A U.S. Perspective on Bilateral Economic Relations

Mark Manyin and Brock Williams*

The past several years have been an era of relative calm in U.S.-South Korean trade and economic relations. The Trump administration, however, has signaled two potential paradigm shifts that could lead to greater tension in the bilateral economic relationship. The first is the president's relatively negative view of existing U.S. trade policy and willingness to at least threaten the use of measures that historically have been infrequently deployed to correct what he views as its failures. This may affect the future course of the South Korea-U.S. Free Trade Agreement (KORUS FTA), which the administration presumably will scrutinize as part of its examination of relationships in which the United States runs a trade deficit. Second and intimately related, the president has signaled in his statements a willingness to use U.S. security relationships to influence economic relations and vice versa. On both fronts, uncertainty abounds, due in part to existing institutional structures that limit the president's ability to take new policy directions without, for example, the consent of Congress. The administration's own lack of clarity on its policy priorities and the possibility that stating seemingly extreme positions may represent a negotiating tactic rather than a policy shift, also cloud the outlook for how the United States will approach the bilateral economic relationship. The uncertainty also reflects the fact that key trade policy officials, including the United States Trade Representative (USTR), have yet to be confirmed.

These uncertainties in turn may make economic diplomacy more vulnerable to factors that traditionally would be considered exogenous to the economic sphere. The likelihood of the Trump administration attempting to explicitly link the bilateral economic and security relationships, as well as the likelihood of this succeeding, may depend on at least four factors: North Korea policy coordination; alliance relations; consultations over how best to approach China; and the U.S. and Trump's popularity among South Koreans. In particular, the administration's elevation of North Korea to a top-tier foreign policy issue, combined with the greater probability of tensions over North Korea policy, and the administration's apparent inclination to explicitly use economic and security issues to increase bargaining leverage could mean that significant tension over economic issues is more likely to occur than at any time in the past decade.

This chapter explores the context of the bilateral economic relationship, and the factors that may affect how future negotiations unfold. The analysis is based on currently known facts, but these issues will continue to evolve as U.S. trade policy is clarified and the administration responds to future global events.

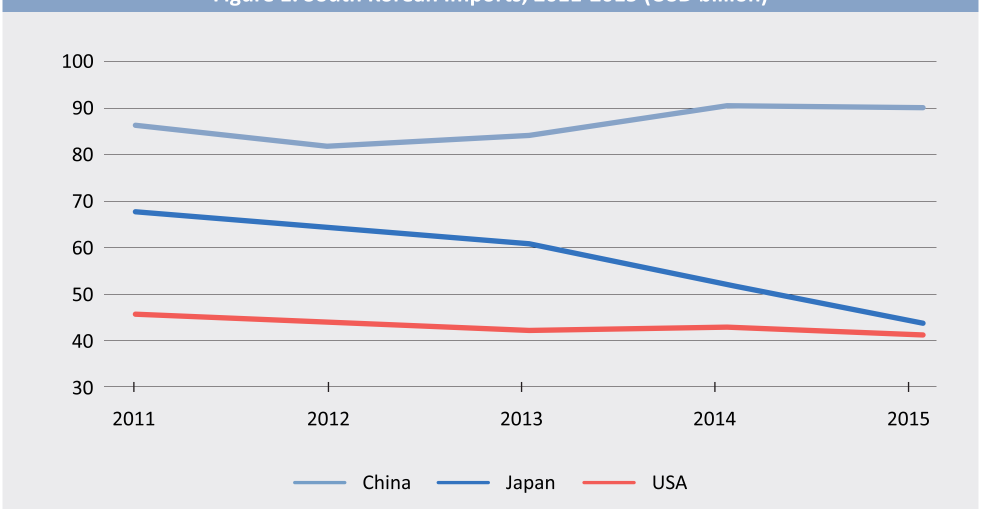
KORUS FTA OUTCOMES SET THE STAGE FOR FUTURE U.S.-SOUTH KOREA ECONOMIC TALKS

March 15, 2017 marked five years since the KORUS FTA entered into force, reducing and eliminating tariff and non-tariff barriers on trade and providing protections and certain standards of treatment for investments between the two parties. The second-largest U.S. FTA by trade flows after the North American Free Trade Agreement (NAFTA), its merits have been much debated in the United States throughout the decade since negotiations began. Those supporting the agreement note that U.S. exports of certain products with tariff reductions under KORUS have risen considerably as have U.S. services exports, while those opposed to the agreement note that the bilateral trade deficit with South Korea has more than doubled since the agreement has been in effect.[2] In its first Trade Policy Agenda, released in March 2017, the Trump administration, which has sharply criticized prior U.S. trade policies and trade agreements in particular, highlighted the bilateral trade deficit with South Korea. The report noted that the rise in the deficit "is not the outcome the American people expected from that agreement."[3] Views on the outcome of the KORUS FTA will undoubtedly inform any future bilateral engagement on these economic issues.

Key Changes in Bilateral Trade and FDI Flows under KORUS

U.S. exports of goods and services to South Korea rose from $61.9 billion in 2011, the year before the KORUS FTA came into effect, to $63.9 billion in 2016.[4] Measured in U.S. dollars, services exports increased by about $5 billion over the period, while overall goods exports fell slightly. U.S. exports of travel services and charges for the use of intellectual property increased by $2.8 billion and $1.4 billion, respectively, accounting for much of the increase in services trade. In terms of goods trade, exports of autos and beef increased concurrently with significant South Korean tariff reductions. Exports of motor cars (HTS 8703) nearly quadrupled from $420 million to $1.6 billion over the period while tariffs fell from 8 percent to 4 percent upon entry into force and were eliminated in 2016.[5] Auto exports also benefited from South Korea's commitment to recognize the equivalence of U.S. motor vehicle safety standards for U.S. automakers exporting fewer than 25,000 units to South Korea. U.S. beef exports (HTS 0201, 0202) have increased by 50 percent or $350 million while their tariffs were reduced to 24 percent, down from 40 percent. U.S. aircraft exports also increased significantly (up by $1.7 billion) but most products were already tariff-free. Drivers of the overall fall in U.S. goods exports since 2011 include a $1.1 billion decline in ferrous scrap exports and $1 billion decline in corn exports, which partly reflect lower commodity prices over the period. Overall exports to South Korea were also likely depressed by the country's economic slowdown as evidenced by a similar drop in South Korea's imports from its other top trading partners, China and Japan. (Figure 1)

Figure 1. South Korean Imports, 2011-2015 (USD billion)



Source: United Nations Comtrade database.

U.S. imports of goods and services from South Korea rose from $67.3 billion in 2011 to $81.4 billion in 2016. Autos and auto parts (HTS 87) account for a large share of the increase in imports from South Korea since the KORUS FTA's entry into force. Imports of these products have increased by roughly $9 billion, or nearly 70 percent of the $13 billion increase in overall goods imports from South Korea. However, one should be cautious in attributing this increase solely to the FTA. For example, auto imports grew by approximately 15 percent each year from 2012 to 2015, before the United States made any reduction to its 2.5 percent auto tariff.[6] After the tariff was eliminated in the fourth year (2016), imports grew by 12 percent.[7] This suggests broader economic factors beyond the tariff reductions, including things like changing consumer tastes and shifts in the level of aggregate demand, played a major role in the growth of U.S. imports. In its 2016 report on the economic outcomes of U.S. FTAs, the U.S. International Trade Commission estimated that the bilateral trade deficit with South Korea would have been even larger without the agreement in place.[8]

Bilateral foreign direct investment (FDI) has increased in both directions since the FTA's entry into force, but most of the growth has been in South Korean FDI to the United States. From 2011 to 2015, the latest year for which investment data are available, the stock of U.S. FDI in South Korea increased from $26.2 billion to $34.6 billion.[9] Meanwhile, the value of South Korean FDI in the United States increased from $19.9 to $40.1 billion, more than doubling. Most South Korean investment in the United States is in the wholesale trade sector ($26.5 billion), while more than half of U.S. investment in South Korea is in the manufacturing ($14.2 billion) and finance ($6.9 billion) industries. This investment supports employment in both countries. In 2014, majority-owned U.S. affiliates of South Korean multinational enterprises employed 45,000 workers and spent $1.3 billion on research and development (R&D) activities according to survey data from the Bureau of Economic Analysis. Majority-owned U.S. firms with affiliates in South Korea employed 125,000 workers and spent $946 million on R&D.

Setting aside the economic merits of the ongoing U.S. debate over trade policy, the trade patterns with South Korea have created challenging political optics for the KORUS FTA in the United States. The 2016 presidential election focused heavily on concerns over import competition and the consequences for employment in the manufacturing sector, and in the five years since the KORUS FTA went into effect, U.S. bilateral imports have increased by 20 percent. Meanwhile, despite significant export gains in products that benefited from KORUS FTA commitments, overall U.S. exports have increased by only 3 percent. Although the general perception from the business community is that market access in South Korea has improved significantly on a number of fronts, U.S. firms have raised certain complaints over South Korea's implementation of its FTA commitments. For example, the Korean Customs Service reportedly required particularly onerous origin verifications on a variety of U.S. exports, making it challenging for U.S. firms, in some instances, to benefit from the agreed tariff reductions. The Obama administration addressed many of these implementation concerns, but according to business groups some persist.[10] This combination of factors suggests the KORUS FTA and trade relationship with South Korea more broadly will be high on the Trump administration's trade agenda. According to press reports, the president's position regarding KORUS is "we'll either terminate or negotiate."[11]

U.S.-SOUTH KOREA TRADE NEGOTIATIONS IN THE TRUMP ADMINISTRATION

There is considerable uncertainty currently as to the specific objectives of U.S. trade policy under the Trump administration, including on issues of consequence in trade with South Korea. The administration has unambiguously stated its intent to change U.S. trade policy, with a focus on trade negotiations.[12] The president himself stated that "no country has ever made bad trade deals like our country has made," and U.S. trade agreements were listed as one of the four priority areas in the 2017 trade policy agenda. At the same time, Congress has established in current law the outlines and specific negotiating objectives of a U.S. trade agreement negotiation, and these guidelines have been in place since 2015 as part of the Trade Promotion Authority (TPA) legislation and will remain in effect at least until 2018 unless Congress were to amend the legislation.[13] While these TPA objectives allow for some flexibility in order to provide space for the administration to effectively pursue negotiations, they do create some broad parameters for negotiation that could serve as a check on the president's proposed shift in U.S. trade policy approach. To date, the administration has provided relatively few details on what specific aspects of trade agreements it intends to change, but its actions suggest some general directions.

In January 2017 the Trump administration gave notice that it does not intend to proceed with ratification of the Trans-Pacific Partnership (TPP), and said instead that it will negotiate future agreements on a bilateral basis. It plans to start these bilateral talks with the renegotiation of NAFTA, and has stated its intent to follow TPA procedures in that process. As with KORUS, the administration appears to be evaluating NAFTA based primarily on the U.S. trade deficit with NAFTA partners, namely Mexico. Among U.S. FTAs, KORUS is second only to NAFTA in the size of the trade deficit. The shift from TPP to bilateral negotiations changes the possible venue for future U.S.-South Korea trade discussions. South Korea had repeatedly expressed interest in joining the TPP and, arguably, was the most likely new candidate for membership due to its comparable FTAs with the United States and European Union. The Obama administration likewise welcomed South Korea's interest, while also using the possibility of entry as leverage to push South Korea to resolve outstanding bilateral frictions.

The objectives for the NAFTA renegotiation will provide the first major data point regarding the Trump administration's trade policy goals. A plethora of views exist in the U.S. trade policy community as to what those objectives should include. Some urge the administration to repackage TPP commitments into bilateral agreements. Others press for new provisions on issues such as currency and labor, and call for the elimination of existing provisions on investor-state dispute settlement. TPP had also been a venue to renegotiate NAFTA in some sense, with both Canada and Mexico as partners in the pact. A draft copy of the administration's objectives for the NAFTA renegotiation obtained by the press had many similarities with the provisions in TPP, but the White House clarified that this draft copy should not be seen as reflective of policy, so the uncertainty remains as of late April 2017. The KORUS FTA, which came into effect nearly two decades after NAFTA, shares more text with the proposed TPP. If the administration uses the TPP's provisions as a benchmark, South Korea theoretically might have to make fewer changes than Mexico in possible renegotiations of their existing FTAs with the United States. However, TPP would have required new South Korean commitments in important areas like digital trade and state-owned enterprises.

Depending on how exactly the Trump administration intends to shift U.S. trade policy, in some respects, it could potentially move quickly on bilateral trade negotiations, including those with South Korea. The negotiated TPP commitments address issues of concern to a broad swathe of U.S. stakeholders, and although the agreement was a contentious aspect of the presidential election, recent polls suggest a slim majority of the electorate feels trade agreements have been a good thing for the United States.[14] In addition, the president retains TPA through at least 2018 and possibly 2021 depending on whether the administration seeks and Congress does not reject an extension. This provides the administration with a window to pursue new agreements with the potential of expedited legislative consideration by Congress so long as the agreements make progress towards the TPA negotiating objectives.

Although the administration's precise objectives for its trade negotiations remain unclear, the information available to date provides some perspective on possible areas of interest. Four areas that bilateral negotiations with South Korea might touch are the trade deficit, currency issues, KORUS FTA modifications, and trade enforcement. These issues are not mutually exclusive and negotiations to address one of the four could easily affect the others.

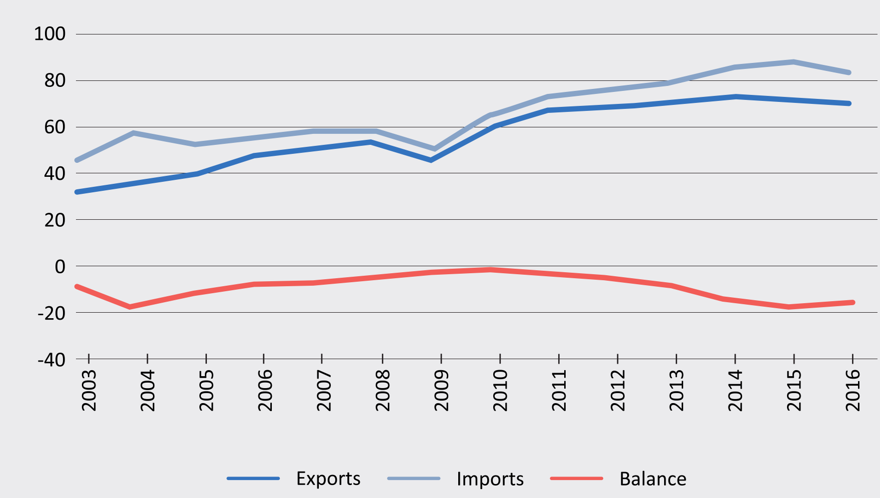
POSSIBLE FOCUS POINTS FOR BILATERAL DISCUSSIONS

Trade Deficit

The Trump administration's analysis on the health of individual U.S. trading relationships appears to rely overwhelmingly on the size of the trade deficit with the target country. On March 31 Trump ordered a report within 90 days on the cause and impact of trade deficits presumably to inform future U.S. policy and negotiations with trading partners.[15] Although most economists argue that trade deficits reflect broader macroeconomic factors such as overall savings, consumption, and investment patterns, many in the administration see large persistent deficits as indicative of an unfair trade advantage on the side of the surplus country. For example, the nominee for USTR, Robert Lighthizer, in his testimony before the Senate Finance Committee noted that he sees trade deficits with U.S. FTA partners as a sign that "[i]n some cases, the rules don't seem to be working as well as with others." One critique of this view is what it potentially implies for the bilateral trading relationships in which the United States runs large and persistent trade surpluses, including existing FTA partners, such as Australia.

With respect to South Korea, the trade deficit has long been a source of bilateral tension, including concerns that U.S. producers have less than reciprocal access to the Korean market. South Korea's export oriented economic growth model focused, to some extent, on protecting domestic industry behind tariff and non-tariff barriers. U.S. businesses with operations in South Korea have also taken issue over the close collaboration between the government and domestic industry, from financing to regulatory treatment. While the tariff barriers have come down over time, some analysts suggest that the tendency for the South Korean government to protect its own firms has been harder to remove, and even with the provisions of the KORUS FTA at their disposal, some U.S. companies argue that regulatory barriers can still be challenging in the South Korean market.[16]

Figure 2. U.S. Exports, Imports, and Trade Balance with South Korea (USD billion)



Source: Bureau of Economic Analysis. Balance of Payments (BOP) basis.

While it is clear the administration is focused on the bilateral deficit, it is less clear how it intends to go about addressing its concern. Because trade balances are driven to such a large degree by macroeconomic factors, minor tweaks to KORUS FTA provisions are unlikely to have a significant impact. The imposition of prohibitive across-the-board tariffs would be more likely to reduce the deficit, but would carry with it negative outcomes in the form of higher prices for, among others, consumers and businesses that rely on imported goods in their supply chains. Some members of Congress have already expressed their concerns about this approach.[17] The president could also take a more direct approach to address the deficit by limiting the quantity of imports either through quotas or voluntary export restraint (VER) agreements with South Korea, though like the imposition of a tariff these would likely violate existing commitments in both the KORUS FTA and the WTO. In the 1980s, an era of significance for many influential players in the Trump administration, VERs were used to manage U.S. trade in steel and autos with Japan and others. Since one product, autos, accounts for a large share of the trade deficit with South Korea since 2011, the administration might see VERs as an efficient means to address its concerns.

Arguably, the least controversial method to address the trade deficit is to focus on increasing U.S. exports to South Korea. Indeed, this appears to be the focus of the new report required by the administration, which is to analyze the cause of trade deficits specifically identifying practices that limit U.S. exports. According to the federal register notice posted by the Commerce Department, which is taking the lead on the investigation together with the USTR, this investigation will focus on 13 trading partners with significant trade deficits in goods, including South Korea. However, since most tariffs have already been eliminated and many non-tariff barriers have been addressed, it is unclear how new negotiations with South Korea could materially affect the trade deficit. Unless South Korea's domestic economy picks up steam in the coming years, trade negotiations appear unlikely to have a major impact. Indeed, a broader challenge to focusing so heavily on this single metric in trade relations is that even if the administration investigates and negotiates remaining barriers to competition in the South Korean market, the trade deficit may persist. If so, such negotiations could be deemed a failure even if they have positive benefits in both countries, as many argue the KORUS FTA has already had to date. Although its negotiating objectives include reciprocal access for U.S. goods and services, nowhere does TPA legislation specifically refer to the trade deficit.

Currency Manipulation

The Trump administration has highlighted currency policies as one set of tools U.S. trading partners use to maintain an unfair competitive advantage. The majority of its criticism on this has focused on China and, to a lesser extent, Germany and Japan, but the issue is likely to be a concern in the bilateral relationship with South Korea as well.[18] The won depreciated sharply against the dollar during the 2008-2009 financial crisis, falling by over 40 percent, from about 900 won/dollar to 1,570 won/dollar, but recovered fairly quickly and has hovered around 1,100 won/dollar since 2010. South Korea has a history of intervening in foreign exchange markets and the Treasury Department has repeatedly, including in its April 2017 report, listed South Korea on its currency monitoring list, an additional monitoring tool required by the 2015 Trade Facilitation and Trade Enforcement Act.[19] Treasury has yet to find a country in violation of all three of the act's criteria for additional engagement (i.e., a significant bilateral trade surplus with the United States, a material current account surplus, and persistent one-sided foreign exchange market interventions), but in each of the reports to date South Korea has met two of the criteria: a large bilateral trade surplus and a large bilateral current account surplus.

Although legislation set the general criteria for this new enforcement and engagement mechanism, the Treasury Department established the specific numerical thresholds. Should the Trump administration wish to more aggressively pursue concerns over currency manipulation it could tighten these thresholds while using existing legislative tools; some signs that the administration may favor this approach have already surfaced. In its most recent report, the Treasury Department noted that under the new administration it expanded the criteria for the monitoring list to include countries with a "large and disproportionate share of the overall U.S. trade deficit" even if those countries do not meet either of the other criteria. In effect, this measure ensured that China, the main focus of the administration's stated concerns on currency issues to date, remained on the monitoring list during this reporting period.

The administration could also address currency issues by adding a side letter to the KORUS FTA similar to the declaration on exchange rate policies signed by the 12 TPP countries. To address the concerns raised during the TPP debate by critics of this approach, such an agreement could also include strengthened commitments and some type of enforcement mechanism. Another alternative would be to consider undervalued exchange rates as a subsidy in U.S. antidumping and countervailing duty cases. Several members of Congress have advocated such an approach, even suggesting that it should be enacted through legislation to ensure its permanence.[20] South Korea's actions in the near term could have a strong influence on how the administration addresses this issue. On one hand, a protracted effort in foreign exchange markets to resist the won's appreciation would almost surely result in increased engagement by the Treasury Department and stronger actions by the Trump administration. On the other hand, were South Korea to take a proactive step to increase the transparency of its transactions on foreign exchange markets, a long-standing complaint of the Treasury Department, it could potentially help diffuse concerns.

KORUS FTA Modifications

The U.S. government may also seek to negotiate with South Korea on specific changes to the KORUS FTA on any number of the issues highlighted by U.S. business groups, USTR, and/or members of Congress.[21] While some of these complaints about lagging implementation of the KORUS FTA's commitments may reflect a learning curve within the Korean government bureaucracy on the intricacies of complying with a complex international agreement, others could reflect vestiges of a regulatory system with an inherent, if sometimes subtle, bias toward the protection of domestic industries. Some of the U.S. complaints have revolved around the interpretation of commitments, with U.S. businesses arguing that in some instances South Korea has not lived up to the spirit of the agreement, even if it adheres to the legal text. Revisiting the KORUS FTA text could allow those making these arguments an opportunity to suggest more precise language that better captures their goals for the agreement. There has also been some debate over provisions that, to varying degrees, would tie U.S. trade concessions to specific export gains in the South Korean market, although such measures would represent a significant shift in approach from existing U.S. trade agreement commitments.

Several members of Congress and various officials or nominees of the administration have also expressed an interest in harvesting aspects of the TPP agreement for future negotiations, presumably including those with South Korea. Although the KORUS FTA arguably has the most extensive commitments of any U.S. FTA in force to date, the TPP included provisions that went beyond KORUS in significant ways. For example, in the area of digital trade and e-commerce, TPP commitments would prohibit localization requirements on servers and require that companies be permitted to transfer data across borders (a similar provision in KORUS applied only to financial services). Despite debate over privacy and regulatory considerations, these digital trade rules were perhaps the TPP's most widely-praised provisions. Commitments to ensure fair competition between private companies and state-owned enterprises (SOEs), another novel area in TPP, could also be economically significant in the context of U.S.-South Korea trade. For example, representatives of the U.S. steel industry have cited concern over South Korea's subsidization of its steel producers through various means to the detriment of U.S. industry, some of which could potentially be resolved with provisions like those in TPP that sought to address unfair competitive advantages received or provided by SOEs.

In addition, although they are few in number, certain products were excluded from the KORUS FTA's tariff concessions. Revisiting these exclusions, such as U.S. rice exports, would likely be of significant interest to the industries affected. A possible challenge of revisiting these exclusions, or other changes to the KORUS FTA text, is the potential for South Korea to seek changes to the agreement that disadvantage U.S. stakeholders. The types of changes South Korea might seek in a potential renegotiation likely depend on how South Koreans perceive the costs and benefits of the KORUS FTA and its potential renegotiation.

Despite a fiercely contentious debate at the time of its implementation, the agreement appears, by some measures, to have achieved a measure of general acceptance, if not support, among South Koreans. Some analysts argue that the anti-KORUS FTA stance taken by the Minjoo (Democratic) Party's predecessor in the April 2012 National Assembly election campaign backfired, contributing to the party's surprising defeat. Judging by the 2016 National Assembly and 2017 presidential campaigns, FTAs seem to have receded as major issue in South Korean politics with both leading presidential candidates emphasizing, to varying degrees, the benefits of the agreement for both parties. This contrast to the characterization by the Trump administration could portend a stronger negotiating position for the United States, if the South Koreans feel they have more to lose in changes to the KORUS status quo. It may also push South Korea to put greater emphasis on the aspects of the agreement that have most benefited U.S. exporters in order to clarify the pain that could be felt were the agreement to dissolve. Mexico appears to have recently taken a similar approach to the NAFTA renegotiation, noting potential alternative suppliers of its agricultural imports from the United States.[22]

General Trade Enforcement

Enhanced enforcement activities are the least controversial of these four areas of focus, and the most likely to be utilized by the Trump administration. Many of the actions involved are unilateral, avoiding the need for lengthy and challenging negotiations, and could be addressed without new legislation by Congress. Politically, strong positions on enforcement also have the benefit of appealing to groups both supportive and opposed to U.S. trade liberalization efforts. Approaches to strengthening enforcement include bringing more cases against South Korea in the WTO, enhancing engagement and potentially utilizing the dispute-settlement mechanisms of the KORUS FTA, or making greater use of U.S. anti-dumping and countervailing duty (AD/CVD) and other trade remedy laws. The latter approach appears to be the most favored of the administration to date as it has begun the process of self-initiating trade cases, rather than waiting for petitions by affected industries, and issued an executive order aiming to strengthen duty collection efforts on imports subject to AD/CVD orders.[23] AD/CVD cases have historically figured prominently in U.S.-Korea trade relations—since 2000, South Korea has been the target of 43 AD/CVD investigations, second only to China—and the administration's enhanced enforcement efforts have already affected a dumping case with South Korea, as the Commerce Department made the first-ever implementation of a 2015 law permitting use of third-country prices to establish dumping margins.[24]

THE ECONOMIC-SECURITY NEXUS

The second major area of possible U.S.-South Korea economic tension is the Trump administration's signaling that it may use U.S. security relationships to influence its economic relationships, and vice versa. If this approach is followed, it would represent a shift in policy. U.S. administrations for at least the past several decades generally have avoided explicitly linking alliance commitments with partners' cooperation on economic matters.

This is not to say that U.S. trade and economic relations have not been influenced by security relationships. Bilateral economic relationships always involve a mix of security and commercial factors. At times, this is done explicitly, as the George W. Bush administration did in its choice of "strategic" FTA partners, countries like Bahrain with which the United States has low economic interaction but strong military ties, particularly after the September 11, 2001 terrorist attacks.

More often, the nexus between economics and security has been unstated. Alliances in many instances have provided the United States, in effect, with an extra seat at the bargaining table, especially with South Korea, accentuating U.S. negotiation leverage. Additionally, power disparities and perceptions of unequal relationships have provided the United States with large—though not always decisive—leverage over partners' trade and economic policies. Security and diplomatic dynamics create the context under which trade negotiations occur, giving national policymakers reasons to overcome or succumb to the sticking points that inevitably arise in the negotiations. For instance, the downturn in South Korea-Japan relations in 2005, when President Roh Moo-hyun threatened a "diplomatic war" after a flare-up of the two countries' territorial dispute over Dokdo/Takeshima, was a major factor that brought their bilateral FTA negotiations to a halt.

Alliance relationships also create an incentive in both partners to avoid a situation where economic disputes or a breakdown in trade agreement negotiations cause damage to the alliance. Clyde Prestowitz, for instance, has argued that during the early 1980s U.S. concerns about potentially disrupting alliance relations with Japan led the Reagan administration to downplay U.S. companies' petitions for relief from allegedly unfair Japanese competition.[25] This desire to prevent trade negotiations from damaging alliance relations also was on display at multiple points and on both sides of the Pacific during the KORUS FTA negotiation and ratification processes. At the outset of the talks in 2006, one of the arguments that many proponents gave was that the agreement would help to restore the health of the U.S.-ROK alliance. The KORUS FTA sometimes was discussed as a counterweight to the bilateral friction that was occurring over issues such as how best to manage relations with North Korea and the realignment of U.S. troops in South Korea. When the Obama administration demanded that the Lee government effectively renegotiate parts of the KORUS FTA in 2010 and 2011, South Korea arguably was more inclined to agree because of considerations of alliance politics. Likewise, when Congress was debating the agreement, the Obama and Lee administrations, with the House leadership, arranged for the final vote to come the same day as Lee's address to a joint meeting of Congress, a move that put the alliance at the forefront of the minds of many members of Congress at a time they were deciding how to vote on the KORUS FTA.

In his rhetoric, Trump has appeared to go beyond the subtle interplay between economics and security by explicitly arguing that the two should be used to extract gains for the United States. During the election campaign, he questioned the value of U.S. alliances with partners that have run persistent trade deficits, a theme he has been raising since at least the 1980s.[26] Although Trump has avoided linking economics and security with U.S. allies since his inauguration, he has not hesitated to threaten to use trade and finance to extract security concessions from China. In March and April, Trump issued a number of tweets implying that he would not push China as hard on trade and currency disagreements if it increases economic pressure on North Korea.[27] One implication is that if the president believes the South Korean approach on a variety of security-related issues diverges too much from the United States, he will be more likely to seek to use bilateral economic pressure. His belief in the value of being unpredictable in foreign relations accentuates this possibility. He also appears to view domestic industrial capacity as highly linked to national security. He has ordered section 232 investigations, a tool not used since 2001, into the potential security implications of U.S. steel and aluminum imports, which could potentially result in higher tariffs.

In addition to the administration's plan to review all existing U.S. FTAs, how at least two developments in U.S.-South Korea relations evolve over the coming months may increase Trump's motivation and opportunities to try to use security and economic issues to extract leverage against South Korea:

- The election of left-of-center President Moon Jae-in who, during his campaign, favored dialogue and engagement with North Korea and is likely to be even less willing than the Park Geun-hye government to criticize China's increased assertiveness in the South China and East China Seas;
- The expiration in 2018 of the U.S.-ROK special measures agreement, which sets the level of payments to the United States to help offset the costs of stationing U.S. forces in South Korea.

In the future, the likelihood of the Trump administration tying commitments in either the trade or security realm to concessions in the other and the likelihood of such an approach succeeding may depend on at least four factors: the level of U.S.-ROK coordination over North Korea policy, alliance relations, consultations over how best to approach China, and U.S. and Trump's popularity among South Koreans. If any of the first three factors deteriorate, Trump may be 1) more likely to use economic tools to attempt to pressure Seoul to cooperate on strategic matters, and/or 2) less reluctant to hold off on increasing the heat on South Korea if and when disagreements over economic matters flare up. For the fourth factor of South Korean public opinion, the popularity of the U.S. and Trump is likely to affect the political costs to South Korean leaders of cooperating with the United States.

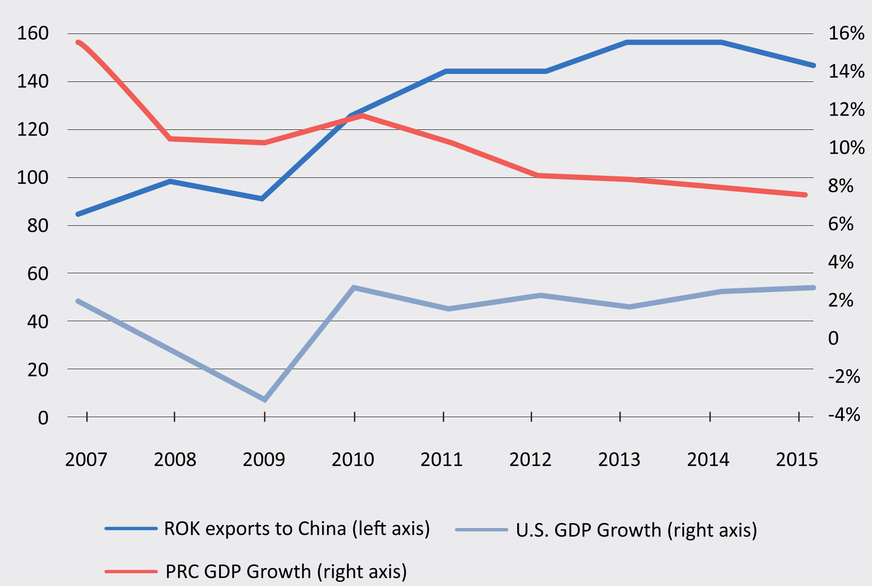
1. **North Korea coordination.** After conducting a review of its options with respect to North Korea's WMD programs, the Trump administration has embarked on an approach of what some are calling "maximum pressure." Though the policy appears to be aimed at pressuring North Korea to come to the negotiating table, talks are likely to be avoided until Pyongyang adopts a more compliant posture on its nuclear and possibly missile programs.[28] Although both Moon Jae-in and Ahn Cheol-soo advocate continuing sanctions against North Korea, they criticized President Park Geun-hye's North Korea policy as being too heavily reliant on pressure tactics at the expense of initiatives, such as Moon call for reinvigorating engagement activities with North Korea, including a dramatic expansion of the Kaesong Industrial Complex, the inter-Korean industrial park inside North Korea that Park shut down in February 2016 after North Korea's fourth nuclear test.[29] Whereas the Obama and George W. Bush administrations generally appeared willing to at least tolerate and occasionally welcome Seoul's outreach and assistance to Pyongyang, the Trump administration is less likely to do so. In contrast to the past, when North Korea was seen as a threat to U.S. interests, its improving nuclear and missile capabilities increasingly now also make it seem a threat to the U.S. homeland. All of these factors point to a higher possibility that coordination over North Korea policy, which was exceedingly close between the Obama administration and the Park and Lee Myung-bak governments, will become more difficult over the coming months and years.
2. **Alliance relations** form another set of factors that will affect the nexus between security and economics. How smoothly are some of the more difficult aspects of the alliance running? How well are the two governments managing the inevitable differences that emerge, such as on the special measures agreement talks or on the deployment of the controversial Terminal High Altitude Area Defense (THAAD) missile defense system? Under the conservative presidencies

of Lee and Park, such differences generally were contained so that they did not become highly politicized in South Korea or become major issues in the alliance. That may not be the case under a left-of-center president.

3. **China.** For a variety of strategic, economic, and historical reasons, South Korean leaders, even those from conservative parties, generally are more reluctant than their U.S. counterparts to take steps to antagonize China. South Korean progressive leaders sometimes have taken this approach a step further, by appearing to want to position South Korea as a type of "balancer"—to use President Roh Moo-hyun's term—between Beijing on the one side and Washington and Tokyo on the other. If Sino-U.S. relations deteriorate significantly—for instance over trade issues or managing disagreements in the South China Sea—the Trump administration may expect support from South Korea to a degree that leaders in Seoul may be uncomfortable providing. China appears to be keen to emphasize the potential negative implications to South Korea of any security measures that go against its interests by, for example, threatening retaliatory economic measures in response to the THAAD deployment.

China may play an important role in ROK-U.S. relations in another sense: the South Korean economy may be particularly vulnerable to a sharp downturn in Sino-U.S. economic relations, specifically to a sharp decline in Chinese exports to the United States. Although China is by far South Korea's largest trading partner, much of South Korea's exports to China are intermediate products that are ultimately tied to Chinese exports to the United States and Europe.[30] Figure 3 shows that although South Korean exports to China from 2007-2015 appear to have had little to no correlation with Chinese GDP growth, they were much more closely correlated to changes in U.S. GDP growth.

Figure 3. South Korean Exports to China vs. Chinese & U.S. GDP Growth Rates (USD billion)



Growth Rates Sources: Exports from UNComtrade, GDP Growth from World Bank.

4. **South Korean perceptions of the United States.** Finally, South Korean leaders' willingness to agree to concessions on economic and other matters will be affected by whether such concessions incur political costs or accrue political gains at home. For much of the conservative era (2008-2017), South Korean approval ratings of the United States were extremely high, with over 80 percent in some polls registering a "favorable" opinion. In the early 2000s, however, polls recorded U.S. favorability ratings of less than 50 percent, as South Koreans reacted to perceived U.S. mishandling of accidents by American servicemen in South Korea, the unpopularity of the U.S. invasion of Iraq, and the Bush Administration's hard-line approach to North Korea, which conflicted with many aspects of Seoul's "Sunshine Policy" of largely unconditional engagement with Pyongyang.[31] If the United States and/or the Trump administration becomes politically unpopular in South Korea, it will increase the political costs of the next South Korean president's compliance with controversial U.S. demands.

CONCLUSION

Three developments may increase President Trump's motivation and opportunity to try to use security and economic issues to extract leverage against South Korea:

- The fact that South Koreans on May 9 elected a left-of-center president who favors entering into more dialogue and engagement with North Korea and is likely to be even less willing than the Park Geun-hye government to criticize China's increased assertiveness in the South China and East China Seas;

- The expiration in 2018 of the U.S.-ROK special measures agreement setting the level of South Korea's payments to the United States to help offset the costs of stationing U.S. forces in South Korea; and

- The administration's plan to review bilateral trading relationships in which the United States runs a trade deficit, a review that is expected to bring special scrutiny to the KORUS FTA because of the agreement's size and of the growth in the U.S. bilateral trade deficit since the agreement has gone into effect.

Thus, policymakers in Washington and Seoul should not only expect greater attention to economic issues under the two new administrations, but also greater difficulty preventing any economic friction from spilling over to other aspects of the bilateral relationship. With respect to South Korea policy, it is possible that the Trump administration's positions largely reflect a shift in negotiating tactics rather than a change in fundamental U.S. interests. Two key questions moving forward then are whether or not these tactics result in a safer Korean Peninsula and U.S. homeland and more prosperous bilateral economic relationship.

**The views expressed herein are those of the authors and are not presented as those of the Congressional Research Service or the Library of Congress.*

ENDNOTES

1. For examples of contrasting positions on the agreement see: "Five Years of Free Trade: KORUS is Not Perfect, But It's Working," U.S. Chamber of Commerce, Above the Fold Blog, March 15, 2017; and "On Unhappy Fifth Anniversary of U.S.-Korea Free Trade Agreement, Deficit with Korea Has Doubled as U.S. Exports Fell, Imports Soared," Public Citizen, Eyes on Trade Blog, March 15, 2017.
2. USTR, *2017 Trade Policy Agenda*, March 1, 2017, p. 6.

3. Bureau of Economic Analysis. Data on a balance of payments (BOP) basis.
4. Industry-specific goods trade data from the U.S. Census Bureau.
5. For most cars, the United States agreed to remove its 2.5% import tariff after four years. The Obama and Lee administrations renegotiated auto tariff phase-outs in the KORUS FTA, after the agreement had been signed, but before considering it for ratification. The governments did not change the text of the agreement signed by the Bush and Roh administrations but instead made the alterations through an additional exchange of letters, which can be viewed along with the KORUS FTA tariff schedules on the USTR website.
6. Includes imports under tariff lines HTS 870321, 870322, and 870324. Data on usage of special import programs from the U.S. International Trade Commission's dataweb.
7. USITC, *Economic Impact of Trade Agreements Implemented Under Trade Authorities Procedures,* Publication Number: 4614, June 2016, p. 139.
8. Investment data is from the Bureau of Economic Analysis (BEA).
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10. Philip Rucker, "Trump: `We May Terminate' U.S.-South Korea Trade Agreement," *The Washington Post*, April 28, 2017.
11. "President Trump has called for a new approach, and the Trump administration will deliver on that promise." USTR, *2017 Trade Policy Agenda*, March 2017, p. 1.
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17. Robin Harding, "Donald Trump's Anger at Asian Currency Manipulators Misses Target," *Financial Times*, February 12, 2017.
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19. Letter from Senators Sherrod Brown and Rob Portman to Wilbur Ross, Secretary U.S. Department of Commerce, March 30, 2017.
20. For example, see Letter from Orrin Hatch, Chairman U.S. Senate Committee on Finance, to Ahn Ho-Young, Ambassador of the Republic of Korea, March 2, 2016.
21. Patrick Gillespie, "Mexico Ready to Retaliate by Hurting American Corn Farmers," *CNNMoney*, February 13, 2017.
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23. U.S. Department of Commerce, International Trade Administration data, available at http://enforcement.trade.gov/stats/inv-initiations-2000-current.html.
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25. Donald J. Trump, "There's Nothing Wrong with America's Foreign Defense Policy that a Little Backbone Can't Cure," advertisement in *The New York Times*, September 2, 1987.
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30. Pew Research Center, "Global Indicators Database," accessed March 3, 2015, and available at http://www.pewglobal.org/database/indicator/1/.