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## REPORTERS' MEMO

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### Survey of Studies on Potential Economic Effects of the Korea Free Trade Agreement Shows Rising Deficits and Job Losses

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**Summary:** *An independent government study suggests that the implementation of the Korea FTA as negotiated by Bush will lead to an increase in the U.S. trade deficit in goods, which will likely cause layoffs here at home. Major changes to the Korea FTA must be made if its harmful effects are to be mitigated.*

President Barack Obama set the Seoul G-20 summit as a deadline for his administration to address outstanding issues with the Bush-negotiated Korea Free Trade Agreement (FTA) in preparation for submitting it to Congress for approval. Significant policy and political questions set the context for the pact's future and the administration's trade policy. The G-20 summit comes on the heels of a midterm election cycle that featured unprecedented campaigning by GOP and Democratic congressional candidates against the offshoring of American jobs. Polls show that a majority of Americans across stunningly diverse demographics oppose the past trade policies that have led to the massive offshoring of jobs.<sup>1</sup>

Underlying the public sentiment are deep concerns about the net loss of more than five million U.S. manufacturing jobs – one of every four in that sector – since implementation of the North American Free Trade Agreement (NAFTA) on which the Korea FTA is based. Facing his own 2012 reelection, Obama must convince the American public that all of his policies are designed to remedy the unemployment crisis.

**This memo reviews five studies that have attempted to predict the economic effects of the Korea FTA, with particular attention paid to an often-cited study conducted by the U.S. International Trade Commission (USITC). The USITC study concluded that the Korea FTA would increase the U.S. goods trade deficit. On both politics and policy, this is a troubling finding and suggests that implementation of the Korea FTA in its current form will likely lead to U.S. job losses. The pact's chief negotiator, Ambassador Karan Bhatia, offered a frank assessment of the impact of FTAs upon the U.S. while he served as former President George W. Bush's deputy U.S. trade representative. In an October 2006 speech to a Korean audience, Bhatia said that it was a "myth" that "the U.S. will get the bulk of the benefits of the FTA." He went on to say, "If history is any judge, it may well not turn out to be true that the U.S. will get the bulk of the benefits, if measured by increased exports." He added that, in the instance of Mexico and other countries, "the history of our FTAs is that bilateral trade surpluses of our trading partners go up," meaning that the U.S. trade deficit with those countries increased.<sup>2</sup>**

*Lori Wallach, Public Citizen's Global Trade Watch director, and Todd Tucker, research director, are available to comment on the political and economic implications of announcements regarding the Korea FTA that President Obama will make at the Seoul G-20 meeting. To schedule an interview with Wallach or Tucker, please contact Bryan Buchanan, press officer for Public Citizen's Global Trade Watch, at (202) 454-5108 or e-mail him at [bbuchanan@citizen.org](mailto:bbuchanan@citizen.org).*

For an analysis of a wider range of factors that will complicate any push for passage of Bush's Korea FTA, see our political backgrounder at: <http://bit.ly/dhITT8>.

South Korea is a major industrial power. U.S. imports of Korean goods are predicted to increase significantly if the FTA is implemented without substantial changes. U.S. export opportunities to Korea are murky. The pact was negotiated under the deadline of Fast Track termination in 2007. With literally minutes to go before losing Fast Track trade authority,<sup>3</sup> the Bush administration agreed to terms that allowed certain Korea tariffs to remain in place for sectors in which the U.S. agreed to zero its tariffs. Turning to U.S. imports from Korea, some goods from South Korea (including motor vehicles and apparel) currently face high tariffs. This stands in contrast to goods from many developing countries that already enjoy U.S. trade preferences. Elimination of those tariffs on Korean goods could lead to a flood of imports.<sup>4</sup> This rise in imports could reduce U.S. demand for domestically produced products, causing factories to reduce production and lay off workers. Ford Motor Company and the United Auto Workers in particular have expressed their outright opposition to the Korea FTA, due to the likely widening of the auto deficit with Korea under the FTA.<sup>5</sup> The AFL-CIO has also expressed its strong opposition to the current text of Korea FTA because it would put thousands of manufacturing jobs at risk.<sup>6</sup>

A study by the Economic Policy Institute has examined this question of the employment impacts of implementation of the Korea FTA. The study examined the U.S. historical experience with major changes in bilateral trade policy – namely changes in trade flows with Mexico and China after NAFTA implementation and Chinese WTO ascension, respectively – to determine the likely impact of the Korea FTA on trade flows.<sup>7</sup> **EPI found that the implementation of the Korea FTA would boost the U.S. trade deficit with Korea by \$13.9 billion over the next seven years.<sup>8</sup> This rise in the trade deficit, in turn, would cost the U.S. economy about 159,000 net jobs.<sup>9</sup>**

Public Citizen conducted a similar exercise in our report “Lies, Damn Lies and Export Statistics: How Corporate Lobbyists Distort Record of Flawed Trade Deals,” available at: <http://bit.ly/bx3JJn>. Examining the relative export growth record to the broader set of America's 17 FTA partners, we found that American exports to FTA countries have on the whole grown at less than half the pace as U.S. exports to countries with which we do not have such pacts. If the difference between the FTA and non-FTA export growth rates for goods for each year were to be put in dollar terms, the total FTA export “penalty” would be \$72 billion over the past decade.<sup>10</sup>

### **U.S. Government Agency Review Projects Rising Deficit with Korea FTA**

The USITC, an independent federal body that analyzes the likely effects of trade agreements for Congress and the executive branch, made projections of the effects of the Korea FTA based on a complex mathematical model of the global economy (a computable general equilibrium [CGE] model). It found that the Korea FTA would result in an increase in the total U.S. goods trade deficit by between \$308 million and \$416 million.<sup>11</sup> Imports are projected to increase by between \$5,100 million and \$5,692 million, and exports will increase by between \$4,792 million and \$5,276 million. (The study did not attempt to project the effects of the agreement on overall services trade, due to insufficient data and widely shared concerns among economists about the feasibility of modeling the non-tariff regulatory changes that affect services trade.)

The structure of the USITC's projection model does not permit the total number of workers to vary, so their report does not contain a net job loss estimate to accompany the estimate of the increased deficit.<sup>12</sup> While holding the total number of workers constant, though, the model does permit the movement of workers from one sector of the economy to another, so it can be useful in illustrating the types of jobs that may be lost with a Korea FTA.

The USITC study indicates that jobs may be lost in many high-wage industries, including auto manufacturing and electronics manufacturing. The average hourly earnings of workers in the electronic equipment manufacturing industry, projected to lose a significant number of jobs, was \$30.38 in 2008. This was 40.5 percent greater than the average hourly earnings of all workers employed in the private sector. Table 1 shows what is driving these declines in employment in these industries: large rises in the trade deficit in these sectors, totaling up to \$1.8 billion for motor vehicles and parts, other transportation equipment and electronic equipment.

Table 1 displays the USITC’s estimates of the employment impact upon a few sectors of the U.S. economy. The USITC developed ranges for the statistically likely effects of the FTA, which are labeled in the Table 1 as “low” and “high” estimates.

The auto manufacturing industry may lose a significant number of workers due to the FTA. The average hourly earnings of workers in the auto industry was \$23.61 in 2008, which was 9.2 percent greater than the average hourly

earnings of all workers employed in the private sector (\$21.62). Interestingly, the USITC predicted that, were the Korea FTA implemented, there would be an absolute decline in the total value of exports in some manufacturing sectors, not just a worsening of the balance. For example, total U.S. exports of electronic equipment are expected to decline by \$293 million to \$381 million due to the Korea FTA implementation.<sup>15</sup>

The USITC projected that the workers shed by these high-paying industries would be absorbed by other industries – principally low-paying industries such as meat processing, which are expected to export more goods under the Korea FTA. Employment in the bovine meat production industry was projected to rise by 0.7 to 1.8 percent. This was the greatest percent increase projected for any industry, except for the industry of actually raising cattle, sheep, goats and horses, whose employment was also projected to rise by 0.7 to 1.8 percent. Workers in the meat production industry are very poorly paid. Their average hourly earnings are only \$13.69, which is 36.7 percent less than the average hourly earnings of all workers employed in the private sector.<sup>16</sup> Working in meat processing is also quite dangerous; the Government Accountability Office noted that, “injury and illness rates among meat and poultry plants remain among the highest of any industry.”<sup>17</sup> (Notably, 80 percent of the top 10 states with the highest concentration of meat processing jobs as a share of total jobs have been given a Republican-leaning Partisan Voting Index score by the Cook Political Report, ranging from R+4 to R+13.<sup>18</sup> This makes it unlikely that Democrats will be able to politically capitalize on any job creation in the meat-processing sector.)

The unfavorable employment effects of the Korea FTA projected by the USITC model can be thought of as the *minimum* level of employment displacement and trade deficit increase (and related employment displacement) that the Korea FTA might bring about, given that past USITC projections have been overly optimistic. For example, a 1999 USITC study using roughly the same model estimated that China’s tariff offer for WTO ascension would increase the U.S. trade deficit with China by only \$1 billion dollars.<sup>19</sup> In reality, the trade deficit with China skyrocketed by \$167 billion between 2001 and 2008.<sup>20</sup> Although China’s WTO ascension alone (and the favorable trade treatment that came with it) likely did not cause the entirety of the huge rise in the trade deficit with China, it almost certainly contributed more than \$1 billion dollars to the rise in the deficit.

	Change in U.S. global trade balance (millions of dollars) <sup>13</sup>		Average hourly earnings of workers <sup>14</sup>
	Low	High	
Motor vehicles and parts	(\$531)	(\$708)	\$23.61
Other transportation equipment	(\$340)	(\$293)	\$30.95
Electronic equipment	(\$790)	(\$762)	\$30.38
Total	(\$1,661)	(\$1,763)	

The results of the most recent USITC report on the Korea FTA differ substantially from the results of a 2001 USITC study on a prospective U.S.-Korea FTA. The 2001 report on a Korea FTA predicted that U.S. GDP would increase by \$25 billion, more than twice as large as the \$10.1-11.9 billion increase in GDP projected by the more recent study.<sup>21</sup> The differences between the two studies are likely due to several factors:

1. The new study's model was based on the actual negotiated tariff reductions of the Korea FTA text, whereas the 2001 study assumed that tariffs on all goods would be completely eliminated;<sup>22</sup>
2. The new study used a more up-to-date database of trade flows and macroeconomic conditions; and
3. The 2001 study simplified the global economy into five regions and 10 sectors, while the new study made projections based on 10 regions and 54 sectors.<sup>23</sup>

### **FTA Proponents in Obama Administration Distort USITC Findings**

Recently, U.S. Trade Representative Ron Kirk has tried to portray the Korea FTA as a job creator by touting the USITC's bilateral exports estimate, while ignoring the import component of their projections. In a speech delivered on July 30, Kirk claimed, "Increased exports due to the Korea deal alone may support as many as 70,000 additional jobs nationwide."<sup>24</sup> He did not directly mention the USITC study, but nevertheless the "70,000" jobs estimate is likely based on a one-sided interpretation of the USITC study.

The President's Progress Report on the National Export Initiative uses the same statistic, but gives it a context that relates to the USITC study. It says, "The Korean FTA would increase goods exports by an estimated \$10-11 billion, which would support an estimated 70,000 jobs."<sup>25</sup> The \$10-11 billion exports figure matches the projected gain in bilateral exports with Korea in Table 2.2 on page 2-8 of the USITC report. It is likely that the authors of the Progress Report multiplied the estimated gain in bilateral exports by an exports-to-jobs ratio to calculate their jobs gain estimate. An April 2010 report from the International Trade Administration estimated that every \$150,000 in U.S. exports supports one American job.<sup>26</sup> Applying this exports-to-jobs ratio to the \$10-11 billion exports figure yields an estimate of 73,333-66,667 jobs. Kirk's "70,000 jobs" figure falls in the middle of that range, so it is highly likely that the figure is based on the USITC bilateral export estimates.

Of course, it is misleading to discuss just exports when examining the potential impact of trade agreements. Just as greater exports tend to support more jobs, greater imports tend to eliminate jobs – all else equal. Kirk chose to ignore the USITC's import estimates entirely. If we were to account for the effects of imports, use this same method of jobs calculation and consider the USITC's estimate of the effect of the Korea FTA on the U.S. global trade balance (available on Table 2.3 on page 2-14 in the USITC report), we would find that the Korea FTA would cost the United States a net 2,100-2,700 jobs, since the trade deficit will increase by \$308-\$416 million. Even if only the USITC's projections on the bilateral trade flows with Korea were to be considered, more than 60 percent of the job gains from exports would be wiped out from job losses due to increased imports from Korea.

### **Other Studies are Questionable**

There are other studies on the Korea FTA's possible economic outcomes, but they make questionable assumptions and/or do not explain their methodology fully. They thus are best ignored. For example, a 60-page study commissioned by the Korea Economic Institute (KEI) accounts for a range of issues that other models do not account for, but also relies on the unrealistic assumption that "trade remains balanced for each country or region, that is, any initial trade imbalance remains constant as trade barriers are changed."<sup>27</sup> Hence, under the assumptions of the model, no matter how tariff levels between countries change, the U.S. global trade balance would stay constant.

To give another example, a study commissioned by the U.S. Chamber of Commerce is generally vague in its explanation of its methodology.<sup>28</sup> More concerning, though, is that nowhere does the report give an estimate of the increase in U.S. imports due to the FTA. At a minimum, any study that claims to predict the effects of a trade agreement upon the U.S. economy should deal with both sides of trade – exports *and* imports. Given that the study doesn't even report any estimates of an effect on imports, it is not clear whether the study accounted for the effects of rising imports at all. Indeed, failing to account for the effects of increased imports would go a long way toward explaining how the study came up with the unreasonably large number of jobs that the Korea FTA would supposedly create.

A 2006 study on a potential Korea FTA from the Peterson Institute for Institutional Economics fails to even report its projected changes in trade flows due to an FTA, so the study's results on effects upon the U.S. trade deficit are unknown.<sup>29</sup> Since the study was carried out before the release of the text of the FTA, it studied two scenarios – one in which rice tariffs were eliminated and one in which they were left unchanged. Rice tariffs *are* left unchanged in the final text of the Korea FTA.<sup>30</sup> The results of the model with unchanged rice tariffs predict that the U.S. will gain \$6.3 billion in welfare in the medium term.<sup>31</sup> However, it predicts that most manufacturing sectors will see significant declines in output, including a 0.3 percent decline in U.S. motor vehicle output and a 0.5 percent decline in the output of electronic equipment.<sup>32</sup> It also projects that the wages of unskilled workers in the United States will change by less than 0.05 percent (the percent change in wage is rounded to 0.0 in the table) and the wages of skilled workers will decline by 0.1 percent.<sup>33</sup>

## **Conclusion**

In summary, an independent government study suggests that the implementation of the Korea FTA as negotiated by Bush will lead to an increase in the U.S. trade deficit in goods, which will likely cause layoffs here at home. Major changes to the Korea FTA must be made if its harmful effects are to be mitigated. (For a list of the most essential changes, see here: <http://bit.ly/dhITT8>.)

## **ENDNOTES**

<sup>1</sup> See Todd Tucker, "Election 2010: The Best Defense Was a Fair Trade Offense," Public Citizen, November 2010. Available at: <http://bit.ly/bdDk2e>

<sup>2</sup> Remarks by Ambassador Karan Bhatia (Deputy U.S. Trade Representative) at Yonsei University, October 24, 2006, Available at: [http://ustraderep.gov/assets/Document\\_Library/Transcripts/2006/October/asset\\_upload\\_file496\\_9901.pdf](http://ustraderep.gov/assets/Document_Library/Transcripts/2006/October/asset_upload_file496_9901.pdf)

<sup>3</sup> For more background on "Fast Track," see Todd Tucker and Lori Wallach, *The Rise and Fall of Fast Track Trade Authority*, (Washington, D.C.: Public Citizen, 2009). Available at: <http://www.fasttrackhistory.org/>

<sup>4</sup> In 2008, imports of Korean goods into the United States faced a trade-weighted average tariff of 1.50 percent. Goods from Colombia and Panama, potential FTA partners, faced trade-weighted average tariffs of 0.95 and 0.56, respectively. World Trade Organization, "Tariff Analysis Online," June 2010 version, Available at: <http://tariffanalysis.wto.org/>

<sup>5</sup> UAW, "International Trade and Investment Policy," 2010, Available at: <http://www.uaw.org/node/1962>; and Doug Palmer, "Ford and South Korea dig in heels over trade deal," Reuters, September 26, 2007, Available at: <http://www.reuters.com/article/idUSN2624078520070926>

<sup>6</sup> Richard Trumka, "Statement by AFL-CIO President Richard Trumka on the U.S.- South Korea Trade Agreement," Press Release, AFL-CIO, June 29, 2010, Available at: <http://www.aflcio.org/mediacenter/prspmt/pr06292010.cfm>

<sup>7</sup> Robert E. Scott, "Trade Policy and Job Loss," Economic Policy Institute, Working Paper #289, Feb. 25, 2010, Available at: [http://www.epi.org/publications/entry/trade\\_policy\\_and\\_job\\_loss/](http://www.epi.org/publications/entry/trade_policy_and_job_loss/)

<sup>8</sup> *Ibid.*, at 9, Table 4.

<sup>9</sup> *Ibid.*, at 10, Table 5.

<sup>10</sup> Travis McArthur and Todd Tucker, "Lies, Damn Lies and Export Statistics: How Corporate Lobbyists Distort the Record of Flawed Trade Deals," Public Citizen, September 2010, Table 5, at 26. Available at: <http://bit.ly/bx3JJn>

<sup>11</sup> 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, Available at: <http://www.usitc.gov/publications/332/pub3949.pdf>

<sup>12</sup> *Ibid.*, at 2-4: "[The model] maintains a balance in the factors of production—labor, capital, and natural resources—so that if some sectors expand and need more labor, other sectors must contract and release that much labor."

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- <sup>13</sup> 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.
- <sup>14</sup> 2008 data from the Current Employment Statistics of the Bureau of Labor Statistics ( <http://data.bls.gov/cgi-bin/dsrv?ce> ). Average hourly earnings for “other transportation equipment” was obtained by multiplying the average hourly wage of the aerospace products and parts, ship and boat building, and other transportation equipment industries by the number of workers in that industry, then dividing by the total number of workers in all three industries.
- <sup>15</sup> 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.
- <sup>16</sup> 2008 data from the Current Employment Statistics of the Bureau of Labor Statistics ( <http://data.bls.gov/cgi-bin/dsrv?ce> ). Industry: “Animal slaughtering and processing” Series ID: CEU3231160003.
- <sup>17</sup> U.S. Government Accountability Office, “Workplace Safety and Health: Safety in the Meat and Poultry Industry, While Improving, Could Be Further Strengthened,” Report to the Ranking Minority Member, Committee on Health, Education, Labor, and Pensions of the U.S. Senate, GAO Report No. 05-96, January 12, 2005, at 27, Available at: <http://www.gao.gov/products/GAO-05-96>
- <sup>18</sup> Employment data is from the Bureau of Labor Statistics' Quarterly Census of Employment and Wages, series IDs ENU<ST>0001053116 and ENU<ST>00010510, 2009 annual data. The Cook Political Report's state PVIs are available here: <http://www.cookpolitical.com/sites/default/files/statepvi.pdf>
- <sup>19</sup> U.S. International Trade Commission, “Assessment of the Economic Effects on the United States of China’s Accession to the WTO,” August 1999, at xi.
- <sup>20</sup> Trade flow data from the USITC DataWeb. Deficit calculated on a domestic imports minus imports for consumption basis. Figures inflation-adjusted to 2009 using the CPI-U-RS.
- <sup>21</sup> The GDP growth estimates of the 2001 report here are reported in 2005 dollars to make them directly comparable with the 2007 study’s projections, which are measured in 2005 dollars. The CPI-U-RS was used as the deflator. U.S. International Trade Commission, “U.S.-Korea FTA: The Economic Impact of Establishing a Free Trade Agreement (FTA) Between the United States and the Republic of Korea,” USITC Publication 3452, September 2001, at 5-14, Figure 5-4, Available at: <http://www.usitc.gov/publications/docs/pubs/332/pub3452.pdf>
- <sup>22</sup> Ibid, at 5-4.
- <sup>23</sup> Ibid, at 5-3, and 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 2-1.
- <sup>24</sup> Ron Kirk, “Remarks by Ambassador Ron Kirk on Enforcement at Allegheny Technologies,” July 30, 2010, Available at: <http://www.ustr.gov/about-us/press-office/speeches/transcripts/2010/july/remarks-ambassador-ron-kirk-enforcement-allegghn>
- <sup>25</sup> The White House, *President’s Progress Report on the National Export Initiative*, July 7, 2010, Available at: <http://www.usitc.gov/publications/332/pub3949.pdf>
- <sup>26</sup> John Tschetter, “Exports Support American Jobs,” International Trade Administration, International Trade Research Report No. 1, April 2010, at Table 1, Available at: <http://trade.gov/publications/pdfs/exports-support-american-jobs.pdf>
- <sup>27</sup> Kozo Kiyota and Robert M. Stern, “Economic Effects of a Korea-U.S. Free Trade Agreement,” Korea Economic Institute of America, 2007, at 24, Available at: <http://www.keia.org/images/stern2007.pdf>
- <sup>28</sup> Laura M. Baughman and Joseph F. Francois, “Trade Action – or Inaction: The Cost for American Workers and Companies,” U.S. Chamber of Commerce, September 15, 2009, Available at: [http://www.uschamber.com/assets/international/uscc\\_trade\\_action\\_inaction\\_study.pdf](http://www.uschamber.com/assets/international/uscc_trade_action_inaction_study.pdf)
- <sup>29</sup> Jeffrey J. Schott, Scott C. Bradford, and Thomas Moll, “Negotiating the Korea–United States Free Trade Agreement,” Policy Brief 06-4, Institute for International Economics, June 2006, Available at: <http://www.iie.com/publications/pb/pb06-4.pdf>
- <sup>30</sup> According to “Annex 2-B Tariff Schedule of Korea,” unprocessed rice tariff categories are in staging category Y, which means that Korea did not commit to lower tariffs on unprocessed rice, according to page 3 of the General Notes on the Tariff Schedule of the Republic of Korea. There are a few products with rice ingredients that Korea has committed to reduce tariffs on, but they are only on heavily processed rice, such as rice cakes and rice bran oil. See “Annex 2-B Tariff Schedule of Korea” at: [http://www.ustr.gov/sites/default/files/uploads/agreements/fta/korus/asset\\_upload\\_file786\\_12756.pdf](http://www.ustr.gov/sites/default/files/uploads/agreements/fta/korus/asset_upload_file786_12756.pdf). See the General Notes at: [http://www.ustr.gov/sites/default/files/uploads/agreements/fta/korus/asset\\_upload\\_file584\\_12758.pdf](http://www.ustr.gov/sites/default/files/uploads/agreements/fta/korus/asset_upload_file584_12758.pdf)
- <sup>31</sup> Jeffrey J. Schott, Scott C. Bradford, and Thomas Moll, “Negotiating the Korea–United States Free Trade Agreement,” Policy Brief 06-4, Institute for International Economics, June 2006 at 26, Table 10.
- <sup>32</sup> Ibid, at 27, Table 12.
- <sup>33</sup> Ibid, at 26, Table 11.