. automotive products trade deficit with South Korea is in auto parts (44 percent of the deficit in 2009). In 2009, U.S. imports of Korean automotive products fell 16.8 percent as compared to 2008, while U.S. automotive exports to Korea fell 42.5 percent last year. The \$8.9 billion 2009 U.S. automotive trade deficit represented 70.1 percent of our merchandise trade deficit with Korea. The U.S. automotive trade deficit with South Korea through the first half of 2010 is just 4.7 percent greater than the deficit experienced in the first six months of 2009. So far this year, the U.S. auto trade deficit with Korea (\$3.9 billion) is greater than our aggregate bilateral merchandise trade deficit (\$3.1 billion).