A Case of Politics over Economics:
Renewed Canada-Korea Trade Negotiations

Briefing Kit, January 2014

Total Canada-Korea Trade:

Canada consistently imports much more from Korea, than we export there. The result is a large, chronic trade deficit – that corresponds to lost sales, and lost jobs, for Canadians. In 2012 we sold $3.7 billion worth of exports to Korea. But we imported $6.4 billion from Korea. The result was a trade deficit of almost $3 billion. In 2013 (based on preliminary data) things got worse. Our exports fell, and our imports grew – and the deficit swelled to almost $4 billion.

It's not just the quantity of trade that is the problem, it's also the composition (or quality) of trade. We purchase from Korea a wide range of high-tech, expensive manufactured goods: appliances, electronics, and cars. Especially cars. In fact, automotive products make up almost half of our total imports from Korea (and the Korean government's primary interest in a trade deal is to increase Korean auto sales here even further).

However, our sales back to Korea (such as they are) consist primarily of natural resource products. Our top four exports to Korea in 2013 were coal, copper, aluminum, and wood pulp. (Our top four imports were motor vehicles, integrated electronic circuits, automotive parts, and smart phones.) Through our entire history as a country, Canadians have learned the hard way that exporting raw resources, in return for imports of expensive value-added products, is no way to build a country. Our trade with Korea typifies Canada's subservient status as a resource supplier in world trade. Worse yet, by opening up our market even further to imports of Korean manufactures, and constraining government's ability to manage trade and ensure it is balanced, a free trade deal will only make things worse.

Canada-Korea Automotive Trade:

Korean-based automakers (primarily Hyundai and its subsidiary Kia) have dramatically expanded their sales in Canada's new vehicle market in recent years. Hyundai and Kia captured 12 percent of Canada's strong total vehicle sales last year. Most of their vehicles are imported from Korea (and the rest are made in the U.S.). No Korean automaker has manufacturing operations in Canada, so every new sale just makes the trade deficit bigger.

Total automotive imports from Korea equalled $2.6 billion in 2012 (mostly finished vehicles, but also including $364 million of Korean-made auto parts). We imported close to 100,000 new vehicles from Korea. In contrast, Canada sells almost no automotive products in Korea. Finished vehicle sales are almost non-existent (blocked by non-tariff barriers, Korean consumer loyalty to domestic-made brand names, taxes and regulations, and currency misalignments). We sold less than 100 Canadian-made vehicles in Korea in 2012, with a total value of $2 million. Parts shipments equaled $10 million. In total, Korea sold $200 worth of automotive products in Canada, for every $1 that Canada sold in Korea. The resulting automotive trade deficit ($2.6 billion) accounts for over two-thirds of Canada's overall trade deficit with Korea (see Table 1).

In 2013, things got worse. Our already puny finished vehicle exports to Korea fell by another two-thirds (and totaled less than $1 million), while our auto imports from Korea continued to grow (by another 6.5 percent in the first 11 months of 2013, the most recent data available). Based on statistics from January through November, it looks like the final 2013 auto deficit will come in above $2.7 billion – the highest in history (see Table 2).

Korea's State-Managed Economic Strategy:

It is important to note how Canada-Korea trade has changed since the 1997 East Asian financial crisis, which was a landmark event in Korea's economic history. When the crisis hit, Canada-Korea trade was balanced. In fact, Canada actually had a tiny surplus (equal to $200 million). Auto trade flowed both ways: we exported $165 million in automotive products, enough to offset about two-thirds of our automotive imports from Korea. So the resulting auto deficit was small.

In the aftermath of the 1997 crisis (caused by a speculative attack by global financiers on the currencies of several East Asian economies), Korea adopted a different path. They emphasized rapid growth in exports to create demand and support job-creation. Government provided important support (capital, technology, infrastructure, export assistance) to giant Korean firms and conglomerates. But at the same time, they strictly controlled access to their own domestic market (to reduce the loss of purchasing power through imports).

Canadian exports to Korea fell after the crisis. In fact, from 1997 through 2012, Canada's automotive exports to Korea declined over 90 percent. But Korean exports boomed. Korea's auto sales to Canada have grown tenfold in the same time. From a small manageable auto trade deficit in 1997, the imbalance has swelled to enormous levels (Figure 1).

The Korean strategy leaves little to chance. A powerful alliance between government and Korean corporations works to support made-in-Korea investment, technology, production, and exports at every turn. Every possible policy measure is invoked to give Korean firms an edge, at home and abroad: capital subsidies, infrastructure investments, technology assistance, effective restrictions on imports, active efforts to suppress the exchange rate (to stimulate more exports), export promotion, and more.

The result has been successful (for Korea), but has nothing to do with “free trade,” “free competition,” or “free markets.” There is little chance that even after signing a free trade agreement, Korea will purchase anything substantial from Canada other than our resource products. Yet tariff elimination and restrictions on government intervention will facilitate an even larger inflow to Canada of sophisticated manufactured goods from Korea.

Canada has much to learn from the successful experience of Korea (and other export success stories, which also rely on active state involvement and industrial policy – like Brazil, Germany, Scandinavia, China, and Japan). Instead of leaving private markets and private business alone to determine the whole nation’s economic destiny, we need active policies (especially in strategic sectors like auto) to encourage domestic investment, domestic content, and domestic jobs. However, given Korea’s effective state-managed approach, it is naïve to hope that merely eliminating tariffs and enforcing other “hands-off” measures will somehow open up Korea’s markets and produce a balance, mutually beneficial trade flow. Without our own active industrial strategies in place, and without safeguards to ensure that trade is balanced and two-way, free trade with Korea can only lock in the existing, destructive imbalance.

Previous research by the CAW estimated that a free trade agreement with Korea would result in the loss of up to 33,000 Canadian manufacturing jobs (including as many as 4,000 jobs in auto assembly and auto parts).

The U.S. and European Experience:

It is important to review the experience of the world’s two biggest economies, following their implementation of free trade deals with Korea. The U.S. signed a deal that was implemented in March 2012. The EU implemented a trade pact with Korea in July 2011. In both cases, Korea’s export surplus widened substantially after the respective deals. Korean firms, backed actively by their government’s economic strategy, used free trade liberalization to push more Korean-made exports into these two enormous markets – but with very little offsetting expansion in imports into Korea.

Keep in mind that both the U.S. and EU automakers had advantages regarding trade with Korea that will not accrue to Canadian-based producers. In the European case, worldwide demand among the wealthy for marquee luxury European automobiles (such as Mercedes, BMW, Audi, etc.) ensured there would be a natural (if limited) market for those products within Korea after a free trade deal made them (modestly) more accessible to well-off Koreans. But that luxury brand recognition does not apply to most Canadian-made vehicles. In the case of U.S.

automakers, President Obama negotiated some special, far-reaching measures governing automotive trade – including unique safeguards against a surge in auto imports from Korea, and an unprecedented "snapback" provision (whereby U.S. tariffs could be reimposed if Korean non-tariff barriers continued to limit U.S. auto exports back to Korea). Almost certainly, these provisions will not exist in any Canada-Korea deal (because the Korean negotiators feel much less pressure, given the Canadian government's obvious willingness to reach a deal, any deal). Given the likely inferior terms of a Canada-Korea trade deal, the outcome for Canada's auto industry will certainly be even worse.

Despite those special advantages, auto trade unfolded in a very lopsided manner after the respective U.S. and EU trade deals with Korea were implemented. For the U.S., automotive imports from Korea increased by $4.5 billion (U.S.) by 2013, compared to 2011 (the last full year before the trade pact was implemented). In contrast, American auto exports to Korea grew by just $200 million (U.S.) in the same period (parts exports actually declined). In other words, Korean producers got 22 times as much advantage from new trade access, as did American producers. As a result, the U.S.-Korea automotive trade deficit widened by over $4 billion, to an estimated $16.5 billion for 2013 (see Table 3). This outcome was consistent with the overall pattern in U.S.-Korea trade after free trade. Total goods exports from the U.S. to Korea actually declined between 2011 and 2013, while imports from Korea grew substantially (see Table 4). The result was a widening of the bilateral merchandise trade deficit by almost two-thirds (or over $8 billion). That negative result occurred even as the U.S. was substantially improving its trade performance (and reducing its trade deficit) with other countries.

In Europe's case, too, the bilateral trade deal with Korea sparked a much larger inflow of new imports from Korea, than new auto sales by European firms in Korea. New imports from Korea were twice as large (in value terms) as new European exports to Korea – and over three times as large in terms of numbers of units shipped. (Since European luxury cars are more expensive on average than Korean vehicles, a larger flow of revenue can be generated from a given number of vehicles – hence the imbalance in value terms was not as large as the imbalance in units.) In Europe's case, too, the deal produced a significant widening of the bilateral auto trade deficit – despite the unique global strength of European luxury vehicles, and their consequent ability to penetrate the Korean market. Moreover, the surge in vehicle imports from Korea occurred at a time when sales of new vehicles within Europe were weakening dramatically (as a result of continuing economic and financial instability during these years); this should have served to weaken European imports.

It is worth noting that the EU's entire bilateral auto trade deficit with Korea, while growing rapidly, is actually smaller in absolute terms than Canada's bilateral auto trade deficit with Korea (even though Europe's economy is roughly ten times as large as ours). Yet European automakers have complained loudly to their governments about the negative effects of the Korea deal on their own industry. U.S. automakers have also spoken out publicly about the failure of the Korea deal to live up to its promises. Proportionately, Canada's auto industry will be hurt much worse by free trade with Korea than was either the U.S. or the EU. That makes it all the more perverse for our government to rush into a deal with Korea, given these negative precedents.

Politics over Economics:

How do we make sense of the Harper government's sudden rush to finalize a trade pact with Korea? Several years ago, the government tried to reach a deal with Korea, but failed – in part due to strong opposition from the Canadian auto industry and other important domestic constituencies. Then the negotiations languished on the back burner for several years. Now, suddenly, the federal government is trying to finalize a deal quickly. This will likely involve making significant concessions to Korean demands for more rapid tariff elimination in autos and other key "offensive interests," as well as giving up Canadian efforts to win U.S.-style safeguards (including "snap-back" provisions).

By rushing to seal a deal at almost any cost, the Harper government has elevated its political ambitions above Canada's interest in trade arrangements that would actually benefit Canada's economy. First, a final deal with Korea would help the government's effort to "change the channel" from scandals and other political problems that dogged it for the last year – and which threaten its re-election chances. The government hoped that the "agreement in principle" with Europe would do that, but it hasn't worked. After all, that deal is not even finalized yet; the big "signing ceremony" last autumn was all about political optics. Moreover, the CETA has not become the "wedge" issue between the Conservatives and opposition parties that the Harper strategists hoped for. So they have decided that having a second deal in hand (one that is actually completed, and one that the opposition parties may actually oppose) fits the Conservatives' strategic goals.

Another possible political motivation stems from the bleeding of active support which the Conservatives have experienced from their rural, conservative political base in the wake of the Senate scandal and other disillusionments. This explains why the government is putting so much emphasis on the Korea deal's potential in securing access for Canadian beef exports. In the first place, those benefits are likely overstated. It remains to be seen whether Korea would truly open up to Canadian beef exports, given so many false starts (and false promises) in the past. But the economic importance of Canada's beef exports to Korea is modest, compared to other sectors. Bilateral trade in automotive products is more than ten times as large as bilateral trade in meat products. The expected expansion of Korean automotive sales in Canada would vastly outweigh (in aggregate dollars) any possible expansion of Canadian beef sales going the other way.

What is important here, however, is not the *amount* of beef exports produced – it is *who* produces it. Signing a deal to improve the beef industry's access to Korea (beef producers have complained loudly about being disadvantaged by the U.S.-Korea deal) would be an important victory for a once-loyal Conservative constituency. Perhaps that is the political calculus behind the "cars for beef" trade-off which the federal government seems willing to make. At any rate, sacrificing further damage to Canada's auto industry for a modest increment in beef sales (and a handful of other resource-based exports) is a trade-off that badly damages our long-run development and diversification.

The Alternative:

A NAFTA-style free trade deal with Korea would cement our current unbalanced trade relationship with that country, lead to a substantial net inflow of high-value manufactured goods (most importantly, automotive products), and undermine production, profits, and future investment in Canadian industries which compete with those imports (again, most importantly, automotive products). We reject the fundamental starting point of NAFTA-style trade deals, which curtail government's ability to manage trade and investment flows, provide corporations with unique and undemocratic access to special judicial powers, and undermine the ability of working people to win a share of future prosperity.

We believe that expanded trade and other economic links with Korea could be very positive, but only under very different rules:

- Tariff reduction must be tied to measurable targets in reducing bilateral trade imbalances in strategic sectors (such as auto).
- As a condition of their tariff-free access to Canadian markets, large Korean firms (such as Hyundai/Kia) should be required to invest in made-in-Canada production facilities, including vehicle assembly operations.
- Government must retain the ability to intervene directly to moderate damaging trade imbalances.
- The trade agreement should contain provisions regarding currency misalignment – including the right to utilize trade policy levers to offset efforts by one jurisdiction to suppress its currency.

Failing these important conditions, the auto sector should be excluded from any bilateral trade agreement between Canada and Korea.

Table 1
Canada-Korea Automotive Trade
1997-2012, $Millions

	1997	2002	2007	2012	Change 1997-2012
Exports to Korea					
Vehicles	$5.5	$6.0	$1.7	$2.0	-64.3%
Parts	$159.2	$6.9	$7.6	$10.5	-93.4%
Total	$164.7	$12.9	$9.3	$12.5	-92.4%
Imports from Korea					
Vehicles	$198.6	$1,291.4	$1,474.8	$2,223.7	1019.7%
Parts	$34.6	$87.2	$200.0	$364.1	951.5%
Total	$233.2	$1,378.6	$1,674.9	$2,587.7	1009.6%
Balance					
Vehicles	-$193.1	-$1,285.4	-$1,473.1	-$2,221.7	
Parts	$124.6	-$80.3	-$192.4	-$353.5	
TOTAL	**-$68.5**	**-$1,365.7**	**-$1,665.6**	**-$2,575.3**	
Ratio of Imports to Exports	1.4	106.9	180.2	207.4	
Source: Unifor Research from Industry Canada, Strategis Database.					

Table 2 Canada-Korea Automotive Trade *2013 Year-to-Date Change and Forecasts, $Millions*		
	YTD Change in 2013 (Jan-Nov)	**2013 Full-Year Forecast**
Exports to Korea		
Vehicles	-63.2%	$0.7
Parts	35.6%	$14.3
Total	19.3%	$14.9
Imports from Korea		
Vehicles	1.0%	$2,245.9
Parts	41.2%	$514.0
Total	6.5%	$2,755.9
Balance		
Vehicles		-$2,245.2
Parts		-$499.8
TOTAL		**-$2,745.0**
Source: Unifor Research from Industry Canada, Strategis Database.		

Table 3
U.S.-Korea Automotive Trade
2010-2013, $Millions

	2010	2011	2012	Projected 2013*	Change 2011-2013
Exports to Korea					
Assembly	$399	$436	$645	$677	$242
Parts	$371	$650	$545	$614	-$36
Total	$770	$1,086	$1,190	$1,291	$206
Imports from Korea					
Assembly	$6,551	$8,613	$10,622	$11,758	$3,145
Parts	$3,550	$4,557	$5,572	$5,998	$1,441
Total	$10,101	$13,170	$16,193	$17,756	$4,587
Balance					
Assembly	-$6,152	-$8,177	-$9,977	-$11,081	-$2,903
Parts	-$3,179	-$3,907	-$5,026	-$5,384	-$1,477
TOTAL	**-$9,331**	**-$12,084**	**-$15,004**	**-$16,465**	**-$4,381**

Source: Unifor Research from US Census Bureau data.
* Projected based on ten months' data Jan.-Oct. 2013.

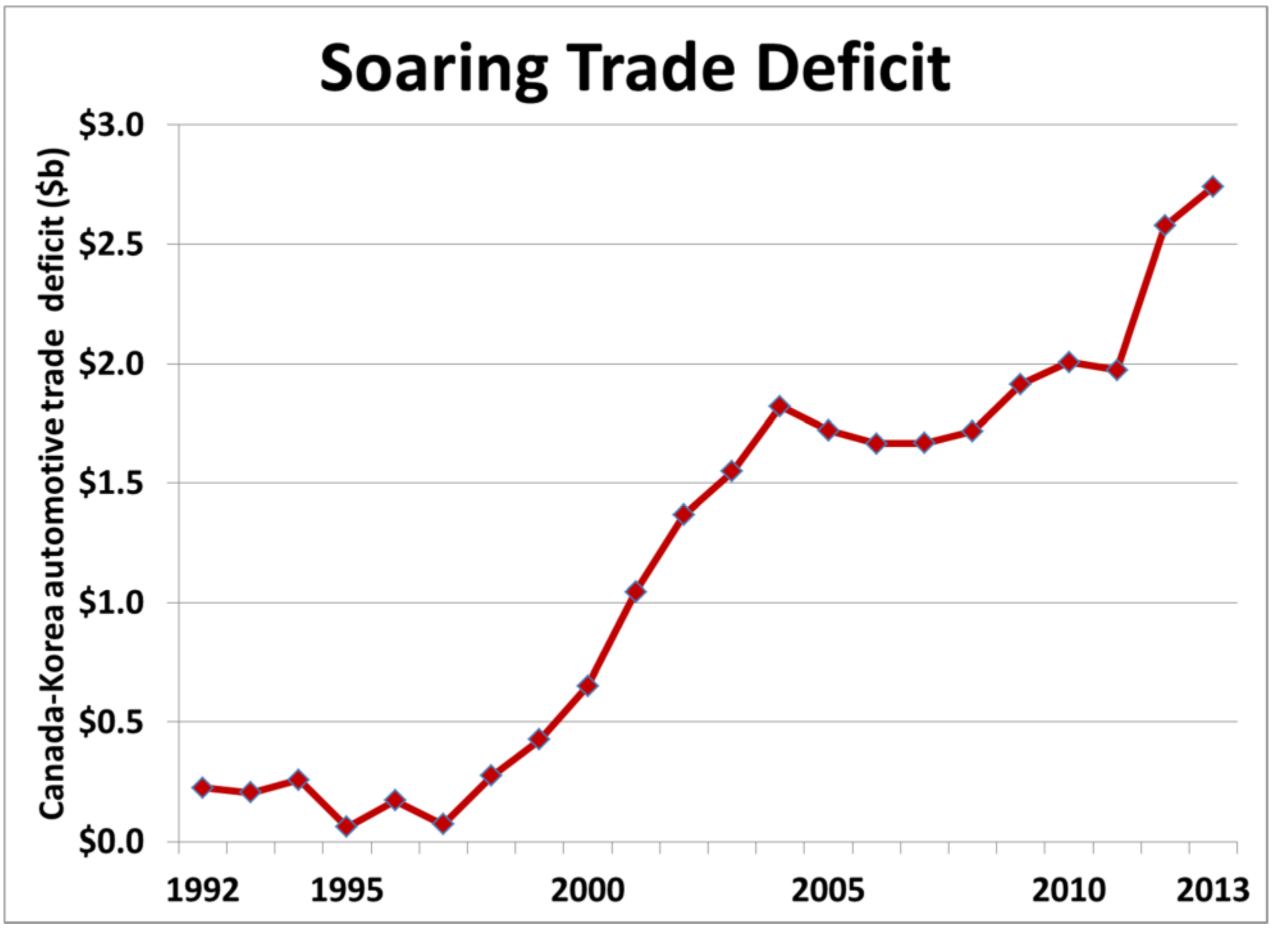
Table 4
U.S.-Korea Manufacturing Trade
2010-2013, $Billions

	2010	2011	2012	Projected 2013*	Change 2011-2013
Exports	$38.8	$43.4	$42.3	$41.0	-$2.4
Imports	$48.9	$56.7	$58.9	$62.7	$6.1
BALANCE	**-$10.1**	**-$13.3**	**-$16.6**	**-$21.7**	**-$8.4**

Source: Unifor Research from US Census Bureau data.
* Projected based on 11 months' data Jan.-Nov. 2013.

Table 5 EU-Korea Finished Vehicle Trade *2010-2012, $Millions (US) and Number*								
	2010		2011		2012		Change, 2010-12	
	Value	Vehicles	Value	Vehicles	Value	Vehicles	Value	Vehicles
Exports to Korea	$2,224	64,170	$2,717	75,189	$3,215	94,674	$991	30,504
Imports from Korea	$3,284	297,770	$4,772	386,611	$5,046	406,698	$1,762	108,928
BALANCE	-$1,060	-233,600	-$2,055	-311,422	-$1,831	-312,024	-$771	-78,424
Source: Unifor Research from Global Trade Atlas. Includes harmonized product codes 870321-870324, 870331-870333, and 870390.								

Figure 1



Source: Unifor Research from Industry Canada, Strategis database.