

18-22 KORUS Amendments: Minor Adjustments Fixed What Trump Called “Horrible Trade Deal”

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In his 2016 campaign and later in the White House, President Donald Trump vehemently expressed his antipathy toward the Korea-US Free Trade Agreement (KORUS FTA), which took effect in 2012. “It’s a horrible deal and we are going to renegotiate that deal or terminate it,”¹ he said a few months after his inauguration in 2017. In his new book, Bob Woodward (2018) reports that Trump was ready to notify his intent to withdraw from the pact but that the director of the National Economic Council, Gary Cohn—who was concerned about the effect of a pullout on national security and the delicate relationship with South Korea—removed the document from Trump’s desk before he could sign it.

It may therefore come as a surprise that Trump’s fix for the KORUS FTA, quickly negotiated and signed in September 2018, involves only limited changes to the original pact. The amended deal rectifies problems with Korean implementa-

tion of KORUS obligations, revises Korean auto regulations, and extends US import protection for trucks. On balance, the modest revisions to the deal will restrict, not enlarge, bilateral trade.

What made Trump accept the pact with only minor adjustments over the status quo? Along with the extension of US truck tariffs and other KORUS amendments, and apart from the deal itself, Korea also accepted new restrictions on Korean steel exports to the US market. And it helped as well that the US trade deficit with Korea was declining while the talks were taking place.

The chronology from threat to talks to accord was surprisingly short. On July 12, 2017, the US trade envoy, Robert Lighthizer, invoked Article 22.2 of the KORUS FTA, demanding a special joint committee meeting of trade ministers within 30 days to discuss how to amend the pact to achieve more fair and balanced trade. Two issues topped the US list of complaints: the large bilateral merchandise trade deficit with Korea and obstacles facing US exports in the Korean market.² The Koreans were taken aback, in part because the new government of President Moon Jae-in, which took office in May 2017, had not yet named a trade minister to respond and meet with Lighthizer.

No surprise then that when US and Korean trade officials got together in late August 2017, the rhetoric was heated; preparatory talks, designed to set the negotiating agenda for KORUS revisions, got off on the wrong foot. But with high tensions on the Korean peninsula, enflamed by frequent North Korean missile tests, neither side wanted trade friction to undercut the US-South Korea strategic alliance. Within a few months, the two sides opted instead to negotiate limited amendments to the KORUS FTA rather than overhauling the entire agreement as was being done concurrently by the United States, Canada, and Mexico in their North American trade talks.

KORUS negotiations were launched on January 5, 2018; an agreement was reached with great fanfare on March 26, 2018. Before the text was finalized, however, US officials pressed Korea to reduce its steel exports to the US market by 30 percent (or more than one million metric tons) instead

1. Stephen J. Adler, Jeff Mason, and Steve Holland, “Exclusive: Trump vows to fix or scrap South Korea trade deal, wants missile system payment,” Reuters, April 27, 2017, www.reuters.com/article/us-usa-trump-southkorea-exclusive-idUSKBN17U09M.

2. US Trade Representative Robert Lighthizer’s letter to Korean Minister of Trade, Industry and Energy, July 12, 2017, <https://ustr.gov/sites/default/files/files/Press/Releases/USTR%20KORUS.pdf>.

Table 1 US trade in goods and services with Korea, 2011-18 (billions of dollars)

Year	Trade balance in goods and services	US goods exports	US goods imports	Trade balance in goods	US services exports	US services imports	Trade balance in services
2011	-8.2	43.5	58.6	-15.1	16.7	9.7	6.9
2012	-11.2	42.3	61.0	-18.7	18.2	10.6	7.5
2013	-12.4	41.6	64.4	-22.8	21.0	10.6	10.3
2014	-17.8	44.6	71.9	-27.3	20.2	10.7	9.5
2015	-20.9	43.5	74.1	-30.6	20.8	11.1	9.7
2016	-18.8	42.3	71.9	-29.6	21.7	10.9	10.8
2017	-11.8	48.3	73.5	-25.1	24.2	10.9	13.3
2018 ^a	-6.0	54.4	73.3	-18.8	25.0	12.2	12.8

a. Annualized values are based on January–July data for goods and on January–June data for services.

Note: US trade in services is on a balance of payments basis.

Sources: US Census Bureau, US International Trade in Goods and Services (FT900), www.census.gov/ft900; US Bureau of Economic Analysis, www.bea.gov.

of having to pay Trump's additional 25 percent tariffs on imported steel imposed under a dubious application of the national security provisions of US Section 232 of the Trade Expansion Act of 1962 (US Department of Commerce 2018).³ That agreement, though separate from the FTA talks, was an essential complement to the trade deal. On September 24, Presidents Trump and Moon signed the deal, hoping to implement the amendments as of January 1, 2019.⁴

Because the amendments do not require changes in US law, Congress does not have to approve implementing legislation. US Trade Representative Lighthizer thus did not have to follow the notification and consultation requirements set by Congress in US Trade Promotion Authority. The agreement does need approval by the Korea National Assembly, however.⁵ Ratification procedures are in process and expected to conclude this year.

This Policy Brief assesses what was changed in the KORUS FTA as a result of the negotiations and, importantly,

what was left unchanged. The revised agreement has reduced short-term trade friction between Seoul and Washington, but it has not resolved the Trump administration's fundamental concerns about bilateral trade in autos and parts. The risk of new US trade protection in that sector cannot be discounted.

US-KOREA TRADE IMBALANCE: SMALL AND DECLINING

The KORUS FTA entered into force on March 15, 2012 and substantially removed tariff and nontariff barriers, affecting about \$165 billion in current two-way trade (exports plus imports) in merchandise and services. The Trump administration's complaint that US trade with Korea needs to be rebalanced focuses solely on the US merchandise trade deficit. In fact, overall trade in goods and services with Korea was in near balance in 2018, with a US deficit of only \$6 billion. Moreover, the US merchandise trade deficit had gone down sharply even before KORUS was amended (see table 1). Through the first seven months of 2018, US goods exports increased 13 percent and the merchandise trade deficit dropped by a quarter. Motor vehicles account for about 20 percent of total US-Korea trade and almost all the US merchandise trade deficit. Although bilateral services trade is smaller than merchandise trade, its growth has been steady since KORUS entered into effect. But US negotiators did not focus on services.

KORUS 2.0: WHAT'S IN THE DEAL?

Unlike NAFTA negotiations, which involved a comprehensive overhaul of the entire FTA, KORUS talks followed a much more limited path. Most of the pact was untouched. Negotiators focused on trade and investment irritants in a handful of specific areas.

3. For more details, see Jeffrey J. Schott and Zhiyao (Lucy) Lu, "Korea Steel Deal Means More US Steel Barriers Lie Ahead," PIIE Trade and Investment Policy Watch, March 28, 2018, <https://piie.com/blogs/trade-investment-policy-watch/korea-steel-deal-means-more-us-steel-barriers-lie-ahead>.

4. White House, "Remarks by President Trump and President Moon of the Republic of Korea at U.S.-Korea Free Trade Agreement Signing Ceremony," September 24, 2018, www.whitehouse.gov/briefings-statements/remarks-president-trump-president-moon-republic-korea-u-s-korea-free-trade-agreement-signing-ceremony/.

5. In Korea, the Ministry of Government Legislation has determined that the KORUS amendments require ratification by the National Assembly under the "Trade Treaty Conclusion Procedure Act" of 2011, even though Korea may not need to change its trade and related laws to implement the amended KORUS FTA.

Table 2 US auto trade with Korea, 2011-18 (millions of dollars)

Year	Trade balance	US exports				US imports			
		Total	Passenger cars	Trucks	Parts	Total	Passenger cars	Trucks	Parts
2011	-14,145	1,284	413	36	834	15,429	8,613	2	6,814
2012	-17,279	1,369	616	36	717	18,648	10,622	(-)	8,026
2013	-18,712	1,622	765	28	829	20,334	12,147	(-)	8,187
2014	-21,316	1,981	1,013	41	927	23,297	14,577	2	8,718
2015	-23,937	2,306	1,285	44	977	26,243	17,278	3	8,962
2016	-22,495	2,633	1,584	16	1,033	25,128	16,070	2	9,056
2017	-21,332	2,528	1,550	35	944	23,860	15,734	(-)	8,126
2018 ^a	-18,809	2,553	1,634	31	888	21,362	13,200	2	8,160

a. Annualized values are based on January–July data.

Note: (-) indicates the value less than \$1 million.

Source: US Census Bureau, US International Trade in Goods and Services (FT900), www.census.gov/ft900.

KORUS revisions comprise two protocols and four exchanges of letters on specific issues.⁶ The protocols delay the elimination of the 25 percent US tariff on imported trucks, modify Korean auto regulations and emissions standards, amend provisions covering transparency and verification of data in unfair trade cases, and revise and restrict the use of investor-state dispute settlement procedures. The letter exchanges cover customs procedures to verify origin, pharmaceutical pricing regulations, special origin rules for Korean textiles, and the agreed date of entry into force.

Maintaining US Tariffs on Trucks until 2041

A key US objective of the KORUS FTA talks was to defer the planned phaseout of the 25 percent US tariff on six categories of imported trucks,⁷ which has effectively blocked Korean truck exports (including pickup trucks, which are very popular in the United States).⁸ In the original KORUS FTA, US officials agreed to phase out the 25 percent tariff by January 2021; the amendment extends the transition period to 20 years until 2041. Hyundai Motors reportedly was considering exporting new hybrid trucks to the US market once

the truck tariff was eliminated.⁹ That option has now been effectively blocked.

Extending the phaseout of the truck tariffs, although clearly protectionist, will have limited immediate impact on Korea-US passenger vehicle trade. Korean officials did not strenuously object to prolonging truck protection because tariffs on passenger cars and auto parts were not affected. Exports of Korean autos and parts have exceeded \$20 billion annually since the KORUS FTA entered into force in March 2012 (see table 2); US tariffs on Korean autos and parts were phased out in 2016.

Modifying Korean Auto Regulations and Emissions Standards

Korea agreed to revise its auto safety and emissions standards so that more US cars can enter the Korean market if they meet US regulatory requirements. In effect, it is a limited mutual recognition agreement. Under the KORUS FTA, each US automaker was allowed to export 25,000 vehicles that are built to US safety standards, not Korean standards. That annual cap is now raised to 50,000 cars. In 2017 Ford, GM, and Chrysler exported 8,107, 6,762, and 4,843 cars to Korea,¹⁰ respectively—well under the 25,000 cap—so this higher ceiling is unlikely to accelerate US auto exports to Korea. Also, Korea agreed to recognize US safety standards for auto parts necessary to provide repair services for US ve-

6. In addition, two other documents include agreed minutes and joint committee interpretation. See USTR, "September 2018 KORUS Amendment and Modification texts," <https://ustr.gov/trade-agreements/free-trade-agreements/korus-fta/september-2018-korus-amendment-and-modification>.

7. Trucks assigned by Harmonized Tariff Schedule (HTS) 87042100, 87042250, 87042300, 87043100, 87043200, and 87049000 are subject to the amendment of KORUS FTA.

8. In 2017 US truck imports from Korea were less than \$1 million, accounting for a minimal share of total US auto trade with Korea.

9. Jonathon Ramsey, "Hyundai Santa Cruz pickup with four doors, five seats, due around 2020," *Autoblog*, April 23, 2018, www.autoblog.com/2018/04/23/hyundai-santa-cruz-pickup-with-four-doors-five-seats-due-around/.

10. Republic of Korea Ministry of Trade, Industry and Energy, "Explanatory Document for the Korea-US FTA Amendment," September 2018, <http://fta.go.kr/us/data/1/> (in Korean).

hicles, and US officials agreed to provide information on US standards without undue delay.

In addition, both countries confirmed the interpretation of the KORUS FTA Joint Committee on testing procedures for automobiles.¹¹ Korea will harmonize relevant testing procedures and methods for gasoline-powered motor vehicles with US federal emissions regulations (as long as they are consistent with California's more stringent emissions standards),¹² allowing US automakers to avoid duplicative

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or additional testing in Korea. And Korea will permit the Korean Certification mark in sticker form on the packaging of a replacement part if the car that the part is installed in is trackable by customs officials, easing the regulatory burden for US auto exporters.

Finally, Korea affirmed its intent to expand eco-innovation credits available to help motor vehicles built with environmental-friendly technology meet Korea's fuel efficiency and greenhouse gas emissions standards. Korea agreed to take account of revised US regulations when it establishes fuel economy targets and greenhouse gas emissions requirements for 2021–25.

Transparency and Verification of Data in Unfair Trade Cases

Korean producers have been deeply concerned about the transparency of trade remedy proceedings in the United States. One of their major complaints is the US Commerce Department's application of the "adverse facts available" (AFA) measure. During antidumping (AD) or countervailing duty (CVD) investigations, the Commerce Department

regards minor errors or mistakes in documents as a failure to cooperate and justification to invoke AFA to determine a punitive level of tariff.¹³ On February 14, 2018, Korea requested consultations with the World Trade Organization (WTO) on the use of such rules in AD/CVD investigations (WT/DS539/1), claiming that such methods do not meet the "best information available" requirement of the WTO's agreements.¹⁴

In the KORUS amendment Korea and the United States agreed to recognize the right to apply trade remedy measures consistent with Article VI of the General Agreement on Tariffs and Trade (GATT) of 1994 and the WTO Antidumping and Subsidies and Countervailing Measures Agreements and to ensure transparency in AD and CVD proceedings and fair opportunity to respond to the outcome. A new provision, Transparency and Due Process, covers the following procedural modifications: An investigating authority should notify the producer in advance of the date that it plans to conduct in-person verification; provide a list of topics and types of supporting documents to be prepared by the producer for the verification review; prepare a written report describing the methods, procedures, and the result of the verification; and make the report available to all interested parties so that they have sufficient time to defend their interests in the proceeding. Consistent with US law, the information disclosed should contain an individual rate of duty, the calculations used to determine the rate of AD and CVD, and the calculations used to decide the rate of duty to be applied to imports so that the producer can readily reproduce the calculation. Increasing the transparency of trade remedy procedures could help producers prepare adequately for the investigation.

11. See "Interpretation by the Joint Committee of the Free Trade Agreement between the United States of America and the Republic of Korea Regarding the June 30, 2007 Exchange of Letters," <https://ustr.gov/sites/default/files/files/agreements/FTA/KORUS/KORUS%20Joint%20Committee%20Interpretation%20-%20Signed.pdf>.

12. If US federal regulations fail to be consistent with California's regulations, Korea may amend relevant testing procedures and methods consistent with California's standards. Under US law, California has been allowed to promulgate more stringent vehicle emissions standards than US federal standards. Several US states have adopted California's regulations, and in 2009 South Korea adopted California's Non-Methane Organic Gases Fleet Average System for gasoline-fueled vehicles.

13. US authorities invoked AFA most recently on April 18 and imposed 75.81 percent AD duties on tubular goods exported by the Korean steel company Nexteel. See US Department of Commerce, International Trade Administration, "Certain Oil Country Tubular Goods From the Republic of Korea: Final Results of Antidumping Duty Administrative Review and Final Determination of No Shipments; 2015-2016," April 18, 2018, <https://enforcement.trade.gov/frn/summary/korea-south/2018-08114.txt>.

14. World Trade Organization, "United States—Anti-Dumping and Countervailing Duties on Certain Products and the Use of Facts Available—Request for consultations by the Republic of Korea," WT/DS539/1, February 14, 2018, https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S009-DP.aspx?language=E&CatalogueIdList=243276&CurrentCatalogueIdIndex=0&FullTextHash=&HasEnglishRecord=True&HasFrenchRecord=True&HasSpanishRecord=True. On April 16, 2018, Korea requested the establishment of a panel. At its meeting on April 27, 2018, the Dispute Settlement Body (DSB) deferred the establishment of a panel.

Investment

Amending the investor-state dispute settlement (ISDS) provisions was one of the few key Korean interests in the bilateral talks. The ISDS mechanism allows foreign investors to challenge changes in laws or regulatory practices that directly or indirectly expropriate investments in partner countries. When the original KORUS was negotiated in 2007, the ISDS provisions met strong political opposition in Korea. Instead of dropping it, the KORUS amendment adopts language from the investment chapter of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), which clarifies and restricts ISDS application in several ways.

First, the KORUS amendment clarifies the definition of legitimate public welfare objectives to safeguard a country's right to regulate in the public interest. It adds text to clarify that investors cannot win a claim for breach of the Article 5 Minimum Standard of Treatment obligation merely by showing that a government measure frustrated its expectations even if there is a loss to the covered investment.¹⁵ And, the KORUS amendment expands existing rules that a government can expeditiously review and dismiss claims that manifestly have no legal merit in order to discourage frivolous claims.

These changes contrast with what US officials included in the revised trade pact with Mexico and Canada. Under the US-Mexico-Canada Agreement (USMCA), the United States and Mexico agreed to apply the original ISDS provisions only to oil and gas, power generation, transportation, infrastructure, and telecommunications. Diluted ISDS provisions will be available for other sectors, while all ISDS will be phased out with regard to Canada in three years after NAFTA terminates.¹⁶ USTR Lighthizer has strongly opposed ISDS proceedings, so it is surprising that Korea did not succeed in wresting more limitations or even removing ISDS from the KORUS FTA.

Customs Procedures to Verify Origin

US exporters and producers have complained about unduly onerous verification procedures for claims of preferential tariff treatment under the KORUS FTA. USTR (2018) cites Korea *inter alia* for excessive and unnecessary documentation during the customs verification process, inconsistent application of customs rules by the Korea Customs Service

15. The Minimum Standard of Treatment obligation guarantees investors due process and certain other protections in accordance with customary international law.

16. For more details, see US-Mexico-Canada Agreement, Chapter 14 on Investment, <https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/14%20Investment.pdf>.

offices, rejection of certification of origin for minor errors, and limitations on corrections.

To resolve these concerns, the two countries agreed to adopt Customs Principles that expedite the certification of origin and verification procedures.¹⁷ The KORUS amendment establishes a Rules of Origin Verification Working Group charged with resolving concerns related to verification of rules of origin, monitoring verifications that take lengthy periods or remain inconclusive, and presenting findings and recommendations to the Committee on Trade in Goods, as appropriate.

Amending Pharmaceutical Pricing Regulations in Korea

Korea also agreed to amend its Premium Pricing Policy for Global Innovative Drugs—a scheme to encourage Korean drug manufacturers to develop new drugs—to make it consistent with its KORUS commitments. If new drugs developed by domestic or foreign pharmaceutical companies fully satisfy specific requirements of the scheme, they will be eligible for a 10 percent price increase.¹⁸ One of the requirements is that the new drug must be released in Korea before being released in other markets. US pharmaceutical companies normally launch new drugs internationally and thus argue that Korean pricing policy discriminates against them, violating KORUS commitments.

To resolve US grievances, Korea agreed that the Health Insurance Review and Assessment Service (HIRA) in Korea will publish a draft amendment to its pricing policy by October 31, 2018 and implement it no later than December 31, 2018. During this process, Korea ensured that the HIRA will consult closely with US pharmaceutical companies.

Rules of Origin for Korean Textiles

The KORUS FTA contains the US standard yarn forward rules of origin, which substantially constrains sourcing of components from third countries. Korea sought to modify the rules of origin for certain end-use yarns, fabrics, and

17. Customs principles include commitments to conduct the knowledge-based self-certification system relying on the importer's knowledge; to allow an exporter or producer to complete a certification of origin regardless of their residential address; to provide zero penalty and more than five working days for making corrections in documents; to reaffirm the conduct of the verification of origin only if the customs authority has doubts on a good's originating status and applies risk management principles; and to conclude the verification procedures within 90 days of receiving the information.

18. Shim Jae-Woo and Kim Do-Nyun, "Drugs from U.S. likely to be more expensive after FTA deal," *Korea JoongAng Daily*, March 31, 2018, <http://koreajoongangdaily.joins.com/news/article/article.aspx?aid=3046309>.

apparel because those textile inputs are not produced in Korea or commercially available in the US market.¹⁹ The KORUS amendment includes a small revision of the rules of origin so that a few Korean textile products containing raw materials that originate outside of Korea receive preferential treatment.

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US officials agreed to expedite the commercial availability review process for the products of concern to Korean exporters. If it is determined that a particular product is not commercially available, US officials will expedite the necessary rule changes.

WHAT DIDN'T CHANGE?

The KORUS FTA negotiations left a number of issues off the agenda. Given US complaints about bilateral merchandise trade imbalances, especially in autos, the talks notably did not address rules of origin for autos and parts. Unlike the NAFTA renegotiation, which focused on auto content rules, the regional content rules for automobiles agreed under KORUS were left intact. The regional content values for automobiles agreed under KORUS range from 35 to 55 percent, depending on the calculation formula, compared with 75 percent in the USMCA.

In the KORUS talks, US negotiators focused on US car exports, not origin rules for US imports. But the Trump administration could still restrict Korean car exports if it decides to restrict auto imports on national security grounds under Section 232 of the Trade Expansion Act of 1962.²⁰ The Commerce Department is expected to complete its investigation by mid-February 2019 and recommend whether import restrictions are needed to protect national security. Korean officials believe Korea will be exempt from such restrictions.²¹ But Mexico and Canada didn't trust US goodwill and ne-

gotiated side letters to the USMCA in which they agreed to restrict their passenger vehicle exports to the United States to no more than 2.6 million units per year in return for an exemption from potential Section 232 measures.²² Korea doesn't have a similar side agreement.

Agriculture was another major area of inaction. Both sides agreed not to pursue new agricultural liberalization. Rice thus remains exempt from liberalization under the KORUS FTA.

Finally, the KORUS FTA talks did not include a side letter on currency issues similar in content to the one signed by TPP countries in November 2015 and included in Chapter 33 of the USMCA. In parallel with the KORUS talks, financial officials started working on a currency side deal to prohibit competitive devaluation and exchange rate manipulation and to ensure data transparency and accountability. The latest US Treasury (2018) report on exchange rate policies continues to include Korea on its currency "watch list" but acknowledges that progress has been made in enhancing the transparency of data on foreign exchange operations (resulting from the bilateral negotiations between the US Treasury and the Korean Ministry of Economy and Finance).

FINAL COMMENT

By January 1, 2019, the KORUS FTA should be "fixed." Unlike the USMCA, Congress will not have to vote on the deal because the amendments do not require changes in US law. The Korea National Assembly needs to approve the deal and seems willing to do so given assurances from Korean officials that auto exports will not face new US restrictions. Prompt ratification by the National Assembly should allow the amendments to be implemented by January 1, 2019 as envisaged by Presidents Trump and Moon at their meeting on September 24 in New York. But if US officials move forward with Section 232 auto measures after the deal enters into force, Korean auto exporters may still be vulnerable. The KORUS amendments have not bought them security from new US protectionism, as the steel quotas amply demonstrate. The goodwill generated by the positive outcome of the trade negotiations should shield US-Korea trade from possible new auto tariffs but perhaps not from "voluntary" export limits.

19. These products include viscose rayon staple fibers (HTS550410 and HTS550700), certain rayon filament yarns (HTS540339), and cashmere yarn (HTS5108).

20. US Commerce Department, "U.S. Department of Commerce Initiates Section 232 Investigation into Auto Imports," May 23, 2018, www.commerce.gov/news/press-releases/2018/05/us-department-commerce-initiates-section-232-investigation-auto-imports.

21. Kim Eun-jung, "S. Korea is not the main target of U.S. auto tariff: minister," Yonhap News Agency, August 21, 2018,

<http://english.yonhapnews.co.kr/news/2018/08/21/0200000000AEN20180821009900320.html>.

22. See US-Canada 232 side letter, <https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/US%20Canada%20232%20Side%20Letter.pdf>, and US-Mexico 232 side letter, <https://ustr.gov/sites/default/files/files/agreements/FTA/USMCA/US%20Mexico%20232%20Side%20Letter.pdf>.

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