President Obama and his predecessors have frequently claimed that free trade agreements (FTAs) and other trade deals will lead to growing exports and domestic job creation. The president is currently negotiating two massive new FTAs that are likely to result in increased outsourcing and growing job losses, especially in the manufacturing sector. This paper reviews recent data on trade with South Korea after the U.S.-Korea Free Trade Agreement (KORUS) took effect, and on trade flows after other free trade agreements. It concludes:

- Claims that trade deals increase exports and create jobs are based on flawed trade models, and on distorted and one-sided interpretations of the findings of those models.

- The flaws in trade models are exemplified in the U.S. International Trade Commission’s estimate that KORUS would increase U.S. goods exports by roughly $10 billion to $11 billion after fully phased in. This estimate focused solely on the impact of tariff cuts on exports, leaving out the effect of changes in foreign direct investment, outsourcing, and all of the other outcomes from trade deals provisions that impact trade flows.

- The USITC also estimated that imports from Korea would increase by about $6 billion to $7 billion, and that the U.S. trade balance with South Korea would improve by about $4 billion to $5 billion. In the year after KORUS took effect, U.S. domestic exports to South Korea actually fell $3.5 billion. Projections for 2013 suggest no reversal of this trend.
The tendency to distort trade model results was evident in the Obama administration’s insistence that increasing exports under KORUS would support 70,000 U.S. jobs. The administration neglected to consider jobs lost from the increasing imports and a growing bilateral trade deficit. In the year after KORUS took effect, the U.S. trade deficit with South Korea increased by $5.8 billion, costing more than 40,000 U.S. jobs. Most of the 40,000 jobs lost were good jobs in manufacturing.

There was also a big gap between predictions and outcomes for the North American Free Trade Agreement enacted in 1994: NAFTA was supposed to create 200,000 new jobs through increased exports to Mexico but, by 2010, growing trade deficits with Mexico had eliminated 682,900 U.S. jobs, with job losses in every U.S. state and congressional district.

Given the big gaps between promised and actual outcomes, the United States should stop negotiating trade deals and fix the ones we have.

Meanwhile, officials should insist that the U.S. International Trade Commission develop trade and investment models that more accurately estimate the effects of FTAs on trade, foreign investment, employment, wages, and the distribution of income, and that they fairly consider the effects of FTAs on both exports and imports, and their impacts on the economy. It is time to shatter once and for all the illusion that FTAs are only about exports.

Trade and jobs under the U.S.-Korea Free Trade Agreement

When the U.S.-Korea Free Trade Agreement was completed in 2010, President Obama said that it would increase U.S. goods exports by “$10 billion to $11 billion,” supporting “70,000 American jobs from increased goods exports alone” (The White House 2010). He based this claim on estimates from the U.S. International Trade Commission that tariff cuts alone in KORUS would stimulate U.S. exports to South Korea, supporting the president’s goals of doubling U.S. exports in five years, and adding 1 million new manufacturing jobs.

Things are not turning out the way the president predicted. KORUS took effect March 15, 2012. In the year after the agreement took effect (April 2012 to March 2013), U.S. domestic exports to South Korea (of goods made in the United States) fell $3.5 billion, compared with the same period in the previous year, a decline of 8.3 percent. In the same 12-month period, imports from South Korea (which the administration consistently declines to discuss) increased $2.3 billion, an increase of 4.0 percent, and the bilateral U.S. trade deficit with South Korea increased $5.8 billion, a whopping 39.8 percent. Estimates for 2013 suggest no reversal in these trends, as discussed later in this paper.

The administration is now negotiating a Trans-Pacific Partnership (TPP) that could include more than a dozen nations in the Asia-Pacific region (Office of the United States Trade Representative 2013d) including Malaysia, Vietnam, Japan, and South Korea (Hyun, Yeon-cheol and Jeong-hun 2013). Recently, China said that it was studying the possibility of joining the TPP talks (Bangkok Post 2013). Many members of the proposed agreement have long histories of currency manipulation (Scott 2013b), dumping, and other unfair trade practices that have dramatically increased U.S. trade deficits and job losses, and the agreement could sharply curtail the ability of the United States to challenge these practices. The TPP would significantly increase the threat that rapidly growing trade deficits and job losses in the United States would be locked in if the TPP is completed.

When it comes to trade, the issue is simple: Increased exports support U.S. jobs and increased imports cost U.S. jobs (Scott 2013c). Thus, it is trade balances—the net of exports and imports—that determine the number of jobs created or displaced by trade agreements. Unless trade agreements promise to reduce our too-high trade deficit, they will not have a net positive effect on U.S.
employment. Rather than reducing trade deficits, past trade agreements have actually been followed by larger trade deficits.

This is not some radical stance on trade—it is textbook economics.

Nobel-prize winning economist and New York Times columnist Paul Krugman responded to claims that KORUS could fuel a recovery by noting that trade agreements are on average “a wash” (Krugman 2010). Specifically, in macroeconomic terms the United States had too little spending on domestically-produced goods and services, with total spending (Y) defined as:

\[ Y = C + I + G + X - M \]

Where C is consumer spending, I is investment spending, G is government purchases of goods and services, X is exports, and M is imports.

While trade agreements lead to higher X, they also lead to higher M, Krugman wrote. Exports support demand for domestically produced goods, so higher X increases employment. However, the growth of imports reduces demand for domestically produced goods, which reduces domestic employment.

Using the president’s own formula relating changes in trade to jobs, the growth in the trade deficit with South Korea in the first year since KORUS took effect likely cost more than 40,000 U.S. jobs, most of them good jobs in the manufacturing sector because most traded goods are made by manufacturing industries. These losses are small when compared with the effects of the sequester, repeal of the payroll tax cuts, and other spending cuts that Congress allowed to take effect in 2013; these cuts have probably reduced GDP growth by about 1.5 percentage points this year (Bivens 2013a). But, taken together, austerity policies and the growing U.S. trade deficit with South Korea help explain why GDP and employment growth have slowed dramatically in 2013, and why manufacturing employment has declined steadily from a peak in February, falling through June 2013—a decline of 24,000 jobs in that period (Bureau of Labor Statistics 2013).

**No sign of an impending turnaround in U.S.-South Korea trade**

There is no evidence of a turnaround ahead in U.S.-South Korea trade. Looking ahead to projected full-year trade for 2013 (based on year-to-date trade through May) the trends so far get even worse, as shown in Figure A. U.S. exports to South Korea are projected to decline 7.3 percent ($2.9 billion) in 2013, while imports are expected to rise 7.7 percent ($4.5 billion), and the trade deficit is on pace to increase this year by nearly half (up 41.3 percent, or $7.4 billion). Unless the domestic economy suddenly improves, growing trade deficits with South Korea and other countries (such as China and Japan) will put additional downward pressure on U.S. manufacturing employment throughout 2013.

Macroeconomics does not explain the divergent trends in exports and imports shown in this figure. GDP growth slowed in both the United States and South Korea in 2011–2012, but the slowdown was steeper in the United States. In 2013, GDP growth is forecast to reach 2.8 percent in South Korea, but only 1.9 percent in the United States according to the International Monetary Fund (2013). Holding everything else constant, faster growth in South Korea should, theoretically, result in rising, and not falling, U.S. exports to that country, and a falling trade deficit.

**Why do forecasters keep getting it wrong?**

For more than two decades, presidents of both parties have claimed that new trade deals would result in rising U.S. exports and new job creation. Bill Clinton (1993) and his supporters claimed in the early 1990s that the North American Free Trade Agreement would create...
200,000 new jobs through increased exports to Mexico.\textsuperscript{7} In fact, by 2010, growing trade deficits with Mexico had eliminated 682,900 U.S. jobs, with job losses in every U.S. state and congressional district (Scott 2011).

The Obama administration claimed that “tariff cuts alone” in KORUS would increase U.S. exports to that country, but it isn’t working out as expected (The White House 2010). The White House cited research by the U.S. International Trade Commission (2010) to back up this claim. The USITC used a sophisticated Computable General Equilibrium (CGE) model to predict the impacts of tariff cuts on U.S. trade in 54 industries (U.S. International Trade Commission 2010, 2-1), and considered the impacts of the agreement on U.S. trade with both South Korea and the world as a whole. But this model focused primarily on projecting the impacts of tariff cuts on trade flows. Since U.S. tariffs are lower than those of most other countries (before FTAs), the model predicted that U.S. exports and at least bilateral trade balances would improve after FTAs take effect. But FTAs cover a lot more than just tariffs.

The White House also seemingly cherry picked export numbers from the USITC study. The USITC report estimated that exports to South Korea would rise in the range of $9.7 billion to $10.9 billion, and Obama, as cited earlier, said KORUS would increase U.S. goods exports by “$10 billion to $11 billion.” But the administration ignored the projected impact of KORUS on imports, specifically, leaving out the USITC prediction that KORUS would increase imports in the range of $6.4 billion to $6.9 billion, producing an improvement of the bilateral trade balance ranging from $2.8 billion to $4.5 billion, not $10 billion to $11 billion as implied by Obama’s comment (U.S. International Trade Commission 2010, Table 2.1 at 2-9). The White House has refused to discuss the negative impacts of imports on the
U.S. economy, and some officials at the Office of the United States Trade Representative have claimed before Congress that imports *benefit* the domestic economy—a highly suspect claim that will be addressed in a future EPI report.

Evaluating trade deals by talking *only* about their impact on exports and ignoring imports is like trying to keep score in a baseball game by counting only runs scored by the home team. It engenders positive feelings but reveals nothing about how well a team is really doing. Talking only about trade deals and exports hides increased imports’ potential damaging effects on the national economy.  

**The ‘lamppost problem,’ or, looking for answers where they cannot be found**

Both FTAs and the China-WTO accession agreement included numerous clauses designed to make those countries safe for U.S. and other foreign investors, to open markets for services and other traditionally nontraded goods, and to secure intellectual property and other investor rights (Scott 2012). But as Lori Wallach of Public Citizen has noted, agreements like KORUS “facilitate offshoring, ban Buy American provisions and erode manufacturing jobs, utterly contradicting the president’s domestic agenda” (Public Citizen 2013).

There are a number of problems with the way the USITC studies the effects of such multifaceted agreements, and the way the USITC studies have been used by President Obama and his predecessors (similar USITC studies were done for most of the 17 other free trade agreements negotiated since NAFTA). A USITC study done for China’s entry into the World Trade Organization (U.S. International Trade Commission 1999) contained spectacularly unrealistic forecasts of the impacts of that agreement.  

The fundamental problem with the USITC model referenced in the president’s support for KORUS is that it is designed to evaluate the effects of tariff changes on trade flows. The structure of this model reflects most economists’ view that tariff cuts are the most important policy changes in FTAs—hence the USITC’s use of its CGE model as its lamppost to forecast the most important “economic effects” of these deals. Tariff-based trade models are the economic equivalent of a lamppost highlighting the ground far from where an inebriated man actually lost his wallet—they shine light on the relationship between tariffs and trade, but they cannot be used to predict the impacts of FTAs on offshoring, on foreign and domestic investment in factories making products for export to the United State and other countries, on other factors affecting trade, investment, and wages that are unrelated to tariff changes.

In the real world, the most important impacts of FTAs, as suggested by Wallach, are on outsourcing. This is reflected in data on foreign direct investment (FDI), a measure of the investment in factories and corporations by U.S. and other foreign multinational corporations (MNCs) to make goods for export from Mexico and China to the United States. Tariff-based CGE models have no ability to forecast the effects of trade agreements on FDI, or the operations of MNCs, including their trade flows. The USITC’s CGE lamppost can shine no light on such questions because it is not designed to evaluate the effects of trade agreements on FDI and MNC operations.

FDI in Mexico nearly tripled, as a share of GDP, in the decade after NAFTA took effect, relative to a similar period before NAFTA, resulting in a huge increase in U.S. imports from Mexico (Scott 2011, Table 1 and Figure B). China is the largest recipient of FDI of all developing countries (Xing 2010) and is the third-largest recipient of FDI over the past three decades, trailing only the United States and the United Kingdom. Foreign-invested enterprises (both joint ventures and wholly owned subsidiaries) were responsible for 52.4 percent of China’s exports and 84.1 percent of its trade surplus in 2011 (Ministry of Commerce, China 2012). Out-
sourcing—through foreign direct investment in factories that make goods for export to the United States—has played a key role in the shift of manufacturing production and jobs from the United States to China since it entered the WTO in 2001. Foreign-invested enterprises were responsible for the vast majority of China’s global trade surplus in 2011. The United States lost 2.7 million jobs due to growing trade deficits with China between 2001 (when that country joined the WTO) and 2011, 76 percent of them in manufacturing industries (Scott 2012).

KORUS is unique in that the results appear to be influenced, in part, by the effects of South Korean MNCs. In the first year under the agreement the U.S. has experienced rapidly rising imports of semiconductors, auto parts and ships from South Korea. These are all products of South Korean conglomerates (chaebol), large family-controlled firms with strong ties to government agencies (Watkins 2013). In 2013, U.S. exports of industrial machinery to South Korea have also fallen sharply, which may reflect competition from Korean firms. These changes help explain growing bilateral trade deficits and job losses.

**No thank you to another poorly evaluated FTA**

Despite the preponderance of evidence that FTAs and other trade deals do not work as expected, and have been harmful to the overall U.S. economy and to manufacturing in particular, President Obama has announced his intention to negotiate two massive new FTAs. The first is the TPP, a pact that could include a dozen countries in the Asia Pacific Region, as described earlier.

In March, the president notified Congress that he intends to negotiate a Transatlantic Trade and Investment Partnership (TTIP) with the European Union (Office of the United States Trade Representative, 2013c). These negotiations began on July 8, 2008 (Office of the United States Trade Representative, 2013b). Although the core of the EU consists of high-income countries with many similarities to the United States, the 27-nation EU also contains many poorer countries from Eastern Europe such as Poland, Bulgaria, the Czech Republic, Estonia, Latvia, and Lithuania. Candidates for EU membership include Serbia and Turkey (European Union 2013), the latter of which is a large exporter and frequent violator of U.S. fair trade laws, especially in steel trade.

If the United States negotiates an FTA with the EU, it could open up Eastern Europe and its Eurasian periphery to FDI, rapidly growing exports to the United States and growing U.S. job losses from trade with those regions. Nonetheless, the EU has confidently predicted that the TTIP will generate gains of 119 billion euros per year for the European Union (545 euros per average household per year) and 95 billion euros per year for the United States (655 euros per average household per year) (European Commission 2013). A much more likely outcome, based on North American experience under NAFTA, is that production workers in all the member countries will suffer falling wages and job losses (Scott et al. 2006), while U.S. and EU investors will profit handsomely, reinforcing the rapidly rising share of profits in corporate and national income that has taken place over the last decade in the United States (Mishel 2013).

Bivens (2007, 2013b) has shown that while the nation as a whole may gain from trade, the benefits are concentrated among college-educated and nonproduction and supervisory workers, and in rising returns to capital. To the extent that the proliferation of FTAs has contributed to the growth in trade, especially with low-wage developing countries, as a share of the economy, FTAs have also contributed to the observed growth in U.S. wage and income inequality. The United States has experienced rapidly growing wage and income inequality over the past three decades (Mishel et al. 2012). As Bivens has shown, structural changes in the U.S. economy, including rapidly growing trade with low-wage less-developed countries are responsible for the rapid rise in wage and
income inequality. These changes have not been accidental; rather they reflect a clear pattern of what Bivens (2011) flags as a “Failure by Design” in his book of the same name.

**The common thread**

FTAs and other trade agreements make it enormously profitable to outsource production to countries such as South Korea and China that use currency manipulation, dumping, and other unfair trade practices to undercut production and wages in the United States. U.S. MNCs, including Apple, Boeing, Dell, Ford, GE, GM, and Intel have also profited enormously from outsourcing to Mexico, China, and other low-wage trade partners under the protection of FTAs and the WTO. The end result is a race to the bottom in wages and working conditions for most members of these agreements (Inequality.is 2013). The United States should stop negotiating FTAs and trade deals and fix the ones we have.

At a minimum, all new FTAs should include labor and environmental standards that are enforceable in the core of the agreements, along with provisions to outlaw currency manipulation. New trade agreements should clearly define currency manipulation and suspend all benefits of membership for any country that manipulates its currency (Scott 2013a). Meanwhile, we should insist that the USITC develop trade and investment models that more accurately estimate the effects of FTAs on trade, FDI, employment, wages, and the distribution of income, and that they fairly consider the effects of FTAs on both exports and imports, and on the economy. It is time to shatter once and for all the illusion that FTAs are only about exports.

_The author thanks Robert Blecker, Celeste Drake, and Ross Eisenbrey for comments and Nicholas Buffie for research assistance._

**Robert E. Scott** is director of trade and manufacturing policy research at the Economic Policy Institute. He joined EPI as an international economist in 1996. Before that, he was an assistant professor with the College of Business and Management of the University of Maryland at College Park. His areas of research include international economics and trade agreements and their impacts on working people in the U.S. and other countries, the economic impacts of foreign investment, and the macroeconomic effects of trade and capital flows. He has a Ph.D. in economics from the University of California-Berkeley.

**Endnotes**

1. Nearly all (98 percent of South Korean tariff cuts and 99 percent of U.S. tariff cuts) would be fully phased in with 10 years (U.S. International Trade Commission 2010, xix), while complete elimination of all tariffs and other trade restraints is phased in over a period of up to 20 years (U.S. International Trade Commission 2010, note 4 at 1).

2. Ten countries have been negotiating terms of the TPP with the United States: Australia, Brunei Darussalam, Canada, Chile, Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam (Office of the United States Trade Representative 2013d). On April 24, 2013, the U.S. Trade Representative notified Congress of its intent to include Japan in the TPP negotiations (Office of the United States Trade Representative 2013d), and it has invited South Korea to participate as well (Hyun, Yeon-cheol and Jeong-hun 2013).

3. It has been shown that the formation of an FTA tends to result in a reduction in antidumping filings, “regardless of facing more imports from FTA partners” (Ahn and Shin 2010).

4. It is important to note that bilateral trade deals can either increase or reduce total U.S. trade with the world as a whole (exports plus imports). If U.S. imports from South Korea were to increase while imports from the rest of the world declined, then the agreement would be “trade diverting,” with no net loss of U.S. jobs. However, that is not the case with U.S.-South Korea trade, as explained later.

5. The U.S. trade deficit with the world as a whole in non-oil goods is on pace to increase by $22.2 billion or 3.5 percent
in 2013, based on year-to-date data through May, relative to 2012 (U.S. International Trade Commission 2013). The U.S. trade deficit with South Korea in non-oil goods is projected to increase $10.6 billion (68.2 percent). Thus, the U.S. trade deficit with the rest of the world in these products, which are dominated by manufactured goods, is projected to increase by $11.6 billion, and KORUS does not appear to be trade diverting, although it will be responsible for nearly half of the growth of the U.S. non-oil goods trade deficit. The U.S. trade deficit in petroleum products is projected to decline sharply in 2013, pulling down the overall goods trade deficit, but oil products do not constitute a significant proportion of U.S.-South Korea trade.

6. Likewise, slower growth in the United States should reduce the rate of growth of imports from South Korea in 2013.

7. See also, Hufbauer and Schott (1993).

8. The U.S. International Trade Commission (2010, Table 2-3 at 2-14) also projected that U.S. exports to the world would increase, on average, by $5.0 billion and that U.S. imports from the world would rise by $5.4 billion, resulting in an increase in the U.S. trade deficit. This result was first noted in a Public Citizen memo in 2011 (Public Citizen 2011).

9. The United States currently has 20 active free trade agreements in place (Office of the U.S. Trade Representative 2013a). FTAs with Israel (1985) and Canada (1989) were negotiated prior to NAFTA, which took effect January 1, 1994. The rest were negotiated since that date.

10. Scott (2010) examines economists’ and USITC’s forecasts of the projected impacts of NAFTA on Mexico trade, and of China’s entry into the WTO, and compares these forecasts with actual outcomes. It uses the results to project expected outcomes of the KORUS agreement five years after it was implemented. It projects the U.S.-South Korea trade deficit would increase by $16.7 billion within five years.

11. Among researchers, the “lamppost problem” refers to the phenomenon of looking for answers where it is convenient to look, rather than where answers can actually be found. It derives from an old joke about an inebriated man who “loses his watch in a dark place but decides to search for it somewhere else where there is a lamppost because the light is better there” (King 2011).

12. FDI also includes taking ownership positions of 10 percent or more in new or existing businesses. Large amounts of FDI in Mexico and China take place in industries such as banking and retail trade which are not trade related. Nonetheless, rapid growth in FDI is associated with rapidly growing exports to and trade surpluses with the United States for these two countries.

References


