Korea FTA Has No Provisions to Counter Currency Manipulation: Another Korean Devaluation Could Negate FTA's Cuts to Korean Agriculture and Industrial Tariffs

The Korea Free Trade Agreement (FTA) will eliminate many U.S. and Korean tariffs over the course of 20 years.[1] Typically local companies and agricultural producers get information about FTAs from their trade associations, like the Chamber of Commerce and Farm Bureau. And often, they do not get the full story. Proponents of FTAs focus on tariff cuts in an FTA text as *proxies* for more market access. However, **whether tariffs cuts in an FTA text translate into *real* export gains for U.S. firms and farmers relies on other non-tariff factors, such as exchange rate manipulation, increasing fuel costs and lower priced competition from other countries supplying the same good or commodity.**

For Korea, currency manipulation is a special concern. 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**.[2] In its February 2011 statutorily-required semi-annual "Report to Congress on International Economic and Exchange Rate Policies" the Treasury Department expressed concern that Korea had again begun intervening in global currency markets to keep the *won* at a deflated exchange rate.[3] Whether these actions are the start of another major devaluation remains to be seen. Korea deflated the *won* between 50 and 60 percent in the late 1980s and again in the late 1990s. If this ten year cycle repeats itself now, it would undermine the prospective tariff cut benefits of the recent FTAs Korea has signed.

Although Korea has a record of significant currency devaluations, which can wipe out the effective benefit of tariff cuts and/or make our imports more expensive, the FTA includes no provisions to counter this. Members of Congress, unions, small business and agricultural producer groups have all demanded that U.S. trade agreements include provisions to counter currency manipulation. [4] Because the Korea FTA does not provide for penalties or adjustments in tariff rates if one party deliberately undervalues its currency, this FTA could result in an outcome where additional market access on paper (tariff cuts) leads to little-to-no actual increase in for U.S. sales in Korea.

Such currency devaluation following FTA implementation has happened in the past – with those promised gains left with losses. A year after NAFTA went into effect, Mexico suddenly devalued its currency by 50 percent.[5] 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 recognized 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."[6] Due to the peso devaluation, American products became much more expensive for Mexican consumers, and U.S. agricultural exports suffered. **For example, thanks to the peso devaluation 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.**[7] Members of Congress should consider the NAFTA experience before relying on optimistic claims about supposed benefits to the beef and pork industries under the Korea FTA.

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.[8] However, the USITC predicts that some sectors will benefit. Yet, the ITC assessment does not take into account the prospect of Korean currency devaluation.

The history of Korea's currency manipulations is a cause for concern with respect to the future under this FTA. 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.[9] 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.[10] 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.[11]

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.[12] 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.**

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] 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

[3] http://www.treasury.gov/resource-center/international/exchange-rate-policies/Documents/Foreign%20Exchange%20Report%20February%204%202011.pdf

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

[5] 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/

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

[7] 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"

[8] 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.

[9] 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

[10] 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

[11] 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

[12] 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