

# Center for Agricultural Policy and Trade Studies North Dakota State University

# NEWSLETTER

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## U.S. Free Trade Agreement with Korea: Implications for Agriculture

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The United States concluded free trade negotiations with the Republic of Korea on April 1, 2007. A free trade agreement (FTA) with Korea would be the largest U.S. free trade pact since the North American Free Trade Agreement (NAFTA) of 1994. Although the United States has a growing trade deficit with Korea, it has maintained a trade surplus for agricultural products. U.S. agricultural exports to Korea totaled \$2.8 billion in 2006, and the trade surplus with the country was \$2.6 billion. U.S. agricultural exports to Korea, which have ranged between \$2 billion and \$3 billion in most years, have been rather stagnant over the last 15 years. Exports of many products are below the highs reached in the mid 1990s, but the country remains an important market for U.S. exports. Korea ranked as the fifth largest market for U.S. agricultural exports in 2006. Meanwhile, Korea has not been a significant supplier of U.S. agricultural imports. Agricultural imports from Korea have slowly been increasing, from \$64 million in 1990 to \$217 million in 2006, but are still quite small.

The major U.S. agricultural exports to Korea include beef, corn, soybeans, cowhides, wheat, cotton, and pork (Table 1). Other exports include poultry meat, oranges, and dairy products. Exports of pork products increased significantly in 2005 and 2006 while beef exports stopped entirely. Beef had been the top U.S. agricultural export to Korea in terms of value prior to the country's ban following the discovery of BSE in the United States in December 2003. Beef accounted for a quarter of U.S. exports to Korea in 2003, and the country also represented about a quarter of the U.S. export market for beef.

The trade agreement with Korea will likely have a more significant impact on U.S. agricultural exports than it will on U.S. agricultural imports because Korean agricultural tariffs and trade barriers are greater than those in the United States, and resource endowments favor exports of agricultural products from the United States to Korea. Table 2 shows current Korean tariffs on a number of agricultural products and the time by which they will be duty-free under the FTA. Wheat, corn, soybeans, and cotton, among other commodities, will be duty-free immediately. These are major exports to Korea, but the elimination of the tariffs may have only a minor impact on trade since the current duties in place are already low for most of these commodities. Table 2 indicates a high tariff on corn, but Korea administers a tariff rate quota (TRQ) for corn, and this

Table 1. U.S. Agricultural Exports to Korea

	Export Value (million dollars)						Export Quantity (thousand metric tons)					
	Corn	Soybeans	Wheat	Cotton	Beef	Pork	Corn	Soybeans	Wheat	Cotton	Beef	Pork
1991	178	240	209	359	177	4	1,530	1,059	1,649	214	49	2
1992	203	246	235	348	212	3	1,803	1,103	1,481	242	55	1
1993	49	247	228	298	151	2	454	1,011	1,516	218	39	1
1994	254	225	227	313	227	6	2,471	925	1,503	213	60	3
1995	1,095	336	260	361	321	27	8,844	1,421	1,461	198	91	12
1996	1,256	437	328	257	244	24	7,964	1,536	1,613	138	71	9
1997	447	372	226	224	292	26	3,397	1,249	1,333	127	90	9
1998	463	304	212	267	142	19	4,393	1,280	1,479	165	53	9
1999	572	227	210	65	331	35	6,045	1,188	1,664	49	106	18
2000	203	266	181	96	477	28	2,294	1,375	1,567	74	137	13
2001	276	219	173	161	361	22	3,068	1,180	1,327	128	131	12
2002	79	247	187	103	610	38	826	1,186	1,237	103	213	21
2003	42	282	205	146	749	75	371	1,070	1,304	112	213	27
2004	542	285	231	157	0	48	4,329	864	1,430	108	0	22
2005	234	199	185	154	0	136	2,175	760	1,180	127	0	61
2006	718	113	188	103	0	212	6,044	440	1,132	74	0	94

is the over-quota tariff. The in-quota tariff is zero or close to zero, and Korea has been keeping the quota level high enough to meet the import demand. The tariff restrictions, similarly, are already low for wheat and cotton. The agreement could have a more significant impact on U.S. soybean exports. The immediate elimination of duties on soybeans and the phase out of soybean oil tariffs will give U.S. exporters an advantage over South American soybean exporters. The agreement does not eliminate duties on food-grade soybeans, but it creates a 10,000 metric ton duty-free TRQ immediately, which will increase to 25,000 metric tons in year 3 and then increase 3% each year after. The above-quota duty for food-grade soybeans, though, will remain at the prohibitive 487%.

Exports of meat products could benefit the most from the free trade agreement. Korea has high tariffs for meat products, and demand for these products in the country is growing. The growth of the Korean economy has led to a shift in consumer dietary patterns. Korean per capita consumption of rice continues to decline while consumption of wheat-based products, meats, and fruits increase. However, Korean beef duties will be phased out over a 15-year period, so the benefits to U.S. exports will not be seen immediately. Similarly, the duties on pork and poultry meats will be phased out over periods of 7 to 12 years. The agreement also does not address Korea's restrictions on imports of U.S. beef products stemming from the U.S. BSE discovery. Korea's main crop, rice, was excluded from the agreement. The Korean rice industry is protected under a quota system under the WTO. Korea could become a significant market for U.S. rice exports if the quota level was increased, but this agreement does not increase access to the Korean rice market.

In summary, this agreement could benefit U.S. agriculture, though the short-term impacts may be small. The benefits could be greater in the long run as duties on beef and other meat products are eliminated. U.S. agricultural imports from Korea would not likely increase significantly under trade liberalization because U.S. agricultural tariffs are lower, and Korea does not have the production capacity to be a significant exporter of agricultural products to the United States.

Table 2. Korean Agricultural Tariffs

Product	Current rate (%)	Years until duty-free
Beef	40	15
Pork	22.5-25	7
Poultry meat	18-20	7-12
Wheat	1.8	Immediately
Durum	3	Immediately
Maltng barley	513*	15
Other barley	317*	15
Corn for feed	328*	Immediately
Wheat flour	4.2	5
Soybeans	487*	Immediately
Soybeans for human consumption	487*	Quota established**
Canola	10	Immediately
Sunflower seeds	25	2
Soybean oil	5.7	5-10
Sunflowerseed oil	10	5
Canola oil	10-30	5-10
Soybean meal	1.8	Immediately
Peas, beans	20	5
Cow hides	2	Immediately
Cotton	1	Immediately
Oranges	50	Quota increases**

\*Over-quota duties.

\*\*Over-quota duties will remain in place.

Exchange Rate Sensitivity of the U.S. Bilateral Agricultural Trade

Jungho Baek and Won W. Koo

The United States has been a net exporter of agricultural products for several decades. During the first half of the 1990s, for example, U.S. agricultural exports increased by more than \$20 billion, from \$39 billion in 1990 to \$60 billion in 1996. In contrast, U.S. agricultural imports were fairly stable during the same period, ranging from \$23 billion in 1990 to \$33 billion in 1996. As a result, the agricultural trade surplus reached a record high of \$27 billion in 1996, a 62% increase over the trade surplus in 1990. However, since 1996, this trend has reversed as a result of the rapid growth of U.S. agricultural imports relative to exports. Over the last ten years, U.S. agricultural imports have nearly doubled, from \$34 billion in 1996 to \$65 billion in 2006. Meanwhile, U.S. agricultural exports decreased in the late 1990s to \$48 billion in 1999 and has since increased to a high of \$71 billion in 2006. Consequently, the agricultural trade surplus shrunk to a low of \$4 billion in 2005, down 85% from 1996 (Figure 1).

Canada, Mexico, the EU, and Japan account for approximately 56% of U.S. agricultural exports and approximately 60% of U.S. agricultural imports (Table 3). The U.S. agricultural trade balance with the EU has significantly deteriorated since 1996. For example, a \$2.7 billion trade surplus with the EU in 1996 became a \$6.5 billion trade deficit in 2005. Over the same period, the U.S. agricultural trade balance with Mexico has been relatively stable, while the trade balance with Japan and Canada has declined. For example, a \$10.1 billion trade surplus with Japan in 1997 decreased to approximately \$7.4 billion in 2004. In addition, the trade balance with Canada declined more than a billion dollars and became a \$1.3 billion trade deficit in 2000, though it has since increased. Notably, consumer-oriented products account for more than 60% of U.S. imports from Canada, Mexico, and the EU during the 2000-2005 period, while both bulk commodities and consumer-oriented products comprise significant shares of U.S. exports to Japan, Mexico, and the EU.

Agricultural economists have long recognized the importance of exchange rate influence on agricultural export volume and/or prices. Little attention has been paid to directly investigate dynamic relationships between exchange rate changes and the agricultural trade balance. In this study, therefore, we examine the short- and long-run effects of exchange rate changes on agricultural exports and imports at the bilateral level between the United States and its ten largest trading partners. A better understanding of the dynamic relationship between exchange rate fluctuations and the trade balance is particularly important

and the simultaneous decline in the U.S. agricultural trade value of the U.S. dollar dropped by 23%, 24% and 12% against , respectively.

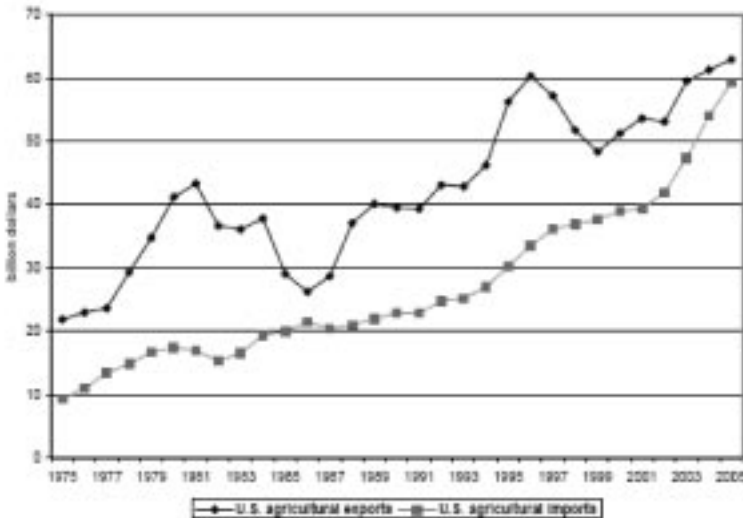


Figure 1. U.S. Agricultural Exports and Imports

We find that, in the long-run, while U.S. agricultural exports are highly sensitive to both the exchange rate and foreign income, U.S. agricultural imports are mostly responsive to the domestic income. In the short-run, on the other hand, both the exchange rate and income in the U.S. and the trading partners are found to have significant effects on U.S. agricultural exports and imports.

An important implication of our findings is that depreciation of the U.S. dollar can improve the trade balance. Another important implication is that, because of the effect of domestic income on U.S. imports is larger than that of foreign income on U.S. exports, economic growth in the United States is the most significant factor affecting the U.S. trade balance. This further provides some clues

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for understanding the recent deterioration of the U.S. agricultural trade surplus since the mid-1990s. The rising relative income in the United States due to the remarkable economic expansion in the late 1990s enabled U.S. consumers to purchase more foreign agricultural goods, particularly processed products, which could be a major reason for the slow growth of U.S. agricultural exports relative to U.S. agricultural imports.

### **Recent Publications**

*An Analysis of the Permanent Emergency Agricultural Assistance*, by Richard D. Taylor and Won W. Koo, Agricultural Policy Brief No. 13, March 2007.

*Analysis of the USDA's 2007 Farm Bill Proposal*, by Richard D. Taylor and Won W. Koo, Agricultural Policy Brief No. 14, April 2007.