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Protectionism With Opportunities for US-South Korea Trade Under Trump 2.0

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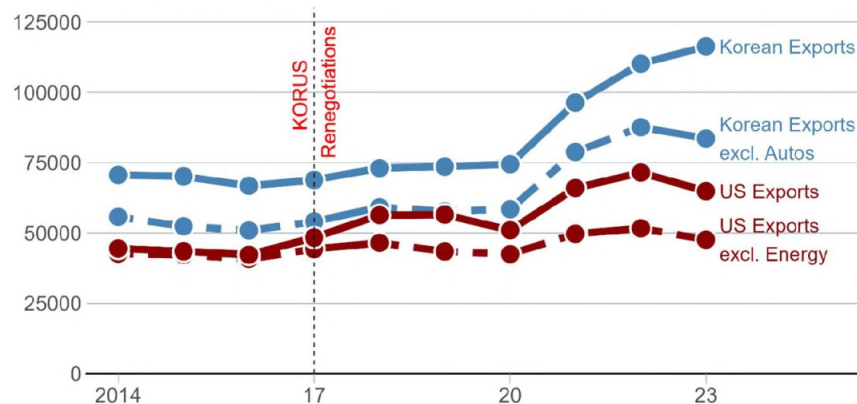


The economic relationship between the United States and South Korea is stronger than ever, but President Donald Trump's promises of higher US tariffs pose risks to the relationship. In 2023, trade between the two countries in goods and services was valued at 256 billion USD, and South Korea became one of the largest sources of Foreign Direct Investment in the United States. However, the relationship is vulnerable to protectionist shifts in US policies. The South Korean response to these risks will ultimately shape the future bilateral economic relationship. As protectionist US trade policies will likely distort current trade patterns, a well-positioned South Korea could stand to benefit.

Impact of KORUS FTA and a New Era of US Protectionism

In 2012, the Korea-US Free Trade Agreement (KORUS FTA) brought significant trade liberalization between the United States and South Korea. Market access improved, and tariffs were eliminated for 95 percent of traded goods. That year, the United States exported 64 billion USD of goods and services to South Korea, which remained steady through 2016. Meanwhile, US imports from Korea grew from 70 billion USD to 80 billion USD, establishing a clear US trade deficit. Importantly, US imports of Korean automobiles increased by 35 percent between 2012 and 2016.

Figure 1: Bilateral Goods Exports between the United States and South Korea (in USD millions)



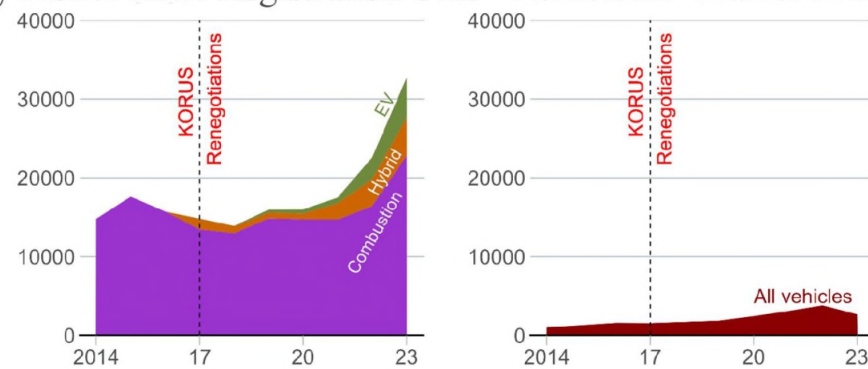
Source: ITC Trade Map.

A new period of US protectionism began in 2016. Trump led a significant departure from the longstanding Washington Consensus and the US pursuit of free global trade in favor of protectionism and promises to bring manufacturing home. Trump introduced new tariffs on imports of steel and aluminum, solar panels and washing machines, and a range of Chinese products. The United States also withdrew from free trade negotiations such as the Trans-Pacific Partnership and undermined the WTO appellate body for dispute settlements.

In 2017, the KORUS FTA became the Trump administration's first target for renegotiations. Motivated by the growing deficit in goods trade, the renegotiation of the FTA focused on the Korean automotive industry. In 2016, automotive imports were valued at 88 percent of the US bilateral goods trade deficit with Korea. While automobile rules of origin continued to require at least 35 percent of value-added be produced in the United States or South Korea to benefit from the tariff exemption, the renegotiated KORUS FTA extended the existing 25 percent tariffs on pickup trucks entering the US market until 2041. Additionally, Korea reduced non-tariff barriers, especially those enacted on the US automotive industry, while the United States introduced tariff-exempt quotas on steel imports from Korea.

The objective to protect domestic production was continued by the Joe Biden administration. His administration did not reverse Trump's protectionist trade policies but, rather, introduced industrial policies—often perceived as discriminatory—such as the Inflation Reduction Act and the CHIPS and Science Act with significant incentives favoring US domestic production. President Biden also increased tariffs against China in 2024. Nevertheless, South Korea's trade surplus with the United States has continued to grow, largely driven by Korean automotive exports (See Chart 1). While US exports to Korea have also grown, the increase is almost entirely driven by energy exports. In 2024, South Korea was the sixth largest trading partner of the United States. As such, while trade between the two nations is more valuable than ever, Trump's persistent focus on the trade deficit in goods should raise questions about the future of the KORUS FTA and bilateral automotive trade.

Figure 2: South Korean Car Exports to the United States; US Car Exports to South Korea (in USD millions)



Source: ITC Trade Map

Potential Scenarios for US-Korea Trade

Based on Trump's public announcements about his administration's likely tariff policies, there are several implications for South Korea. The net impact on Korean exports will be driven by the amount of trade diversion created by the new tariffs, which would shift the sourcing of imports from lower to more expensive suppliers.

One possible scenario consists of universal US tariffs against all imports. Experts have stated at least some tariffs should be expected and that non-discriminatory tariffs would be the simplest for the United States to implement. All else equal, and without free trade agreements such as the KORUS FTA, higher prices of final and intermediary imported goods facing US consumers and producers, respectively, will lower demand for imports and increase demand for goods produced in the United States. Considering the size of the US economy, South Korean exports could suffer from lower demand and falling global prices in this scenario.

Another scenario involves universal tariffs accompanied by higher tariffs against China. While universal tariffs would make all imported goods more expensive in the United States, the disproportionately higher tariffs against China would make exports from other countries relatively more competitive. Current Chinese exports to the United States would have to be filled from other countries. Disproportionately large tariffs against China may divert trade in favor of other exporting nations, including South Korea, and this could offset the negative effects of universal US import tariffs. President Trump has also suggested higher tariffs, up to 25 percent, levied on US imports from Canada and Mexico, despite the current FTA between the three nations. Such tariffs would be an extension of the scenario with asymmetric tariffs, bringing even more trade diversion.

Whichever tariff policy the United States pursues, the future of the KORUS FTA will impact either scenario. If non-discriminatory tariffs are levied on US imports from all countries, and South Korean exports are exempt under the KORUS FTA, South Korean goods become more competitive. Nations that enjoy FTAs with the United States could benefit, even if China faces the same tariffs as all other countries. In the case of higher tariffs against China, a continuation of the KORUS FTA would position South Korea to benefit even more from trade diversion.

Conclusion

There are several factors that will determine the future of the US-South Korean economic relationship as Trump assumes office. Tariffs should be expected, although at which levels remains unclear. However, not all tariffs are necessarily bad for South Korea. Targeted tariffs against China present an opportunity for South Korea. As a manufacturing powerhouse, South Korea is well positioned to benefit as the United States limits trade with China and the resulting trade diversion as prices of Chinese goods in the United States become relatively more expensive. Tariffs may also protect Korean manufacturing investments in the United States and reduce Chinese competition in the automotive industry.

Rules of origin would become increasingly important to ensure that Korean exports avoid higher tariffs against China. The more entwined South Korean supply chains are with China, the greater the risk that higher tariffs will be applied to South Korean exports if rules of origin become more restrictive. As showcased through the Biden administration's CHIPS Act, which contains guardrails against Chinese components of advanced semiconductor imports to the United States, reducing or even eliminating Chinese contents in some value chains may become particularly important for Korean export industries with strategic or national security implications in the United States.

South Korean exports and investments in the United States face both risks and opportunities. While a repeat of the 2017 KORUS FTA renegotiations should not necessarily be expected, the growing trade imbalance driven by South Korean car exports highlights the need to carefully navigate the risk of potential renegotiations. Preserving the KORUS FTA and well-positioned industrial supply chains could allow South Korea to take advantage of higher tariffs against China should they become a reality.

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