

## **U.S.-Korea Economic Relations and the Next U.S. Administration**

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### **Abstract**

When the next United States president is inaugurated on January 20, 2017, he or she may face one of the more challenging domestic political environments for international trade in the modern political era; at that time, the U.S. will need to make significant decisions regarding its economic relationship with East Asia, including South Korea. The most significant decision facing the next administration will be handling the Trans-Pacific Partnership (TPP). While there is still time for the U.S. Congress to pass the TPP prior to the next administration taking office, it is increasingly likely that the next administration will have to grapple with either passing or renegotiating the Asia-Pacific-wide agreement, as well as determining how to bring South Korea into the region wide agreement. Bringing Korea into the TPP will further solidify the U.S.' economic relationship with South Korea, enhancing efforts to move toward a free trade area within the Asia-Pacific. While South Korea's accession to the TPP will likely be the next administration's major economic objective, they should also work to strengthen the economic relationship with South Korea by deepening cooperation on small and medium sized enterprises (SMEs), cyber security, the digital economy, energy, and New Frontier issues.

**Key Words:** KORUS FTA, Trans-Pacific Partnership, New Frontiers, Trade Policy, Energy Cooperation, SMEs, Cyber Security, Digital Economy, U.S. Politics, Trade Environment

### **Introduction**

Shortly after the next president is sworn in, the United States and South Korea will mark the 5<sup>th</sup> anniversary of the U.S.-Korea (KORUS) FTA. The anniversary will present the new administration with an opportunity to take stock of the economic relationship between the U.S. and South Korea, and consider what should be the next steps in advancing economic relations between the two allies.

As of March 15, 2016, 95 percent of bilateral trade in goods are duty

free, with the majority of the rest set to become so shortly after the next administration's term comes to a close.<sup>1</sup> Trade in goods and services between Korea and the U.S. has grown from \$128.5 billion in 2011 (before the KORUS FTA came into force) to reach a high of \$147.3 billion in 2015. In that time, bilateral trade has grown 14.6 percent, moving South Korea from the U.S.' 7<sup>th</sup> to 6<sup>th</sup> largest trading partner.

Despite these gains, the KORUS FTA has faced criticism in the United States. The next administration may face a more tense economic relationship with South Korea than the U.S. has in more than a decade. How the administration chooses to address those tensions will determine whether Seoul and Washington are able to build on the successes of both governments.

However, the U.S.-Korea economic relationship will not take place in a vacuum. The next administration also faces a changing environment for international trade that has become increasingly unpopular both among the American public and on Capitol Hill. If the U.S. Congress is unable to ratify the Trans-Pacific Partnership (TPP) prior to the presidential inauguration, it could take up much of the next administration's attention on trade and economic engagement in the Asia-Pacific.

The U.S. is not alone in facing a new environment for trade legislation. South Korea's recent National Assembly election saw neither of the two major political parties gaining an outright majority; the opposition Minju Party of Korea holds a plurality of only a single seat. Change will continue next year as South Korea will hold its own presidential election in December 2017. While the lack of a majority in the National Assembly may make legislation difficult, it will not likely have the same impact as a candidate such as Donald Trump winning the White House for South Korea's trade policy.

Despite the potential challenges for U.S.-Korea economic relations, there are also opportunities. If the U.S. Congress is able to pass the TPP, South Korea would be a natural partner for the pact. Beyond trade, both countries would benefit from increased cooperation among a range of issues including development assistance, energy cooperation, and cyber, the last of which is part of what is now called the New Frontier issues, which also include cooperation on climate change, space, and global health.

## **The Political Dynamics in the United States**

Regardless of who wins the U.S. presidential election, the next U.S. administration will assume office at a time when American public opinion on the country's place in the world may be shifting. The presidential campaign season has been dominated by themes of declining U.S. involvement in the world, and the idea that the U.S. may not be getting the best deal it can from its partners. The campaign rhetoric has pushed even moderate candidates such as Hillary Clinton into more skeptical positions on issues related to trade.

This is not the campaign that many expected. As contenders for the Democratic and Republican primaries began to take shape in the fall of 2015, most experts anticipated that centrist candidates such as Hillary Clinton and Jeb Bush would win their party's nomination. On the Democratic side, there was little seen to be standing between Hillary Clinton and the nomination. Republican pundits expected the eventual nominee would emerge from a core group that included Jeb Bush, Scott Walker, Ted Cruz, and Marco Rubio. Despite his initial strong poll numbers, Donald Trump was not seen as a serious contender on the Republican side. Similarly, Bernie Sanders was given little chance to secure the Democratic nomination. Instead, both candidates have driven much of the debate during the 2016 election cycle and Donald Trump has secured the Republican nomination.

The Pew Research Center recently completed a comprehensive study on the U.S. place in the world that identifies some of the shifts in U.S. public opinion that the Trump and Sanders campaigns have been able to tap into. Pew found that 57 percent of Americans believe that the U.S. should let other countries handle their own problems, with 62 percent of Republicans and 47 percent of Democrats sharing that sentiment. Additionally, 54 percent of Trump supporters think that the U.S. does too much to solve the world's problems, as do 42 percent of Sanders supporters.<sup>2</sup>

The skepticism of U.S. involvement abroad extends more deeply to economic issues, which is perhaps not surprising as the one common theme in the Trump and Sanders campaigns has been to question U.S. trade policy. Nearly half Americans see engagement in the global economy as bad for the U.S. with 55 percent of Republicans and 65 percent of Trump supporters having a negative view of U.S. engagement in the global economy. Forty-eight percent of Sanders supporters share these views. While a slightly different question was asked in 2013,

support for trade has clearly fallen in the U.S. When asked if greater engagement with the global economy was good or bad for the United States in 2013, 66 percent of Americans thought it was good, as opposed to 25 percent who did not.<sup>3</sup>

On the campaign trail Trump has talked about raising tariffs on China to address Beijing's manipulation of the Chinese currency. He has raised the issue of trade costing jobs, and promised to force plants to return to the U.S. Trump stated, "[o]ur country is in serious trouble. We don't win anymore. We don't beat China in trade. We don't beat Japan, with their millions and millions of cars coming into this country, in trade. We can't beat Mexico, at the border or in trade."<sup>4</sup>

Bernie Sanders on the Democratic side has expressed similar concerns:

I do not believe in unfettered free trade. I believe in fair trade which works for the middle class and working families, not just large multinational corporations. I was on the picket line in opposition to NAFTA. We heard people tell us how many jobs would be created. I didn't believe that for a second because I understood what the function of NAFTA, CAFTA, PNTR with China, and the TPP is, it's to say to American workers, hey, you are now competing against people in Vietnam who make 56 cents an hour minimum wage. This is an area where the secretary and I have disagreements.<sup>5</sup>

These concerns have forced Clinton to change her position on the TPP. While still Secretary of State, Clinton said that "[t]his TPP sets the gold standard in trade agreements to open free, transparent, fair trade, the kind of environment that has the rule of law and a level playing field. And when negotiated, this agreement will cover 40 percent of the world's total trade and build in strong protections for workers and the environment."<sup>6</sup> However, later in the campaign she said that "[a]s of today, I am not in favor of what I have learned about it (TPP)," adding, "I don't believe it's going to meet the high bar I have set."<sup>7</sup>

On the specific issue of imports, only a narrow majority of Americans support importing goods from developing countries, with only 42 percent of Republicans supporting more imports. Interestingly, there is fairly strong support among Democrats at 57 percent. This appears to parallel greater support among Democrats for foreign aid and

U.S. investment in developing countries. While Sanders supporters may have concerns about U.S. trade deals, nearly 60 percent support importing goods from developing countries, foreign aid, and U.S. investment in developing countries. In contrast, between 63-78 percent of Trump supporters oppose those issues.<sup>8</sup> While the two candidates may both be skeptical of trade, there are differences in their concerns.

In ordinary times, one would expect a President Clinton to secure side letters from the U.S. partners in the TPP and move its passage forward much as Bill Clinton did with NAFTA. However, the current environment may make that difficult, especially if Bernie Sanders continues to insist on trying to shape the Democratic agenda. The Democratic Party platform is more skeptical on trade than in 2012,<sup>9</sup> and Clinton's VP choice Tim Kaine quickly changed his position TPP after joining the ticket.<sup>10</sup> At the convention itself, there was a strong push to have Clinton come out strongly against the TPP in her acceptance speech.<sup>11</sup> How this will play out if she wins is difficult to determine, but aides have suggested that if she wins she'll focus on job creation issues rather than trade.<sup>12</sup>

On the Republican side, it is less clear that a President Trump would shift his position after the election. In the campaign, Trump has shown little inclination to move to the center during the general election as candidates traditionally do. As a businessman who has criticized U.S. trade agreements, he may be less likely to take advice on trade and economic issues from traditional experts. In his speech on trade, Trump said that he would leave the TPP, renegotiate NAFTA, and label China a currency manipulator.<sup>13</sup> Additionally, one of his chief foreign policy aides has indicated that a Trump administration may seek to "go back to ground zero" on the U.S. FTAs.<sup>14</sup> He has even gone so far as to suggest that he would withdraw the U.S. from the World Trade Organization.<sup>15</sup>

In the case of Trump, it is difficult to know if these statements reflect actual policies, negotiating bluster, or ignorance. Regardless, his push against trade has influenced the Republican Party Platform, where there has been a shift towards calls for balanced trade and not approving the TPP in the lame-duck session of Congress.<sup>16</sup>

Why are voters increasingly pushing politicians towards anti-trade stances? As the Brexit vote demonstrates, there is a sense that change is needed despite potential economic costs. While the issue of trade in the U.S. is different from the United Kingdom's decision to leave the European Union, there are similar undercurrents: significant segments of

the population believe politicians have failed to look after their interests as they feel jobs have moved overseas. A majority of voters in the U.S. feel as though the U.S. has lost more than it has gained from globalization,<sup>17</sup> and politicians such as Trump are able to tap into announcements such as Carrier's decision to move its plant in Indiana to Mexico.<sup>18</sup>

There are deeper economic issues at play as well. The middle class in the U.S. has declined in size and seen its median income decline by 4 percent since 2000. Since 1970, middle-income households have seen their share of national income shrink from 62 percent to 43 percent in 2014.<sup>19</sup> While the unemployment rate is below 5 percent, the long-term unemployment rate remains high and some 2.6 million Americans would like a job, but have given up looking. Although the economy has improved since the Great Recession, there are still significant amounts of Americans, who either haven't seen the benefits or feel that they are falling further behind.<sup>20</sup>

While there is no single answer for why opposition to trade is growing in the U.S., as long as there is a sense of economic insecurity among the middle class, we should expect current trends to remain.

### **Challenges in U.S.-Korea Economic Relations**

The U.S. and South Korea cooperate across a wide range of economic issues and the economic relationship is closer than it has ever been. The passage and implementation of the KORUS FTA has brought the two countries closer together by increasing trade, investment, and creating a broader framework for the economic activity between the two countries. It also demonstrates how far the United States' economic relationship with South Korea and the South Korean economy have come since the end of the Korean War.<sup>21</sup>

The two countries also cooperate on an ever-growing range of international and bilateral economic issues. Internationally, the U.S. and South Korea work closely in G-20 on policies to "promote strong, sustainable, and balanced growth," as well as on fiscal and financial issues. Bilaterally, the U.S. and South Korea recently concluded a new 123 agreement that will help to promote continued civilian nuclear cooperation, and have established a commercial dialogue to promote foreign direct investment, entrepreneurship, and other issues of commercial interest to both countries.<sup>22</sup>

However, despite the increasing closeness of the relationship,

challenges remain. Many of these stem from the implementation of the KORUS FTA, but they also include issues related to Korea's currency practices and on the handling of economic sanctions on North Korea.

### ***Implementation of the KORUS FTA***

The KORUS FTA represents one of key achievements in U.S.-Korea relations in the last decade, but the process of implementation has not gone as smoothly as many would have hoped, and the agreement itself has faced a higher degree of scrutiny than perhaps any U.S. FTA besides the North American Free Trade Agreement (NAFTA). This is largely a function of the KORUS FTA serving as a baseline for the TPP talks. As a result, critics of free trade looked to the performance of the KORUS FTA to make their case against the passage of the TPP.

Public Citizen and the Economic Policy Institute (EPI), groups often looked to by Democrats on trade, have pushed hard against the KORUS FTA. Public Citizen has criticized the agreement for doubling the U.S. trade deficit with South Korea and costing the U.S. 106,000 jobs.<sup>23</sup> A recent report from EPI similarly criticizes the agreement, though it has a slightly lower job loss number at 95,000.<sup>24</sup> Both also suggest that the KORUS FTA demonstrates why Congress should not pass the TPP.

Beyond the lobbying of outside groups against the KORUS FTA, the individual challenges that have arisen on Capitol Hill over the implementation of the KORUS FTA have not helped build support for the agreement. One early difficulty in the agreement's implementation process related to the rules of origin, with South Korean customs officials often denying tariff benefits to U.S. goods. One well known case concerned tariff benefits for U.S. orange juice that took over a year to resolve.<sup>25</sup>

More recently, Senator Orin Hatch, chairman of the Senate Finance Committee and a supporter of the KORUS FTA, has raised concerns over compliance issues related to the FTA and the impact that they have on U.S. businesses. Specific concerns that he has raised include a lack of transparency in the pricing and reimbursement of pharmaceuticals and medical devices, the lack of the establishment of an independent review mechanism for stakeholders, regulations relating to the liberalization of legal services, the implementation of regulations for the transfer of data, and the procedural fairness and transparency decisions by the Fair Trade Commission in competition matters.<sup>26</sup> Ambassador Mark Lippert has also raised the issue of the regulations being put in place to open Korea's

legal services market.<sup>27</sup>

As with most issues, the reality is more complex. According to the U.S. International Trade Commission (USITC), the KORUS FTA has resulted in a \$1.8 billion to \$2.1 billion benefit to the U.S., more than any FTA other than NAFTA.<sup>28</sup>

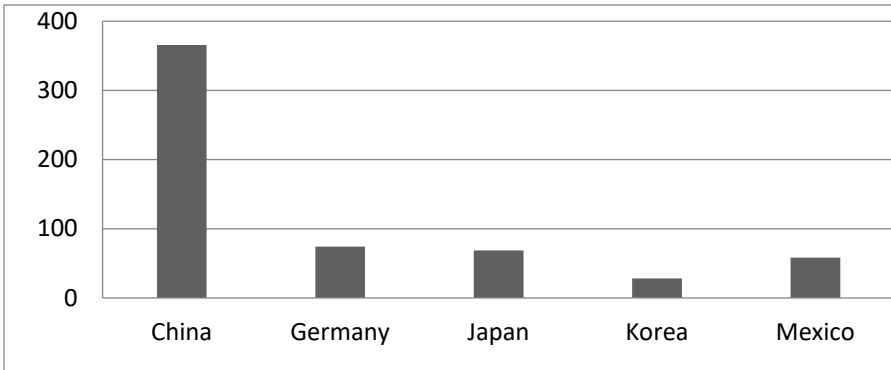
At the same time, as critics of the agreement point out, the U.S. trade deficit with South Korea has expanded since the KORUS FTA came into effect. The deficit has expanded from \$15.1 billion the year before KORUS came into effect to \$30.6 billion last year. However, according to estimates by the USITC, the deficit would have been \$15.8 billion higher in the absence of the KORUS FTA.<sup>29</sup> Additionally, critics generally fail to take into account services and foreign direct investment when considering the overall impact of the agreement. Services are not only the U.S. area of competitive advantage, but increasingly they are becoming a larger share of global trade. In value terms, the weight of trade in goods has fallen from 71 percent of trade in 1980 to 57 percent of trade in 2008.<sup>30</sup> Foreign direct investment represents a more permanent commitment to an economic relationship, while trade flows can change relatively quickly in response to external international factors.

In the case of services, the U.S. has a trade surplus with South Korea of \$9.4 billion that has grown from \$7 billion the year before the KORUS FTA came into effect. When services are taken into account, the U.S. trade deficit, while still growing, has grown at a slower pace. In 2011, the U.S. had a trade deficit with South Korea of \$8.1 billion that is now \$21.2 billion.

Placed in the context of the U.S. trade deficits with other major trading partners the deficit is more manageable. The deficit is roughly half of the U.S. deficits with Germany, Japan, and Mexico, and significantly smaller than the U.S. trade deficit with China (Figure 1).



**Figure 1: U.S. Bilateral Trade Deficit with Major Trading Partners  
2015 (Millions of U.S. Dollars)**



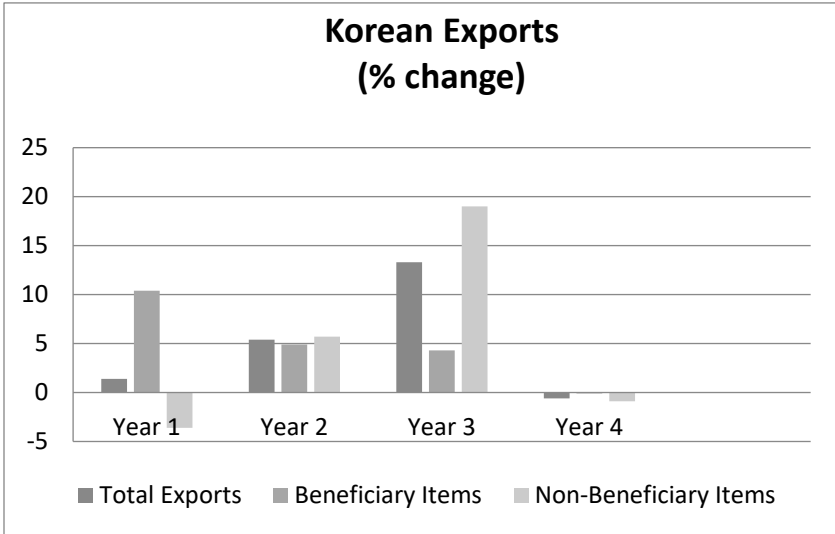
Source: U.S. Bureau of Economic Analysis

In the case of Foreign Direct Investment (FDI), Korea's stock of FDI in the U.S. has risen from \$19.9 billion in 2011 to \$36.1 billion in 2014, while U.S. stock of FDI has grown from \$28.2 billion to \$34.9 billion over the same timeframe. The significant increase of Korean FDI into the U.S. has made Korea the 14<sup>th</sup> largest investor in the U.S. and the White House estimates that Korean investment supports 38,000 jobs.<sup>31</sup>

If the numbers for services trade and FDI are better, why have we seen an increase in the overall U.S. trade deficit with Korea? There are a series of factors.

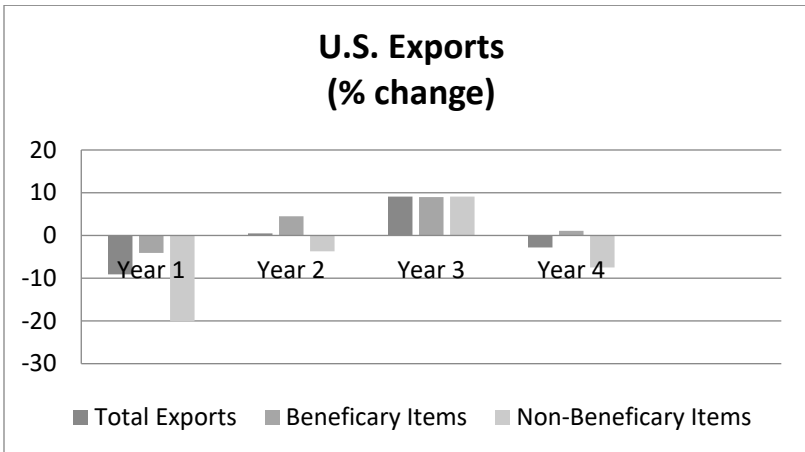
One area to review is how U.S. exports of goods have performed under the KORUS FTA in terms of beneficiary items (items covered by the KORUS FTA) and non-beneficiary items (items not covered by the KORUS FTA).<sup>32</sup> As can be seen in the breakdown of South Korean and U.S. exports (Figures 2 & 3). South Korea has generally seen growth in its exports both in terms of beneficiary and non-beneficiary items. In contrast, the U.S. has only seen strong growth in both categories during year three. However, as the data indicates, the challenge for the U.S. has been in the area of non-beneficiary items where there has been significant downturns, especially in years one and four. On the beneficiary side, while the U.S. did not see export growth in year one, it has seen growth among beneficiary items in each subsequent year.

**Figure 2: Change in Exports of Korean Beneficiary and Non-Beneficiary Items**



Source: U.S. Korea Connect

**Figure 3: Change in U.S. Exports of Beneficiary and Non-Beneficiary Items**

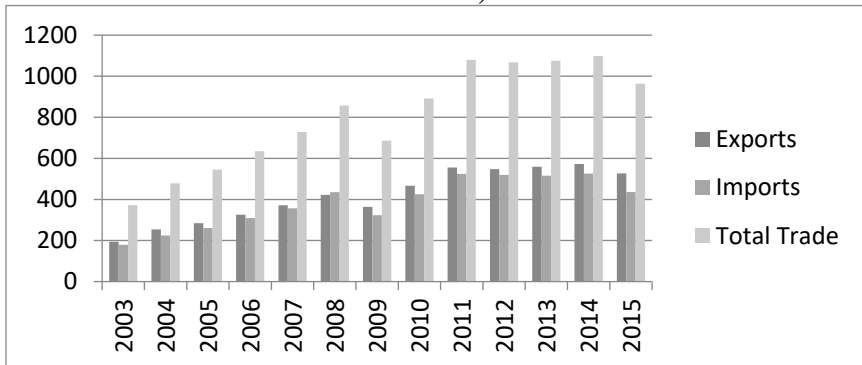


Source: U.S. Korea Connect

There have been specific issues which have contributed to the decline in non-beneficiary items, particularly in year one when there was crop failure in the U.S. that lead to a significant drop in exports of corn from the U.S. to South Korea. However, there are also larger systemic issues on the U.S. side that have played a role as well. Since 2011, the U.S. dollar has appreciated and growth in U.S. exports has slowed.<sup>33</sup> To an extent, this has mirrored U.S. trade with South Korea. The U.S had its largest trade deficit in 2015 with Korea at time when its export growth more generally had largely stopped.

Another challenge has been growth in private consumption in Korea. Since 2013, private consumption in South Korea has trailed Gross Domestic Product (GDP) growth by a minimum of 0.4 percent in 2015 and by a percentage point or more in 2013 and 2014. Contributing to declines in private consumption in the last two years have been the Sewol ferry accident and outbreak of Middle East Respiratory Syndrome. When coupled with higher-than-OECD-average levels of household debt and a savings rate that has risen to 9 percent,<sup>34</sup> private consumption in South Korea has become constrained relative to the U.S. growth in private consumption, which has exceeded GDP growth each year since 2013.<sup>35</sup>

**Figure 4: Korean Exports and Imports 2003-2015 (Millions of U.S. Dollars)**



Source: Korea International Trade Association and author's calculation

One last factor to consider are broader trends in South Korea's own trade. For the last two years South Korea has seen a decline in total trade, falling below \$1 trillion in total trade in both years (Figure 4). Compared to South Korea's other FTA partners, the U.S. outperformed all of them except Chile and Turkey, with a decline in exports to South Korea of only 2.2 percent. In contrast, Korea's imports overall fell 16.9 percent last year with all of South Korea's other FTA partners seeing drops in exports of 8 percent or more.<sup>36</sup>

While the U.S. has not seen the export growth to date that many expected, a deeper analysis indicates that for items currently covered by the KORUS FTA, there has been economic growth. At the same time, factors in both the U.S. and South Korean economies have likely contributed to slower growth overall and the decline that we have seen in beneficiary items. More to the point, the contention of the agreement's critics that the KORUS FTA has cost the U.S. jobs is difficult to substantiate in light of the growth in exports of beneficiary items.

### ***The Question of Unfair Currency Practices***

In international trade, the currency practices of countries can be a controversial issue, especially if those practices are seen as providing an unfair advantage to one country. As trade deficits with China have grown, the U.S. Congress has regularly raised concerns about the value of the Chinese Renminbi (RMB) over concerns of fair play and lost U.S. manufacturing jobs. China's practices with the RMB are estimated by EPI to have cost the U.S. millions of manufacturing jobs, and some have estimated that ending Chinese currency practices could create as many as 1 million new jobs in the U.S.<sup>37</sup>

Concerns over the currency practices of other countries is not limited to the U.S. South Korea's economy is built on a model of export-led growth. In international markets, South Korea competes in many industries with companies from Taiwan and Japan, making its economy sensitive to changes in the Japanese yen and the Taiwanese dollar. After Japan introduced quantitative easing under Prime Minister Abe Shinzo and Bank of Japan Governor Kuroda Haruhiko, South Korea began to raise concerns about Japan's policy.<sup>38</sup> While quantitative easing is not designed to lower the value of a currency, that can be one of the secondary effects of the policy. As a result of the Bank of Japan's actions, the yen declined in value relative to the South Korean won, raising concerns in South Korea about Japan's currency policies and that

Korea would be harmed disproportionately as a result of its high level of international trade.<sup>39</sup>

To address concerns about international currency practices, the U.S. Congress provided the Treasury Department additional tools for monitoring, reporting, and addressing unfair currency practices as part of the Trade Facilitation and Trade Enforcement Act of 2015. The Act requires that the Treasury Department analyze the practices of major U.S. trading partners that meet three criteria: (1) a trade surplus with the U.S., (2) a current account surplus, and (3) an intervention in currency markets in a persistent manner.<sup>40</sup>

Treasury has defined these criteria as thresholds. In the case of each country, it should not have a trade surplus with the U.S. of \$20 billion or more, a current account surplus of more than 3.0 percent of its GDP, or have engaged in persistent currency interventions that are more than 2 percent of GDP over the course of a year. As a result of these criteria, Treasury has placed South Korea on its new “Monitoring List,” along with China, Japan, Taiwan, and Germany.<sup>41</sup>

South Korea meets Treasury’s standards on two of the three criteria: It has a trade surplus with the U.S. of more than \$20 billion and a current account surplus of more than 3 percent. In the case of the trade deficit, it has only been in the last three years in which South Korea’s trade surplus in goods with the U.S. has moved past \$20 billion, and only in the last year in which South Korea’s total trade surplus with the U.S. has moved past \$20 billion. However, it looks to do so again this year. South Korea has also run a current account surplus in excess of Treasury’s 3 percent of GDP threshold since 2012.<sup>42</sup>

With Treasury’s new mandate in place and concerns over transparency in South Korea’s foreign currency market interventions, this is a sensitive issue in the relationship that will likely remain during the next administration. However, should the OECD’s projections be correct and the growth in savings decline in South Korea and private consumption increase, this issue could self-correct if South Korea’s trade surplus with the U.S. declines.

### ***Economic Sanctions and North Korea***

The next administration may face a challenge in managing international sanctions on North Korea. At the moment, the U.S. and South Korea remain on the same page in regard to sanctions on North Korea for its nuclear weapons and missile programs. South Korea has

been a leader in helping to rally international support to pressure North Korea into returning to denuclearization talk through the closure of the Kaesong Industrial Complex,<sup>43</sup> and more recent diplomatic efforts to convince nations friendly to North Korea to fully enforce the new UN sanctions.<sup>44</sup>

However, members of the opposition in South Korea may seek a different approach to North Korea if they win the next presidential election, and some have been critical of the decision to close the Kaesong Industrial Complex (KIC).<sup>45</sup> Absent a significant shift in North Korea's policy toward denuclearization, the reopening of the KIC could cause tension in the alliance.<sup>46</sup>

Shortly after closing the KIC, the opposition floor leader suggested the National Assembly passing a special law to reopen the industrial complex,<sup>47</sup> but under the current sanction environment that would be extremely difficult. The new Section 311 designation of North Korea as a primary money laundering concern means that banks are required to ensure that North Korea does not have access to U.S. correspondent accounts through direct, indirect, or illicit indirect means.<sup>48</sup> Unless North Korea were willing to accept payment in South Korean won from a bank without any ties to the U.S. financial system, something Pyongyang has never indicated a willingness to do, there would be no means through which to finance the reopening of Kaesong or other economic engagement projects.

While the U.S. has provided exceptions for non-governmental organizations (NGOs) conducting humanitarian work in North Korea, an exception for South Korea to restart the Kaesong Industrial Complex would be unworkable. Until North Korea enters into serious denuclearization talks, projects like Kaesong will likely be unfeasible in light of the new financial restrictions on North Korea; the new Section 311 designation and UN Security Council Resolution 2070 call for the discontinuation of correspondent accounts with North Korea that are believed to be tied to the nuclear weapons program, the missile program, or other sanctioned activities.

### **Next Steps for the Next Administration in U.S.-Korea Economic Relations**

While the KORUS FTA was perhaps the most significant step in enhancing U.S.-Korea economic relations, opportunities exist for continuing to deepen the economic relationship. The U.S. and South

Korea already cooperate on issues such as international development assistance and civilian nuclear cooperation; where possible, the depth of that cooperation should be expanded. However, there are five areas where the next administration should take specific steps to enhance cooperation with Seoul. These include South Korea's participation in the TPP: expansion of small- and medium-sized enterprise (SME) trade, energy cooperation, cybersecurity and the digital economy, and building closer partnerships on the New Frontier issues.

### *The Trans-Pacific Partnership and the Free Trade Area of the Asia-Pacific*

TPP's future is uncertain. However, should the current or next administration manage to pass and implement the agreement, South Korea would be a natural partner. South Korea's accession to the TPP should be the next administration's major economic goal for the alliance. Including South Korea as one of the first countries to accede to the TPP in its next tranche would provide significant benefits to both countries.

As previously noted, the TPP utilized the KORUS FTA as a baseline for the negotiations, so South Korea should already have implemented the reforms needed for many of the provisions currently in the TPP. To prepare for South Korea's entry into the TPP, the next administration will need to work with the South Korean government to address any lingering issues related to the implementation of the KORUS FTA; under the new version of Trade Promotion Authority, the way in which a country has implemented prior trade deals with the U.S. is one of the factors for consideration when entering into a new trade agreement with potential partner countries.

The TPP represents a "next generation" of trade agreements that seek to smooth the flow of goods and services across borders. The global trade regime has shifted from one of bilateral agreement to multilateral agreement such as the TPP. With global free trade at the WTO level stalled, the TPP is the primary vehicle for promoting trade liberalization more broadly. For the U.S., an agreement as ambitious as the TPP is incomplete without key trading states such as South Korea; Seoul's inclusion in the TPP would further expand the rules-based trading system envisioned by TPP and include a key partner if future efforts to develop a Free Trade Area of the Asia-Pacific (FTAAP) were to take place.

The question is whether and when South Korea should join the TPP. South Korea has free trade agreements with most of the TPP countries,

with Japan and Mexico being the significant exceptions. While Seoul has resumed negotiations on an FTA with Mexico and is engaged in talks with Japan on both a bilateral level, trilateral level, and as part of the Regional Comprehensive Economic Partnership negotiations (RCEP), joining TPP would provide South Korea with high-quality FTAs with both Mexico and Japan. As Peter Petri and Michael Plummer found, South Korea stands to see income gains of \$45.8 billion from TPP and would see a small income loss of \$2.8 billion if it fails to join.<sup>49</sup>

In light of South Korea's extensive free trade network, some have questioned whether South Korea needs to join the TPP. Though South Korea would realize a larger income gain from RCEP (\$82.0 billion), it stands to gain more from an eventual FTAAP (\$129.3 billion).<sup>50</sup> While South Korea should continue to pursue RCEP, it should seek to shape RCEP into a high-standard agreement that would help non-TPP participants move closer to eventually meeting the standards of an agreement like TPP.

Additionally, as South Korea shifts its economy more toward innovation, the rules of trade agreements will become increasingly important for protecting those innovations and ensuring the free flow of goods and ideas.<sup>51</sup>

### ***Cybersecurity and the Digital Economy***

Whether it is the Sony hack, previous cyber attacks on South Korean banks and nuclear facilities, the theft of U.S. corporate secrets, or the more recent cyber attack by North Korea that resulted in the theft of 42,000 defense files,<sup>52</sup> both the U.S. and South Korea face a common vulnerability to the disruption of key infrastructure facilities and the theft of trade secrets via cyber attacks in an age of increasing global connectedness. While cyber security is also one of the New Frontier issues, because of its connection to the digital economy, the traditional economy, and national security, it should be an area that receives extra attention between the two governments.

However, the digital economy, with its emphasis on providing goods and services through the use of information technology, also holds significant promise for South Korea and the U.S. As was noted earlier, 43 percent of international trade by value is services trade. Digital trade will become an increasingly important aspect of international services trade. While the U.S. is well established in the field of digital commerce internationally with firms such as Amazon, Google, and Apple that have

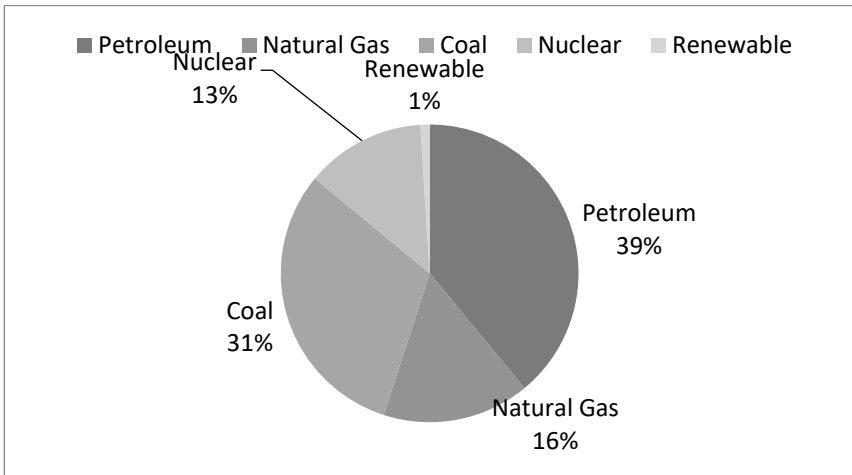


significant digital presences, South Korea is only beginning to expand into the digital field: as newer firms such as Kakao are expanding and joining South Korea’s already successful on-line gaming industry. With one of the world’s fastest internet connections, a thriving digital gaming industry, and a tech-savvy society, South Korea has the potential to be a burgeoning digital economy superpower. As firms such as Kakao expand into a range of digital fields and Hallyu continues to expand in digital formats, ensuring the firms and innovators behind South Korea’s creative content have fair access to markets abroad and are protected from cyber piracy will increasingly become an important issue for the South Korean economy.

Earlier this year the U.S. and South Korea agreed to cooperate on the development of cyber security tools.<sup>53</sup> The next administration should continue this cooperation and encourage private-sector cooperation as well. Additionally, the next administration should work with the South Korean government to encourage global rules on data transfer and access for digital content across borders that will allow both countries’ digital content to compete internationally.

***Energy Cooperation***

**Figure 5: South Korean Energy Consumption by Fuel Source in 2014**

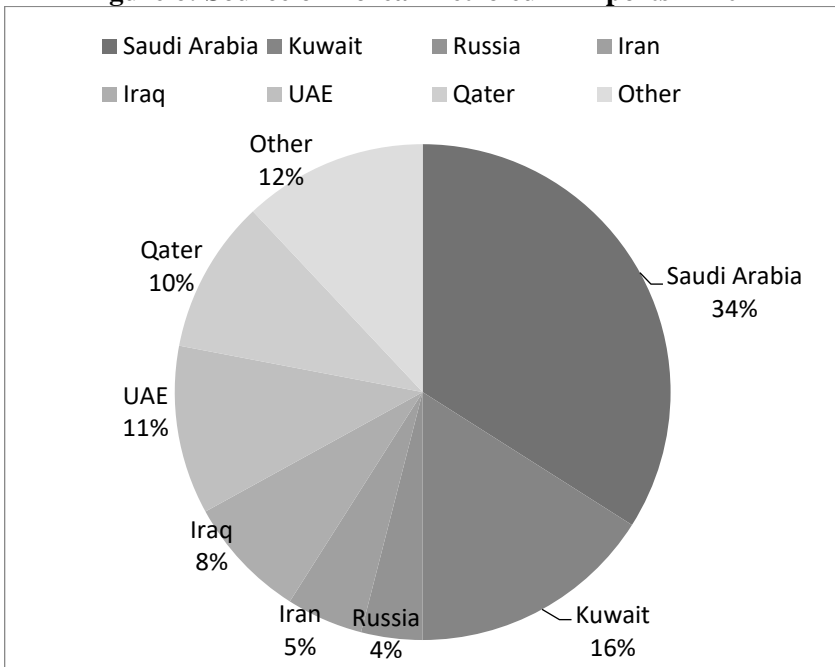


Source: U.S. Energy Information Administration

There should be a wide scope for the next administration to pursue energy cooperation with South Korea on both traditional fossil fuels and renewable energy. Lacking domestic energy reserves, South Korea is dependent upon foreign sources for coal, petroleum, and liquefied natural gas (LNG) to supply much of its energy.<sup>54</sup> Domestic sources of renewable energy and hydroelectric power only contribute trace amounts to South Korea's energy mix (Figure 5).

In the case of petroleum, roughly 85 percent of South Korea's imports come from inside the Strait of Hormuz (Figure 6). While the nuclear deal with Iran has calmed some tensions in the region, the Middle East is still a region with significant instability. Diversifying South Korea's supply of petroleum, and to a lesser extent LNG, from the Middle East to more stable suppliers would supply additional energy security to the South Korean economy.

**Figure 6: Source of Korean Petroleum Imports in 2014**



Source: U.S. Energy Information Administration

With the removal of restrictions on the export of U.S. crude oil and the development of low-cost shale gas in the U.S., the next administration should work with South Korea to develop a deeper energy partnership. However, beyond providing an alternative source for hydrocarbons, the next administration should deepen the energy partnership in the area of renewables as well. The development of offshore wind platforms that can withstand a wide range of stress could help both nations, as well as partners such as Japan, tap significant offshore wind resources. A deeper energy partnership could help both countries address short and long-term needs, while boosting the economic efficiencies of both economies.

### *Exploring the New Frontiers*

The New Frontier issues include cooperation on climate change, space, cyber security, and global health issues. While not economic issues in the classic sense, they have the potential to have an impact on economic growth. As previously mentioned in the case of cyber security, these issues can expose vulnerabilities in each country's economy. In the case of global health, preventing the spread of potential pandemic diseases is not merely an issue for helping disease stricken-areas abroad; in 2015, South Korea suffered from an outbreak of Middle East Respiratory Syndrome (MERS). As concern spread domestically and internationally, the outbreak resulted in a contraction in domestic consumption.<sup>55</sup>

If health and cyber security can present potential negative consequences for the South Korean or U.S. economy, they can also present opportunities. As was noted earlier, South Korea's economy is highly dependent on foreign energy imports. Cooperation on issues such as climate change present potential economic opportunities for both the U.S. and South Korea. These can come in the form of the development of renewable energies, the development of equipment or processes that make the usage or storage of renewable energy possible or technologies that reduce the consumption of fossil fuels.

South Korea and the U.S. are already working on the development of the battery storage capacity that will be needed to make intermittent renewable energy sources such as wind and solar more viable: by storing energy when there is no wind or sunshine, the need for base load power is reduced. Similar developments of new technologies that could drive economic growth could be developed in the areas of health and space.

While South Korea invests more than most countries in R&D, it is fairly deficient in terms of international collaboration on R&D,<sup>56</sup> weakening its potential for innovation. Increased collaboration with the U.S. would increase South Korea's potential to develop the innovations that will help to drive its economy in the future as it faces increasing competition from both high-tech economies and low- cost developing economies.

The next U.S. administration should expand cooperation on the New Frontier issues, but it should also consider increasing collaboration on R&D with South Korea, as well as encouraging South Korea to better integrate its R&D further into international networks.

### ***Growing SME Trade***

The Obama Administration and the Park Administration have both placed a priority on expanding international trade by small- and medium-sized enterprises, or SMEs. To help promote matchmaking between U.S. and Korean SMEs, the South Korean government created a portal on the website U.S.-Korea Connect ([uskoreaconnect.com](http://uskoreaconnect.com)) to help U.S. and Korea firms find companies looking to purchase or supply goods to each other.

When the next administration comes to office, the KORUS FTA will have been in effect for five years. One initial step it should take with South Korea, in conjunction with a broader review of efforts to promote SME exports, is a review of how effective [uskoreaconnect.com](http://uskoreaconnect.com) has been in promoting exports for U.S. and South Korean SMEs. As part of this review, the two governments should also survey their respective SMEs to see if there are steps that they could take that would help SMEs find prospective partners in their respective countries. As part of this review in the U.S., the next Congress and administration should consider having the U.S. International Trade Commission conduct a follow up to its 2013 review of the potential impact of the KORUS FTA on SMEs<sup>57</sup> to see how beneficial the agreement has been and what barriers they still face.

### **Conclusion**

As the climate for trade policy becomes increasingly challenging, the next U.S. administration may face constraints on expanding economic cooperation with South Korea. Should Hillary Clinton win the U.S. presidency, there is an expectation that she will try to pivot on trade to continue to encourage the expansion of international economic

cooperation. However, given the rhetoric and background of the Trump campaign, U.S.-Korea economic relations could face a more difficult period if he holds to his campaign pledges to impose tariffs on countries that he believes are “winning” in terms of trade with the U.S. and potentially renegotiate the U.S. FTAs with other countries. In an ordinary campaign, there would be an expectation that a Trump administration would behave as those that have campaigned against trade in the past (and Hillary Clinton is expected to should she win). Bill Clinton campaigned against NAFTA, but ultimately supported the pact after concluding additional side agreements. Barack Obama campaigned on a pledge to renegotiate NAFTA, but ultimately focused instead on negotiating additional agreements with South Korea, Peru, and Colombia prior to supporting those agreements and then negotiating the TPP and launching the Trans-Atlantic Trade and Investment Partnership. However, Donald Trump is not a traditional candidate during a traditional election.

If the next administration is able to pivot to a more positive trade agenda, working with South Korea to address any lingering issues with the implementation of the KORUS FTA and preparing its entry into the TPP should be the primary item for expanding U.S.-Korea economic relations. However, the next administration should include in its priorities for economic cooperation more than seeing South Korea join the TPP. It should seek to expand cooperation with South Korea on a range of issues that include cyber security and the digital economy, energy cooperation, expanding trade by SMEs, and effectively cooperating on the New Frontier issues.

The last two U.S. and South Korean administrations have taken significant steps to expand the U.S.-Korea economic relationship and further develop cooperation between the two countries. The next administration in the U.S. should seek to build upon that legacy rather than fundamentally altering the economic relationship between the U.S. and South Korea.

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<sup>32</sup> Beneficiary items are those items that are covered by the U.S.-Korea FTA and have seen their tariff or other benefits begin to be implemented. Non-beneficiary items are

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those items that are either not covered by the FTA, such as goods that are already duty free under prior agreements such as the World Trade Organization's Information Technology Agreement, or that are set to have benefits from the agreement phased in at a later date.

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<sup>46</sup> Current Obama Administration officials such as Ben Rhodes and former officials such as Wendy Sherman have suggested that the United States needs to utilize the Iran approach when dealing with North Korea, and Sherman has said that the leadership in North Korea must realize that the choice is between the regime's survival and its nuclear program. These comments are likely in line with the approach a Clinton administration



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might take. It is less clear how a Trump administration would handle North Korea and how South Korean efforts at engagement with Pyongyang would be received. Wendy Sherman's remarks at CSIS on this topic can be found here:

<https://www.csis.org/analysis/honorable-wendy-r-sherman-luncheon-address-joongang-csis-forum-2016>, while Ben Rhodes can be found here:

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