Currency Manipulation Could Negate Cuts to Korean Agricultural Tariffs in Korea FTA

The Korea Free Trade Agreement (FTA) will eliminate nearly all U.S. and Korean agricultural tariffs over the course of 20 years.[1] While some agricultural tariffs go to zero immediately, the tariff of the sector in which the United States has the largest possible gain – beef – phases out in equal annual stages over 15 years.[2]

Proponents of the Korea FTA are advocating for its congressional passage by highlighting prospective gains for the U.S. agricultural sector related to tariff cuts. However, given Korea's past history of significant currency manipulation, it is worth noting that Korea could again devalue its currency in a manner that effectively cancels the benefits of the tariff cuts. Unfortunately, despite calls from various U.S. economic sectors to include safeguards against such devaluations,[3] the Korea FTA does not provide for penalties if one party deliberately undervalues its currency. In other words, the promised new market access in Korea being promised as a result of this FTA by various government officials and agribusiness trade associations and firms aimed at persuading farm state legislators to support it could well turn out to be completely hollow. This would leave nothing but voter anger at these legislators long after the expiration of their only major chance – threatening to vote no on the Korea FTA – to obtain inclusion of additional FTA rules to discipline currency manipulation practices.

The U.S. International Trade Commission, the independent federal agency tasked with estimating the likely economic effects of trade agreements, predicts that implementation of the Korea FTA will lead to an increase in the overall U.S. goods trade *deficit* of $308-416 million.[4] The USITC predicts that some agricultural sectors will benefit from tariff cuts and some agricultural sectors would actually experience a worsening trade balance if the Korea FTA were to be implemented.

The USITC predicts that several agriculture sectors would be losers under the Korea FTA, including:[5]

- Wheat, which would suffer a fall in its trade surplus of $14-69 million.
- Oilseeds, which would suffer a fall in its trade surplus of $18-39 million.
- Miscellaneous crops, which would suffer a rise in its trade deficit of $48-53 million.

The USITC predicts that some agricultural sectors would have improved trade balances after full phase in of tariffs cuts under the Korea FTA: [6]

- Once tariff cuts are fully implemented over 15 years, the U.S. trade deficit in beef will decline by between $605 million and $1.7 billion due to the elimination of Korea's 38 percent beef tariff.
- When tariff cuts are fully implemented, the U.S. trade surplus in non-beef meat products will increase by $394-661 million due to the elimination of Korea's 24.8 percent tariff on non-beef meat products.
- When tariff cuts are fully implemented, the U.S. trade deficit in dairy products will decline by $152-294 million due to the elimination of Korea's 39.6 percent tariff on dairy products.
- When tariff cuts are fully implemented, the U.S. trade surplus in other animal products will increase by $39-45 million due to the elimination of Korea's 3.3 percent tariff on these products.
- When tariff cuts are fully implemented, the U.S. trade surplus in vegetables, fruit, and nuts will increase by $84-123 million due to the reduction of Korea's 38.5 percent average ad valorem equivalent tariff across these items to a 6.7 percent average ad valorem equivalent tariff.

- When tariff cuts are fully implemented, the U.S. trade deficit in miscellaneous food products will be reduced by $196-213 million due to the elimination of Korea's 10 percent tariff on these products.

Korean currency manipulation could negate tariff cuts; the FTA provides no safeguards against this

Historically, Korea has been a chronic currency manipulator. Korea is one of only three countries (China and Taiwan being the others) that have ever been placed on the Treasury Department's list of currency manipulators.[7] During the mid to late 1980s, the Korean won was undervalued against the dollar by about 60 percent, meaning that all U.S. goods exported to Korea faced a barrier equivalent to a tariff of about 60 percent during that period.[8] Korea's deliberate effort to keep its currency undervalued during this time prompted the Treasury Department to place it on the 1988 currency manipulators list.[9] In the early 1990s the value of the Korean won shifted so it was no longer undervalued, but in the late 1990s Korea rapidly acquired foreign exchange reserves and the won again became severely undervalued against the dollar by about 50 percent.[10]

If Korea again reverts to strategically undervaluing its currency to boost exports and reduce imports, the Korea FTA's agricultural tariff cuts – and prospective benefits to U.S. exports – could be negated.

The Korean won has not been undervalued in recent years.[11] However, because the Korean won is not undervalued, Korea is thus well positioned to push the value of its currency down as it did in the late 1980s and 1990s. This is the case because to push down its currency's value, it must have the resources to buy dollars and U.S. Treasury bonds – which it would not be able to do if its currency already was of relatively low value in exchange for U.S. currency. Unfortunately, because the FTA does not include provisions disciplining such currency manipulations or defining them as actionable subsidies, Korea could devalue away the market access gains provided on paper without penalty. In sum, there are no provisions in the Korea FTA that limit or allow redress against currency manipulation.

Examples of what Korean devaluations would mean for U.S. agriculture benefits under the FTA:

Say that, following implementation of the FTA tariffs cuts, Korea returned to its old habits and undervalued its currency by 50 percent. Then the FTA tariff cuts combined with the 50 percent devaluation of the Korean won would result in a net effective *increase* in Korean agricultural tariff equivalents of:

- **12 percent for beef.**
- **25.2 percent for non-beef meat products.**
- **46.7 percent for other animal products.**
- **18.2 percent for vegetables, fruit, and nuts.**
- **10.4 percent for dairy products.**
- **40 percent for miscellaneous food products.**

Such currency devaluation following FTA implementation has happened in the past. A year after NAFTA went into effect, Mexico suddenly devalued its currency by 50 percent.[12] The devaluation of the peso negated NAFTA's tariff cuts, as noted by a former World Bank Chief Economist who wrote, "Nonetheless, it must be recognised that the real depreciation of the peso [in 1994], given its magnitude, was a larger influence on trade than was the entry into NAFTA. This is because the total reduction in tariffs at the end of 15 years would average only 10 per cent, in contrast with the 50 per cent real

depreciation."[13] Due to the peso devaluation, American products became much more expensive for Mexican consumers, and U.S. agricultural exports suffered. For example, U.S. exports of beef and pork to Mexico in the first three years of NAFTA were 13 and 20 percent lower, respectively, than beef and pork exports in the three years before NAFTA was enacted.[14] Members of Congress should consider the NAFTA experience before making optimistic claims about supposed benefits to the beef and pork industries under the Korea FTA.

ENDNOTES

[1] U.S. International Trade Commission. "U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects." USITC Publication 3949. September 2007, Corrected printing March 2010, at 1-8, Table 1.4, Available at: http://www.usitc.gov/publications/332/pub3949.pdf

[2] U.S. International Trade Commission. "U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects." USITC Publication 3949. September 2007, Corrected printing March 2010, at 3-38.

[3] See, for instance, National Farmers Union resolution on Trade Reform. Available at: http://nfu.org/wp-content/trade-reform.pdf

[4] U.S. International Trade Commission. "U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects." USITC Publication 3949. September 2007, Corrected printing March 2010, at 2-14, Table 2.3.

[5] The worsening trade balance is partially due to shifts in how agricultural land is used in the United States after the FTA is implemented. U.S. International Trade Commission. "U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects." USITC Publication 3949. September 2007, Corrected printing March 2010, at 2-14, Table 2.3.

[6] Tariff rates are quoted as the trade-weighted average ad valorem equivalent tariff for the sector. U.S. International Trade Commission. "U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects." USITC Publication 3949. September 2007, Corrected printing March 2010, at 2-14, Table 2.3.

[7] The two other countries are China and Taiwan. Robert Scott, "Currency Manipulation—History Shows That Sanctions Are Needed," Economic Policy Institute, Policy Memorandum No. 164, April 29, 2010, at 3, Available at: http://www.epi.org/page/-/pm164/pm164.pdf

[8] Se-Eun Jeong and Jacques Mazier, "Exchange Rate Regimes and Equilibrium Exchange Rates in East Asia," *Revue économique*, vol. 54, No. 5, September 2003, at 1174 and 1176, Available at: http://www.cairn.info/load_pdf.php?ID_ARTICLE=RECO_545_1161

[9] Robert Scott, "Currency Manipulation—History Shows That Sanctions Are Needed," Economic Policy Institute, Policy Memorandum No. 164, April 29, 2010, at 3, Available at: http://www.epi.org/page/-/pm164/pm164.pdf

[10] Se-Eun Jeong and Jacques Mazier, "Exchange Rate Regimes and Equilibrium Exchange Rates in East Asia," *Revue économique*, vol. 54, No. 5, September 2003, at 1174 and 1176, Available at: http://www.cairn.info/load_pdf.php?ID_ARTICLE=RECO_545_1161
and Ernest H. Preeg, "Exchange Rate Manipulation to Gain an Unfair Competitive Advantage: The Case Against Japan and China," *Dollar Overvaluation and the World Economy*, eds. C. Fred Bergsten and John Williamson, Peterson Institute for International Economics, at 270, Available at: http://www.piie.com/publications/chapters_preview/360/13iie3519.pdf

[11] See William R. Cline and John Williamson, "Currency Wars?" Peterson Institute for International Economics. Policy Brief number PB10-26, November 2010, Available at: http://www.iie.com/publications/pb/pb10-26.pdf

[12] Juan R. Espana, "The Mexican peso crisis: impact on NAFTA and emerging markets," Business Economics, July 1995, Available at: http://findarticles.com/p/articles/mi_m1094/is_n3_v30/ai_17221265/

[13] Anne O. Krueger, "NAFTA's Effects: A Preliminary Assessment," *The World Economy*, Volume 23, Issue 6, at 764, June 2000.

[14] Author's calculations based on data obtained from the United States Department of Agriculture Foreign Agricultural Service's Global Agricultural Trade System on January 21, 2011. Data was inflation-adjusted using the Consumer Price Index-U-RS as estimated by the Congressional Budget Office in the backup data for Table C-1 of their "The Budget and Economic Outlook: An Update", released August 2010. FAS aggregations used for beef were "Beef & Veal,Fr/Ch/Fz" and "Beef&Veal, Prep/Pres". FAS aggregations used for pork were "Pork, Fr/Ch/Fz", "Pork,Hams/Shldrs,Crd", "Pork, Bacon, Cured", "Hog Sausage Casings", "Pork,Prep/Pres,Nt/Cn", and "Pork,Prep/Pres,Cannd"