



CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

October 12, 2011

S. 1642 **United States-Korea Free Trade Agreement** **Implementation Act**

As reported by the Senate Committee on Finance on October 11, 2011

SUMMARY

S. 1642 would approve the free trade agreement between the government of the United States and the government of the Republic of Korea (Korea) that was signed on June 30, 2007, and modified by a later agreement on December 3, 2010. It would provide for tariff reductions and other changes in law related to implementation of the agreement. The bill would extend user fees collected by Customs and Border Protection (CBP) that expire under current law and would increase those fees. In addition, it would establish a reporting requirement for federal and state prisons for tax administration purposes and increase the penalties on tax preparers who did not comply with due-diligence requirements for the earned income tax credit. It also would shift some corporate income tax payments between fiscal years.

The Congressional Budget Office (CBO) and the staff of the Joint Committee on Taxation (JCT) estimate that enacting S. 1642 would reduce revenues by \$31 million in 2012 and by about \$7.0 billion over the 2012-2021 period. CBO estimates that enacting S. 1642 would increase direct spending by \$53 million in 2012 but would decrease direct spending by about \$7.0 billion over the 2012-2021 period. The net impact of those effects is an estimated reduction in deficits of \$16 million over the 2012-2021 period. Pay-as-you-go procedures apply because enacting the legislation would affect direct spending and revenues.

Further, CBO estimates that implementing the legislation would cost \$7 million over the 2012-2016 period, assuming the availability of appropriated funds.

CBO has determined that the nontax provisions of S. 1642 contain no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA), and would impose no costs on state, local, or tribal governments.

CBO has determined that the nontax provisions of the bill contain private-sector mandates with costs that would exceed the annual threshold established in UMRA for private-sector mandates (\$142 million in 2011, adjusted annually for inflation).

JCT has determined that the tax provisions of S. 1642 contain no intergovernmental or private-sector mandates as defined in UMRA.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of S. 1642 is shown in the following table. The costs of this legislation fall within budget functions 150 (international affairs), 370 (commerce and housing credit), 750 (administration of justice), and 800 (general government).

	By Fiscal Year, in Millions of Dollars											
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2012-2016	2012-2021
CHANGES IN REVENUES												
Free Trade Agreement	-158	-312	-381	-462	-726	-873	-954	-1,043	-1,146	-1,254	-2,040	-7,310
Prison Reporting Requirement	0	6	13	13	14	14	15	15	16	16	46	122
EITC Preparer Penalty	9	19	19	20	20	21	21	22	23	23	87	197
Corporate Payment Shift	<u>118</u>	<u>-118</u>	<u>0</u>	<u>0</u>	<u>1,894</u>	<u>-1,894</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>1,894</u>	<u>0</u>
Estimated Revenues	-31	-405	-349	-429	1,202	-2,732	-918	-1,006	-1,107	-1,215	-13	-6,991
CHANGES IN DIRECT SPENDING^a												
Extend Customs User Fees												
Estimated Budget Authority	0	0	0	0	0	0	0	0	-1,957	-2,186	0	-4,143
Estimated Outlays	0	0	0	0	0	0	0	0	-1,957	-2,186	0	-4,143
Exemption from Merchandise Processing Fee												
Estimated Budget Authority	53	95	99	104	161	180	189	198	208	184	511	1,470
Estimated Outlays	53	95	99	104	161	180	189	198	208	184	511	1,470
Increase the Merchandise Processing Fee Rates												
Estimated Budget Authority	0	0	0	0	-572	-720	-756	-794	-835	-657	-572	-4,334
Estimated Outlays	0	0	0	0	-572	-720	-756	-794	-835	-657	-572	-4,334
Total Direct Spending ^a												
Estimated Budget Authority	53	95	99	104	-411	-540	-567	-596	-2,584	-2,659	-61	-7,007
Estimated Outlays	53	95	99	104	-411	-540	-567	-596	-2,584	-2,659	-61	-7,007

Continued

	By Fiscal Year, in Millions of Dollars											
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2012-2016	2012-2021
NET INCREASE OR DECREASE (-) IN THE DEFICIT FROM CHANGES IN DIRECT SPENDING AND REVENUES												
Impact on the Deficit	84	500	448	533	-1,613	2,192	351	410	-1,477	-1,444	-48	-16

Sources: Congressional Budget Office and the staff of the Joint Committee on Taxation.

Note: Components may not sum to totals because of rounding; EITC = Earned Income Tax Credit.

a. In addition, CBO estimates that implementing the provisions of S. 1642 would have a discretionary cost of \$7 million over the 2012-2016 period, assuming appropriation of the necessary amounts.

BASIS OF ESTIMATE

For the purposes of this estimate, CBO assumes that S. 1642 will be enacted early in fiscal year 2012.

Revenues

Under the United States-Korea free trade agreement, tariffs on U.S. imports from Korea would be phased out over time. The tariffs would be phased out for individual products at varying rates, ranging from immediate elimination on the date the agreement enters into force to gradual elimination over 10 or more years. According to the U.S. International Trade Commission, the United States collected about \$660 million in customs duties in 2010 on \$48 billion of imports from Korea. Based on expected imports from Korea, CBO estimates that implementing the tariff schedule outlined in the U.S.-Korea free trade agreement would reduce revenues by \$158 million in 2012, and by about \$7 billion over the 2012-2021 period, net of income and payroll tax offsets.

This estimate includes the effects of increased imports from Korea that would result from the reduced prices of imported products in the United States, reflecting the lower tariff rates. It is likely that some of the increase in U.S. imports from Korea would displace imports from other countries. In the absence of specific data on the extent of this substitution effect, CBO assumes that an amount equal to one-half of the increase in U.S. imports from Korea would displace imports from other countries.

S. 1642 would increase the penalties imposed on paid tax return preparers who do not comply with due-diligence requirements for determining their clients' allowable earned income tax credits (EITC), from \$100 under current law to \$500 for each failure. JCT

estimates that this change would increase revenues by \$197 million over the 2012-2021 period.

S. 1642 also would require prisons located in the United States to provide the names and Social Security Numbers of all inmates serving sentences longer than one year to the Internal Revenue Service for tax administration purposes. JCT estimates that this change would increase revenues by \$122 million over the 2012-2021 period.

S. 1642 also would shift payments of corporate estimated taxes between fiscal years 2012 and 2013 and between fiscal years 2016 and 2017. For corporations with at least \$1 billion in assets, the bill would increase the portion of corporate estimated payments due from July through September in both 2012 and 2016. JCT estimates that those changes would increase revenues by \$118 million in 2012 and decrease them by \$118 million in 2013, and would increase revenues by about \$1.9 billion in 2016 and decrease them by about \$1.9 billion in 2017.

Direct Spending

Under current law, certain fees collected by CBP will expire in January of 2020. The bill would extend COBRA fees (which were established in the Consolidated Omnibus Budget Reconciliation Act of 1985) from January 14, 2020, through December 8, 2020, and would extend merchandise processing fees from January 7, 2020, through August 2, 2021. CBO estimates that those changes would increase offsetting receipts (a credit against direct spending) by about \$4.1 billion over the 2020-2021 period. For merchandise entered from December 1, 2015, through June 30, 2021, the bill would raise the merchandise processing fee from 0.21 percent to 0.3464 percent of the value of goods entered. CBO estimates that this would increase offsetting receipts by about \$4.3 billion over the 2012-2021 period.

In addition, the bill would exempt imports from Korea from merchandise processing fees. CBO estimates that this would reduce offsetting receipts by about \$1.5 billion over the 2012-2021 period.

Spending Subject to Appropriation

Implementing provisions of S. 1642 would increase the costs of several agencies affected by the bill including:

- The Department of Commerce to provide administrative support for dispute-settlement panels established in the agreement;
- The International Trade Commission to conduct investigations, if petitioned, into whether Korean imports might threaten or cause serious injury to domestic competitors; and

- The Department of the Treasury and the United States Trade Representative to establish regulations to carry out provisions of the agreement.

Based on information from the agencies, CBO estimates that those activities would cost \$7 million over the 2012-2016 period, assuming appropriation of the necessary amounts.

PAY-AS-YOU-GO CONSIDERATIONS

The Statutory Pay-As-You-Go Act of 2010 establishes budget-reporting and enforcement procedures for legislation affecting direct spending or revenues. The net changes in outlays and revenues that are subject to those pay-as-you-go procedures are shown in the following table.

CBO Estimate of Pay-As-You-Go Effects for S. 1642 as ordered reported by the Senate Committee on Finance on October 11, 2011

	By Fiscal Year, in Millions of Dollars											2012-	2012-	
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2016	2021		
NET INCREASE OR DECREASE (-) IN THE DEFICIT														
Statutory Pay-As-You-Go Impact	84	500	448	533	-1,613	2,192	351	410	-1,477	-1,444	-48	-16		
Memorandum:														
Changes in Revenues	-31	-405	-349	-429	1,202	-2,732	-918	-1,006	-1,107	-1,215	-13	-6,991		
Changes in Outlays	53	95	99	104	-411	-540	-567	-596	-2,584	-2,659	-61	-7,007		

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

CBO has determined that the nontax provisions of S. 1642 contain no intergovernmental mandates as defined in UMRA and would impose no costs on state, local, or tribal governments. JCT has determined that the tax provisions of S. 1642 contain no intergovernmental mandates as defined in UMRA.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

CBO has determined that the nontax provisions of S. 1642 would impose private-sector mandates, as defined in UMRA, by extending the customs user fees, by increasing merchandise processing fees and by enforcing new recordkeeping requirements. CBO estimates that the aggregate costs of those mandates would exceed the annual threshold established in UMRA for private-sector mandates (\$142 million in 2011, adjusted annually for inflation). JCT has determined that the tax provisions of S. 1642 contain no private-sector mandates as defined in UMRA.

PREVIOUS CBO ESTIMATE

On October 5, 2011, CBO transmitted a cost estimate for H.R. 3080, the United States-Korea Free Trade Agreement Implementation Act, as ordered reported by the House Committee on Ways and Means on October 5, 2011. S. 1642 and H.R. 3080 are identical, and the CBO cost estimates are the same.

ESTIMATE PREPARED BY:

Federal Revenues: Kalyani Parthasarathy

Federal Spending: Sunita D'Monte, Mark Grabowicz, Matthew Pickford, and Susan Willie

Impact on State, Local, and Tribal Governments: J'nell L. Blanco

Impact on the Private Sector: Marin Randall

ESTIMATE APPROVED BY:

Peter H. Fontaine

Assistant Director for Budget Analysis

Frank Sammartino

Assistant Director for Tax Analysis