Impact of the Chile-South Korea and the EU-South Korea Free Trade Agreements on U.S. Pork Exports to South Korea

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Introduction

The purpose of this report is to project the likely impact of South Korea's free trade agreements (FTAs) with the European Union (EU) and Chile on U.S. pork exports to South Korea. South Korea's FTAs with the EU and Chile will eliminate the 22.5 to 25 percent import duties that South Korea charges on imported pork from other countries, including the United States.

The South Korea-EU FTA has not yet been implemented. However, when it is, South Korean import duties on EU pork will be eliminated over a period ranging from 5 to 10 years. Although South Korea will maintain a safeguard on pork imports from the EU for fresh/chilled pork falling under tariff lines 02031910 and 02031990 during the full 10-year implementation period, the safeguard will not have a serious impact on trade, since South Korea imports almost no fresh/chilled pork from the EU.

South Korea's FTA with Chile was implemented in 2004. Import duties are already being reduced, and South Korean duties on Chilean pork imports will go to zero in 2014. In 2010, South Korea import duties on Chilean pork were 9 to 10 percent based on the FTA tariff reduction schedule.

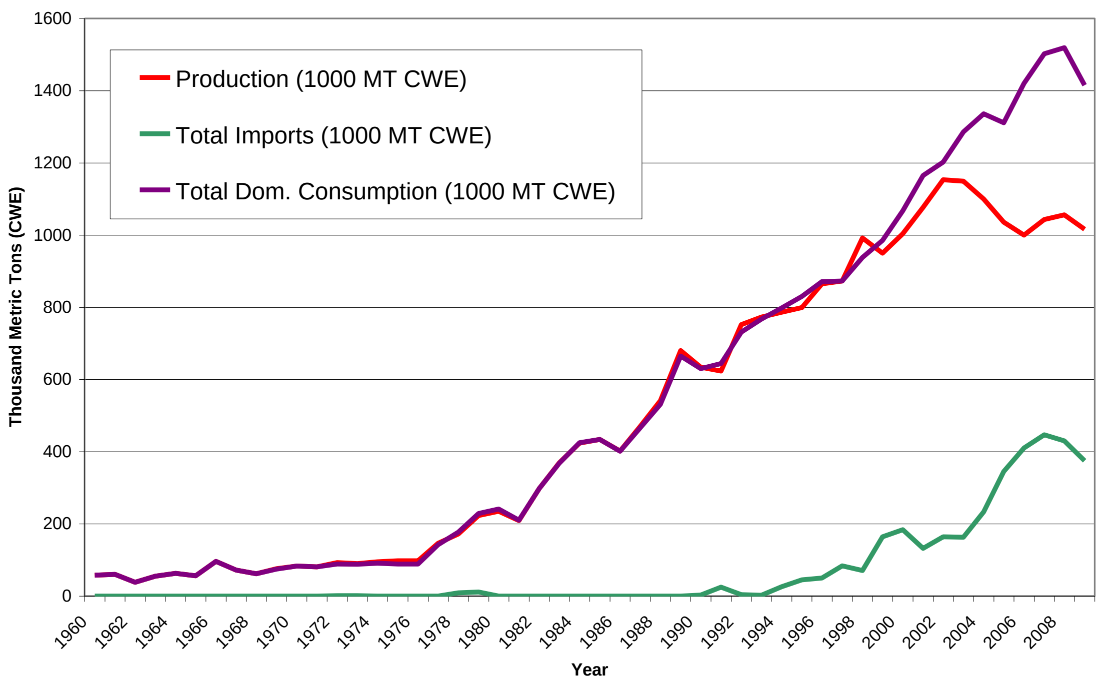
Live hog prices in South Korea are about three times U.S. levels, indicating that at this point South Korean import restrictions are still working to support domestic hog prices.

Background

Graph 1 below shows trends in the South Korean pork market. The country was self sufficient in pork up to 1994. Since the WTO Uruguay Round, pork imports have grown rapidly, and now equal approximately 40 percent of consumption.

Graph 1

The South Korean Pork Market, 1965:2009



In 2008, imports from all sources equaled 323,000 tons (product weight), of which 98,000 tons came from the U.S., representing a 31 percent market share. (See Table 1 below.) Overall South Korean pork imports grew prior to the recent economic downturn and the outbreak of H1N1. Imports in the last 12 months have fallen by about 16 percent due to the combined impact of the economic downturn and H1N1.

U.S. pork exports surged from 12,000 tons in 2001 to 98,000 tons in 2008, resulting in an increase in the U.S import market share to about 31 percent. The increase in the U.S. market during this period came at the expense of the EU and Chile and was driven by the strength of the Euro and of the Chilean Peso relative to the U.S. dollar. Canada has maintained an 18 to 20 percent share in the South Korean market.

Table 1
South Korea Import Statistics
Commodity: 0203, Meat Of Swine, Fresh, Chilled Or Frozen
Year To Date: January - December

Partner Country	Unit	Quantity			percent Share			percent Change
		2007	2008	2009	2007	2008	2009	2009/2008
World	T	338,686	323,598	294,935	100.00	100.00	100.00	- 8.86
United States	T	86,983	98,688	89,318	25.68	30.50	30.28	- 9.50
Canada	T	63,946	58,141	58,356	18.88	17.97	19.79	0.37
Chile	T	43,494	32,058	43,233	12.84	9.91	14.66	34.86
Spain	T	20,165	21,064	19,416	5.95	6.51	6.58	- 7.82
Austria	T	14,868	17,375	14,849	4.39	5.37	5.03	- 14.54
France	T	21,864	19,540	14,572	6.46	6.04	4.94	- 25.42
Netherlands	T	13,880	11,597	11,486	4.10	3.58	3.89	- 0.95
Belgium	T	17,475	15,875	11,411	5.16	4.91	3.87	- 28.12
Denmark	T	20,309	17,396	9,519	6.00	5.38	3.23	- 45.28
Poland	T	14,775	10,718	5,561	4.36	3.31	1.89	- 48.12
Hungary	T	10,204	12,164	5,546	3.01	3.76	1.88	- 54.41
Finland	T	2,796	4,532	5,184	0.83	1.40	1.76	14.37
Mexico	T	1,889	1,910	4,202	0.56	0.59	1.42	119.96
Sweden	T	1,485	1,578	1,571	0.44	0.49	0.53	- 0.48
Australia	T	1,148	549	550	0.34	0.17	0.19	0.25
Ireland	T	743	243	161	0.22	0.07	0.05	- 33.55
Slovakia	T	187	0	0	0.06	0.00	0.00	0.00
New Zealand	T	0	22	0	0.00	0.01	0.00	- 100.00
Palestine	T	9	22	0	0.00	0.01	0.00	- 100.00
Germany	T	3	0	0	0.00	0.00	0.00	0.00
Ukraine	T	2	0	0	0.00	0.00	0.00	0.00
United Kingdom	T	2,460	126	0	0.73	0.04	0.00	- 100.00

The combined import share of all EU countries in the South Korean market fell from 41 percent in 2007, to 39 percent in 2008 and to 34 percent in 2009. The reduction in the EU import share is largely due to a 20 percent appreciation in the Euro relative to the U.S. dollar. This appreciation allowed the U.S. share to increase by about 5 percent as the EU share fell by 7 percent.

This rapid movement in relative shares shows how price sensitive the South Korean market can be. The results shown in the FTA analysis in the section below assume that the economic forces that caused the U.S. share to increase through 2008 can be reversed at about the same rate if the EU achieves a tariff advantage of a magnitude similar in impact to the EU currency appreciation over that period.

There are economic factors other than import duties that also affect the EU's ability to supply pork to markets like South Korea. The EU is a highly protected market with very limited market access opportunities for foreign suppliers and high internal prices. The European pork industry can typically cover most of its production costs by selling shoulders, loins and trimmings into heavily protected EU internal markets where prices are about 80 percent higher than in the U.S. This high level of profitability allows the EU to cross-subsidize the export of "by product" cuts such as bellies at prices that can compete with the U.S. in foreign markets. In cases where it cannot compete in a foreign market, the EU makes use of export subsidies.

The rapid increase in the Chilean market share in 2009 seen in Table 1 is due in large part to the gradual reduction of duties under the South Korea-Chile FTA. This tariff reduction allowed Chile to increase its sales to South Korea by approximately 11,000 tons from 2008 to 2009. These additional Chilean exports have come at the expense of U.S. sales to South Korea, which must pay the full 22.5 to 25 percent import duties.

Free Trade Scenarios

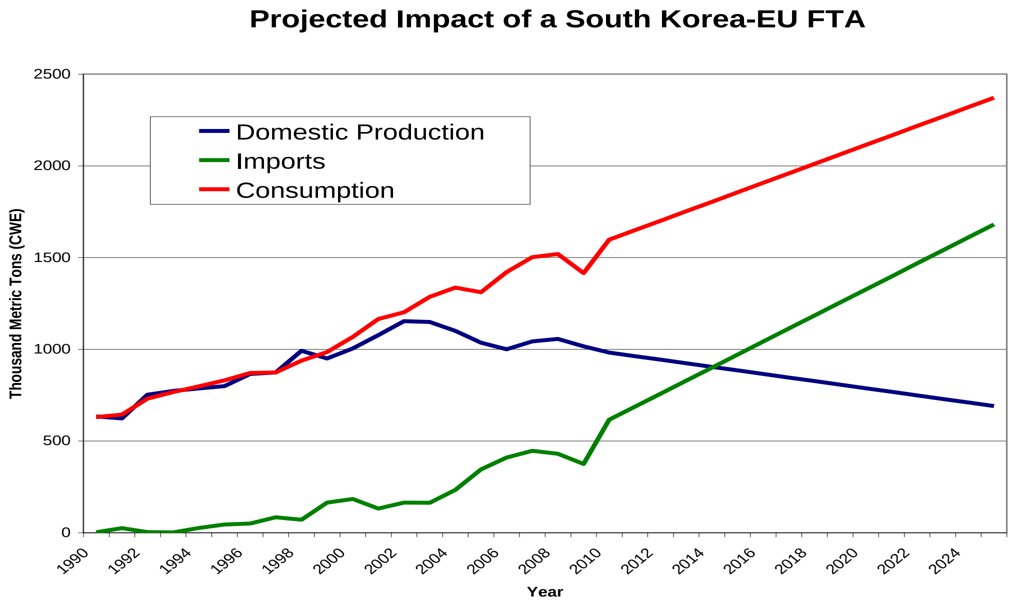
Because South Korea is a relatively small country, an FTA with the EU will allow pork prices to fall as the import tariff is gradually reduced. As pork prices fall, South Korean producers will produce less than they otherwise would have, and South Korean consumers will consume slightly more pork. Evidence from other countries such as Japan and Mexico suggest that these responses will be muted, in part due to a consumer preference for domestic product. The economic response to the tariff reductions goes out to four years after the duty phase-out as consumers and producers adjust to the new environment.

Although the United States and South Korea have signed an FTA, it is unclear at this point whether the U.S. Congress will actually approve the agreement. Until such time as the United States and South Korea actually implement their FTA, and assuming the EU implements its FTA with South Korea, the EU and Chile will both have preferential access to the South Korean pork market. South Korea will charge duties of 22.5 to 25 percent on imported U.S. pork and eventual zero duties on pork from the EU and Chile. This would be akin to the delivered price of U.S. pork increasing 22.5 to 25 percent relative to EU and Chilean pork.

Results

The graph below summarizes the results of analysis on the South Korea-EU FTA. Total South Korean pork imports grow dramatically and amount to 1.2 million tons by 2020. Domestic production falls slightly, and domestic consumption grows at about the pace of consumption growth seen over the last decade.

Graph 2



U.S. Market Share

In the absence of the U.S.-South Korea FTA, U.S. pork will be at a severe disadvantage in the South Korean market. An example of how this type of disadvantage can work in the long run can be seen in Mexico where the NAFTA agreement has allowed the U.S. to capture 94 percent of the market with the remaining 6 percent owned by Canada.

While import duties will clearly have a major impact, the extent of the disadvantage that the U.S. will face in South Korea is also dependant on the behavior of the U.S. dollar. The scenario results assume that the U.S. dollar returns to a price of 1.25 to the Euro, reflecting the assumed long-run equilibrium between these two currencies. The Chilean Peso is assumed to average 600 to the dollar. It is also assumed that the EU and South Korea actually implement their FTA. **Under these assumptions, the U.S. market share falls by 3 percentage points per year for the entire projection period, and the U.S. is eliminated from the South Korea market over a 10-year period.**

If the U.S. implements its own free trade agreement with South Korea, it should be able to maintain a 33 percent share of the South Korea import market. This is slightly higher than the 30 percent share the U.S. has held recently. As South Korea reduces its domestic hog slaughter, imports will move to replace missing domestic production. This trend will help reverse a key EU advantage in selling selected seasonal cuts. Under this scenario the enormous production cost advantage that the U.S. enjoys over both EU and Chilean pork production will become evident.

To put the enormous size of the potential U.S. market loss in South Korea in perspective, assume that with the implementation of a U.S.-South Korea FTA the U.S. achieved a 33 percent share in a market worth 1.2 million tons. Under these circumstances, U.S. exports would reach 400,000 tons. This would amount to an increase in demand for U.S. pork (compared to the no U.S.-South Korea FTA scenario) of approximately 3.6 percent and a price increase for U.S. pork of approximately 7.2 percent worth approximately $10 per hog.

Impact of the Chile FTA in the absence of an EU or U.S. FTA

As mentioned earlier, the South Korea-Chile FTA is already having a negative impact on U.S. pork exports to South Korea. This trend will continue as long as Chile has preferential access into the South Korean market. Chilean pork production is small relative to the needs of the South Korean market, and therefore, the impact of additional pork exports will cause a rapid increase in live hog prices in Chile. This will eventually cause Chilean pork production to increase. The erosion of U.S. pork exports under a South Korea-Chile FTA (leaving the EU out of the scenario) will be slower than under a scenario where both the EU and Chile achieve FTAs, possibly taking as much as 20 years. This is true because it will take decades for the Chilean pork industry to grow to take full advantage of the opportunity created by the FTA. However, the end result will be the same. **Even under a scenario where only Chile has an FTA with South Korea, the U.S. will eventually completely lose a South Korean market worth $10 per hog.**