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REPORTERS' MEMO

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Korea Trade Deal's Negative Impact on U.S. Agriculture

USITC Identified Losing Agricultural Sectors under Korea FTA

The U.S. International Trade Commission's (USITC) congressionally required study of the U.S.-South Korea Free Trade Agreement (FTA) projected a worsening U.S. trade balance in:

soy	horses	sugar	forage
cattle	wheat	other oilseeds	cotton
sheep	alfalfa	rice	peanuts
goats	corn	oats	tobacco
			nursery products

This is notable, and probably underestimates the damage, because the USITC always uses the same modeling in its studies that has assumptions that tend to produce overly optimistic results. USITC's study on the North American Free Trade Agreement (NAFTA) concluded that deal would *decrease* our trade deficit, and its study of China's World Trade Organization (WTO) entry predicted an increased U.S. deficit of less than $1 billion. In reality, the U.S. saw hundreds of billions of dollars in increased deficits. The USITC also projected that the U.S. trade balance in beef, swine and pork, chicken and eggs would improve if the Korea FTA goes into effect. However, importantly, this data does not take into consideration the prospect of a Korean currency devaluation, nor does the FTA have a mechanism to counter Korea again devaluating. Yet, this would wipe out any FTA tariff cuts and price the U.S. out of Korea's market – making all U.S. agricultural commodities losers under the deal.

Even if There's Not Another Devaluation, Do the FTA Agriculture "Winners" Really Win?

The USITC study of the Korea FTA also projects that 50 percent of prospective U.S. agricultural gains would be in beef, 25 percent in other meat products (mainly pork), and the rest in fruits, vegetables, nuts, dairy and "other food products." Yet, even if a congressional district has a lot of cattle, the FTA is designed to benefit packers, not producers. It has a "substantial transformation" rule-of-origin for livestock. This would allow FTA tariff cuts to apply to meat from livestock from non-FTA countries – if slaughter and processing occurs in the U.S. or Korea. So a U.S. packer could import live cattle for immediate slaughter from Canada and Mexico and export the resulting beef duty-free to Korea as being of U.S. origin with a USDA grade stamp. This would allow packers here to keep prices down by constantly increasing non-US supply. It also explains why the USITC found that U.S. beef exports would see an improved trade balance while our cattle trade balance would decline. Meanwhile, China has the third-largest cattle herd in the world. If Chinese cattle were shipped to Korea and slaughtered, the FTA would grant them duty-free access here. Under this scenario, U.S. cattle producers would not realize benefits from increased export sales, which would flow exclusively to U.S. beef packers. Moreover, the cattle and other animals entering the U.S. for slaughter are not required to meet identical U.S. safety requirements, thus posing a threat to the U.S. reputation as a supplier of safe food products.

FTAs Have Resulted in Slower U.S. Export Growth
Despite claims by these corporate interests that FTAs are a mechanism to expand exports, U.S. exports to FTA countries have grown at less than half the rate of those to non-FTA countries. This means that U.S. farmers alone missed out on nearly $3 billion in export opportunities over the past decade – the amount we would have seen had just agricultural exports to Mexico and other FTA countries simply grown at the average rate over the period. The NAFTA model has been a failure for rural communities. Since NAFTA and similar deals with 17 other countries were implemented, America has lost hundreds of thousands of family farms. Large agribusiness companies have been able to use these trade deals to drive down the prices that farmers receive – playing producers in trade partner countries off of each other while concentrating ownership of trading, seed and other agribusiness firms.

The FTA Rules of Origin Allow China, Vietnam and Other Countries to Gain at Our Loss
The FTA's rules of origin promote "leakage" of the trade pact's "benefits" to countries such as China and Canada. Many developing nations that are U.S. competitors in the Korean market have very low farm-gate prices, often because they don't have to comply with the same labor and environmental standards as U.S. farmers. But the so-called "rules of origin" of the Korea FTA – which allow food processed in the U.S. or Korea but grown elsewhere to get FTA benefits – allow Canadian, Chinese, Vietnamese or even North Korean food commodities to be merely processed in the U.S. or South Korea and receive the special duty-free access provided by the deal. NAFTA-style trade deals are bad enough: We shouldn't be allowing Canada or China to free-ride on them.

Korea FTA Fails to Deal with Currency Manipulation – Devaluation Could Gut Effect of Tariff Cuts, Make U.S. Exports Expensive Within Korean Market
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. Despite demands from National Farmers Union, among others, to counter this threat, the FTA includes no currency provisions. Korea has been a chronic currency manipulator and is one of only three countries (China and Taiwan being the others) that have ever been placed on the U.S. Treasury Department's official list of currency manipulators.[1] During the mid- and late-1980s, Korea devalued the won by 60 percent and in 1988 was cited by Treasury.[2] That devaluation meant all U.S. goods exported to Korea faced a new trade barrier equivalent to a tariff of about 60 percent. In the early 1990s, the won was allowed to float back to market value. But in the late-1990s, Korea again severely devalued its currency by about 50 percent.[3] If Korea again reverts to strategically undervaluing its currency to boost exports and reduce imports, the FTA's agricultural tariff cuts – and prospective benefits to U.S. exports – could be negated while the price of foods imported into Korea would rise above pre-FTA levels. In February 2011, the Treasury Department issued a warning that Korea was again intervening in currency markets. 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.

Tariff Cuts on Paper Do Not Necessarily Translate into New Access to the Korean Market
Many members of Congress report that their local farmers were speaking to them about the prospect for export gains under the FTA. However, typically local producers get information about FTAs from their trade associations. Sometimes, they do not get the full story. Typically, 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. farmers and food producers** relies on other non-tariff factors such as exchange-rate manipulation, increasing fuel costs and lower-priced agricultural competitors. These factors could result in an outcome where additional market access on paper (tariff cuts) leads to little-to-no actual increase in sales in Korea. (I.e. for every Hawaiian sector where farmers were told they would get gains based on the tariff cuts, a much lower-priced competitor would wipe out any chance of increased sale. For instance, Thailand, the world's largest pineapple exporter, sells

pineapple at a price that is 25 percent of Hawaii's. The only sector where Hawaii is price-competitive is macadamia nuts, for which there is a very low dollar-demand in Korea.)

Farmers Were Sold the Same Bill of Goods with NAFTA – and We Know How That Turned Out

Many current members of Congress do not know that during NAFTA, lawmakers also were given lists of *tariff cuts* for crops in their districts as *evidence* of the new market access their farmers would obtain. In reality, those tariff cuts were eliminated when Mexico devalued the peso 50 percent[4] shortly after NAFTA went into effect. Now, it's the same old promises again: "U.S. beef exports to South Korea could increase by $600 million to $1.8 billion under the FTA," (USDA on Korea FTA in 2008). Then, farmers were told: "U.S. beef exports to Mexico are expected to expand to more than 200,000 metric tons by the end of the 10-year transition period," (USDA on NAFTA in 1993). *But*, U.S. exports to Mexico of "NAFTA winners" beef and pork in the first three years of NAFTA were 13 percent and 20 percent lower, respectively, than beef and pork exports in the three years before NAFTA.[5] As noted by a former World Bank Chief Economist: "…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 percent, in contrast with the 50 percent real depreciation."[6] Due to the peso devaluation, U.S. products became *more* expensive in Mexico after NAFTA, and many sectors suffered. The Korea FTA does not provide for penalties or adjustments if one party deliberately undervalues its currency. And even later, U.S. export gains in beef that did occur under NAFTA were wiped out by greater imports. The U.S. deficit in cattle and beef with the existing 17 FTA countries increased from $1.3 billion in 1989 to more than $2.1 billion in 2008, and the cumulative U.S. trade deficit generated over this period with the 17 FTA countries was $37.6 billion.

Another Korean Devaluation Would Wipe Out all FTA Tariff Cuts

If the Korean won were to again be devalued by 50 percent after FTA implementation:

- The elimination of the 25 percent Korean tariff on U.S. pork over three years would be transformed into a net *increase* in the effective tariff rate of 25 percent. U.S. pork would become 25 percent more expensive in Korea.
- The elimination of the 40 percent Korean tariff on U.S. beef over 15 years would be transformed into a net *increase* in the effective tariff rate of 10 percent; U.S. beef would become 10 percent more expensive in Korea.
- The elimination of Korea's 20 percent tariff on U.S. chicken over 10 years would be transformed into a net *increase* in the effective tariff to 30 percent. That increases the price for these U.S. goods in Korea by 30 percent.

Past devaluations – and economic science – suggest that Korean consumers would respond in one of two ways. First, they might continue consuming the same kinds of foods but switch to domestically produced food instead of imported products. Such "substitution" is a possibility in the case of pork and beef, since they are also produced in Korea.[7] Second, Korean consumers could decrease their consumption of foods available only through importation and switch to other foods that are domestically produced and, thus, after a devaluation have not become more expensive.

Deceptive American Farm Bureau Study on Korea FTA Now Confusing Members of Congress

The Farm Bureau released a study that estimates that the Korea FTA would result in $1.65 billion in additional U.S. agricultural sales to Korea. The bureau turned these "findings" into congressional district fact sheets. Unfortunately, this data is being widely relied upon in Congress to conclude that the FTA would benefit various districts. The methodology of the Farm Bureau study is wildly manipulated to result in a rosy outcome.

- The study assumes no increase in imports. The study focuses only on gross exports, not the net result of the pact. Given that the USITC projected many U.S. agricultural sectors would face a worsening trade balance were the FTA implemented, this is a very serious manipulation.
- The study arbitrarily assumes a 10 percent increase in U.S. market share in Korea. This figure appears to be pulled out of the air. The study does not explain why this assumption is used.
- This 10 percent assumption is carried out across every sector – including rice (which is not covered in the FTA), as well as wheat, soy and cereal grains (like corn), which we know to be net losers under the agreement. In fact, $556 million of the $1.65 billion in gains (or 34 percent) come from sectors that the USITC projects will lose under the deal, plus rice.

Manufacturing Sector Job Losses

The USITC study of the Korea FTA concluded that its implementation would lead to an increase in the overall U.S. trade deficit in goods.[9] This is an especially notable finding, as the USITC consistently employs a computable general equilibrium model that includes assumptions that tend to produce overly optimistic results. (Its NAFTA study concluded that the trade pact would *decrease* our trade deficit. Its study of China's WTO entry predicted a deficit increase of less than $1 billion. The reality was a deficit increase of hundreds of billions of dollars.) The USITC studies are based on full implementation of a pact. Thus, the changes made to the deal by the Obama administration in December 2010 – which changed timelines for some tariffs' elimination but not the final outcomes – do not alter the findings.

Table 1: USITC Estimates of Trade Balance Effects of Korea FTA, Selected Industries		
	Change in U.S. global trade balance (millions of dollars)[8]	
	Low	High
Motor vehicles and parts	($531)	($708)
Other transportation equipment	($340)	($293)
Electronic equipment	($790)	($762)
Metal products	($169)	($187)
Textiles	($169)	($190)
Apparel	($56)	($74)
Iron-containing metals	($65)	($75)
Total	($2,120)	($2,289)

The USITC found that the Korea FTA would result in worse trade balances in seven industrial sectors. Public Citizen used the USITC findings, data on the locations of the sectors' companies, and geo-mapping of these firms' zip codes relative to each congressional district's parameters to isolate how many jobs are vulnerable in each of these sectors. Some districts are hit harder than others. You can see this data for every congressional district at http://www.citizen.org/Page.aspx?pid=4750.

The Korea FTA's chief negotiator, Ambassador Karan Bhatia, offered a frank assessment of the impact of FTAs on the U.S. when 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.**[10]

ENDNOTES

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[1] 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

[2] 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; 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] 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

[4] 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

[5] Calculations based on data obtained from the USDA Foreign Agricultural Service's (FAS) Global Agricultural Trade System on Jan. 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"

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

[7] FAOSTAT, Accessed February 7, 2011.

[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] 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

[10] Remarks by Ambassador Karan Bhatia (Deputy USTR) at Yonsei University, Oct. 24, 2006
Available: http://ustraderep.gov/assets/Document_Library/Transcripts/2006/October/asset_upload_file496_9901.pdf