# KOR-U.S. FREE TRADE AGREEMENT
# : A New Development Policy for Korea?

**By**

**Noh, Joo-Hee**

**THESIS**

Submitted to

KDI School of Public Policy and Management

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Approval as of ____________________
Supervisor You, Jong-Il _____________________

## ABSTRACT

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The Roh Mu-Hyun government defined Korea as a “sandwich country” whose economy is being squeezed in the two powerful neighboring countries China and Japan, and as a quick remedy to get out of the sandwich situation, it pursued a free trade agreement (FTA) with the United States of America. In explaining the necessity of the Kor-U.S. FTA were three assumptions lied: (a) Korean economy is in need of a new development strategy; (b) The new development strategy shall incorporate policies to promote goods exports and to shock and advance services sector; (c) To achieve these goals, it is best to pursue a FTA with the U.S. among other trade partners. The first assumption is not ungrounded given the vicious cycle of low growth and bipolarization that has haunted the Korean economy since the 1997 financial crisis, while the other two seem unfounded and even dangerous. Furthermore, detailed investigations into the text of the Kor-U.S. FTA present little substantive evidence that it will promote economic growth of Korea, but abundant evidence that it shall undermine Korea’s policy space for future development. In sum, it is questionable that the Kor-U.S. FTA will make a ‘good’ development policy package. Rather, the pact is highly possible to serve as a ‘dangerous’ lock-in tool that limits the government and other public entities’ rights and abilities to initiate, implement, modify, evaluate, and when necessary annul development policies in the future.

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## Ⅰ. INTRODUCTION

Is South Korea a developing country or a developed country? The Roh Mu-Hyun government defines Korea as a 'sandwich country' whose economy is being squeezed in the two powerful neighboring countries, that is China (world's most powerful developing country) and Japan (leading developed country). It is controversial whether the two economies threaten the Korean economy and/or help for further economic growth, yet it is widely agreed that Korea is in the midst of whether to become a developed country or remain among the developing countries group. In the sense, defining Korea as a sandwich country is not entirely wrong.

Then, what would be the best development policies for a sandwich country to adopt in order to reap to a developed country? Before the academic arena seeked for answers and the public debates were brought for broader consensus, the Roh government gave one determined answer: a free trade agreement with the United Sates of America (hereafter the Kor-U.S. FTA). The governments of Korea and the U.S. launched the negotiations in early 2006 and the agreement was reached within one and a half a year. The two governments signed on the agreement on June 30, 2007[1], and the final text of the agreement has been publicly available since the date

[1] At the moment, the agreement is waiting for the two congresses' ratification. Details on the periodic bilateral meetings involving the negotiation of the Kor-US FTA are available on the official Websites of the Office of the U.S. Trade Representative (www.ustr.gov) and the Korean Ministry of

July 2, 2007.

The Roh government's arguments for the Kor-U.S. FTA lies in three basic assumptions: (a) Korea is in need of a new development strategy to address both domestic challenges including low investments and high unemployment and international challenges including fiercer price competitions along with rise of new powerful developing countries, notably China; (b) The new development strategy shall incorporate policies to promote goods exports and to shock Korea's services sector so as to advance itself; (c) To achieve these goals, it's best to pursue a free trade agreement with the U.S. among other trade partners because it will provide Korean exporters with preferential market access to the world's largest imports market, will make Korea's services sector expose to world's top-class services sector, and will attract U.S. investment and investors into Korea.

The research questions of this paper are simplified into two: "Are those assumptions plausible?" and "will the Kor-U.S. FTA function as an appropriate trade policy contributing to Korea's economic development?" In an effort to answer these questions, this paper first scrutinizes the current status of Korea's

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Foreign Affairs and Trade (www.mofat.go.kr).

economy and its economic relation with the U.S. and the global economy. And then, it deals with the above three basic assumptions that have been propagandized by the government to justify the seemingly hasty pursuit of the Kor-U.S. FTA. Finally, the paper goes into the official text of the FTA to picture how the agreement will affect the Korean economy in general and its development policies in specific.

Why are these questions worthwhile? Indeed, these are critical questions that must have been discussed and whose answer should have been drawn upon people's consensus before the embarking of the FTA negotiations. Unfortunately, it did not happen. Many of what is publicly available as serious research on the Kor-U.S. FTA have been considered as little more than *ex post* rationalization[2].

The paper draws its results as follows: the Kor-U.S. FTA presents little sustentative evidence that it will promote economic growth for Korea, but abundant evidences that it might uproot industrial foundations and undermine national integrity, which are widely agreed to be among basic elements of sound economic development for a national economy. In other words, the Kor-U.S. FTA is not only a 'questionable' development policy given the current situations of the Korean economy and the world economy, but also a 'possibly dangerous' lock-in tool that will limit the government and other public entities' rights and abilities to

[2] Lim (2006a).

initiate, implement, modify, and when necessary annul development policies in the future.

## Ⅱ. KOR-U.S. FTA AS A NEW DEVELOPMENT POLICY

### A. Korea in the 'Second' Development Phase

South Korea has long been extolled as the most successful example of how international trade and trade policy can transform an underdeveloped country from a condition of widespread poverty to one of high-income countries in a single generation. Its success is recognized as largely due to the commonly shared goals of its people, supported by a relatively equal distribution of income over three decades of rapid growth. Korea was designated a "high-income" country by the World Bank and joined the Organization Economic Cooperation and Development (OECD) in 1996. Indeed, Korea's development performance has been the envy of the developing world.

The glorious story seemed to end when it was hit by the 1997 Asian financial crisis. The 1997 real GDP growth rate of 6% plummeted to a negative 5%

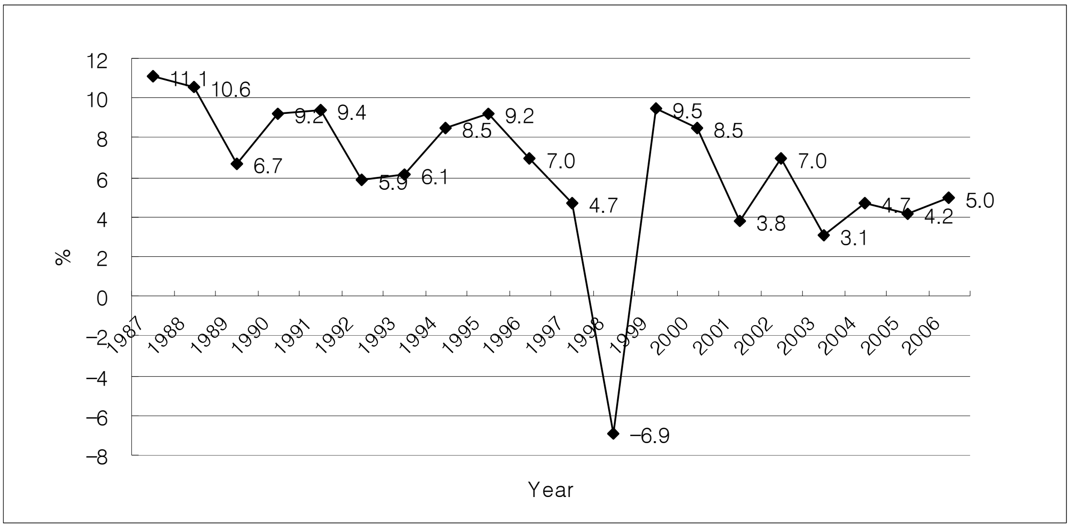
in 1998, the first year of falling output since 1980. Unemployment rates more than doubled from 3.5% to 9%. Bankruptcies skyrocketed from under 1,000 per month in 1997 to over 3,300 in 1998[3].

But, to the repeated surprise to the world, Korea quickly recovered from the crisis and resumed its growth. Korea paid back most of the debt to the International Monetary Fund (IMF) earlier than the due date. Its GDP growth rates were back to the pre-crisis level. Partially thanks to the devaluated Korean won, exports growth has been robust since the crisis except for in 2001 and 2002 when the U.S. economy was on the decline. Current account balance that has been negative since 1990 turned positive after the crisis. Although the complete impacts of the crisis remains uncertain because it is still too early to evaluate, it seemed clear that Korea was again back on the track of its legendary economic development.

It is worth noting that all the recoveries, in particular the robust growth in exports, were achieved when many economists and businessmen were concerned that Korea was losing its price competitiveness in the global trade arena because rising developing countries including so-called BRICs (Brazil, Russia, India and China) have taken over Korea's share in the international market.

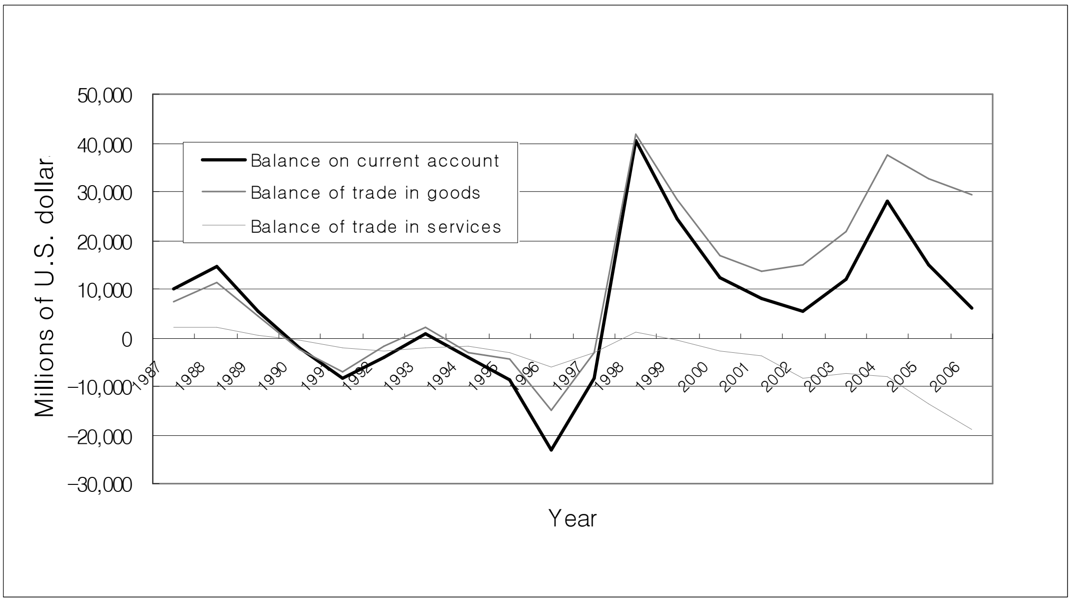
[3] International Monetary Fund (IMF).

[Figure 1] Real GDP growth rates




*Source*: Bank of Korea (BOK).

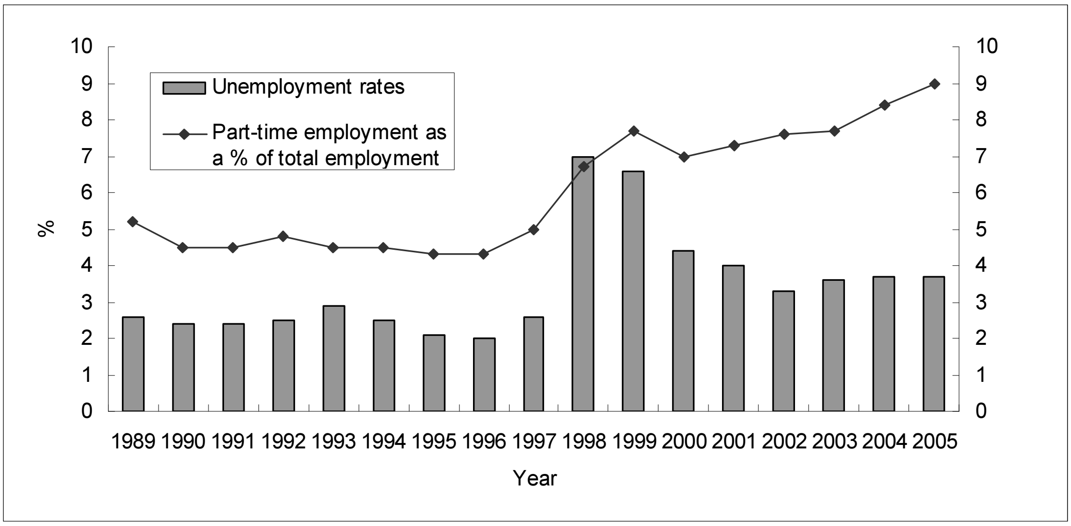
[Figure 2] Current account balance




*Source*: Bank of Korea (BOK).

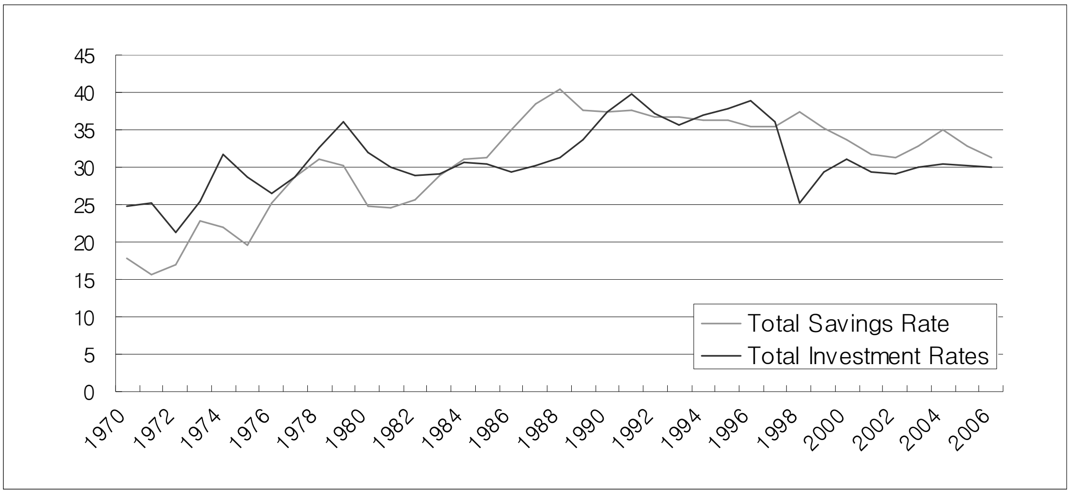
Nevertheless, this time Korea's growth pattern showed whole different aspects from those of during the pre-crisis period. Above all, job growth was poor even though the real GDP and exports were robustly growing. Unemployment rates that skyrocketed to 9 percent in 1998 were lowered but remained higher than the pre-crisis level. The number of irregular laborers including part-timers who get paid lower wages and less job security continued to increase. Domestic total capital formation rates and total saving rates also remained lower than the past. In addition, real estate and land prices increased and the equities markets expanded, leading to a greater concentration of wealth and income. Gini's coefficient has been constantly rising, proving less equal distribution of wealth and income. Many economists defined these new growth aspects of Korea's post-crisis development as "jobless growth."

[Figure 3] Unemployment rates



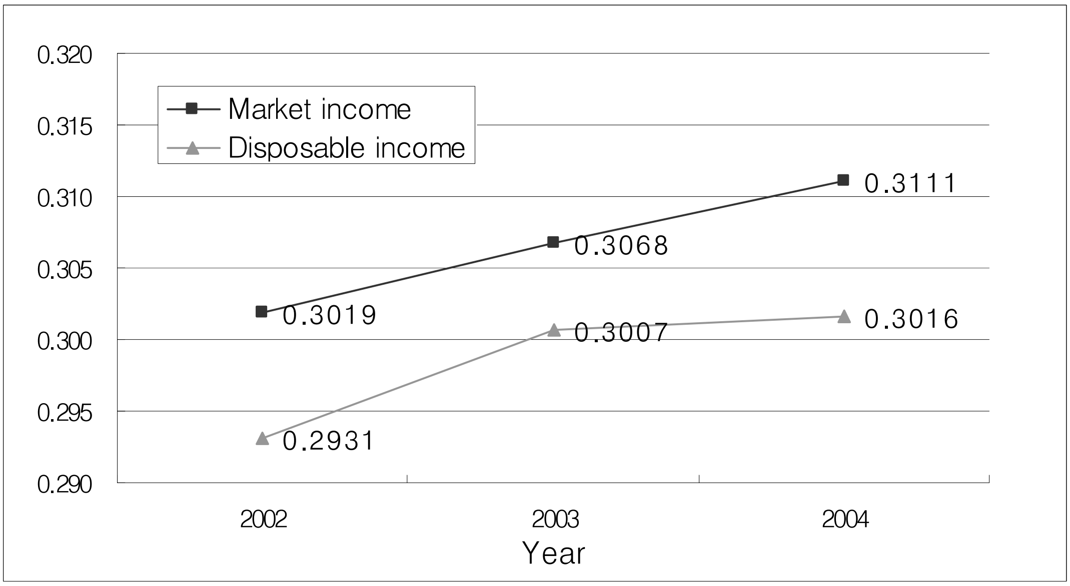

*Source*: Organization of Economic Cooperation and Development (OECD), OECD Fact Book 2007, 2007.

[Figure 4] Savings and investment rates




*Source*: Bank of Korea (BOK).

[Figure 5] Gini's coefficient




*Source*: Korea Institute for Health and Social Affairs (KIHSA).

Meanwhile, the outside atmosphere has not been friendly to the Korean economy. Competitions in the international markets has gotten fiercer as rising developing countries including BRICs and many other Asian countries such as Viet Nam emerged as major players in the global trade arena. Many of manufacturing companies in Korea, in particular small and medium enterprises have been pressed for cutting down the expenses in order to survive in the competition with these economies armed with ‘cheap labor’.

Especially, there has been an outcry that emerging economies have take over Korea’s share in the U.S. manufacturing imports market, the world’s largest imports market. Given that the U.S. economy occupies 16.2 percent of the world imports in 2005, although it is quite down from 21.8 percent in the previous year[4], Korea seemed to lose its past glory as a strong manufacturing country.

Yet, Korea’s services sector has remained left behind compared to those of developed countries, including the U.S., Japan and many of the European Union (EU) nations. When Korea’s productivity in services sector of the year 2000 is set at 100, those of the U.S., Japan, France, and Germany are calculated as 219.2, 195.3, 199.9, and 180.4, respectively.

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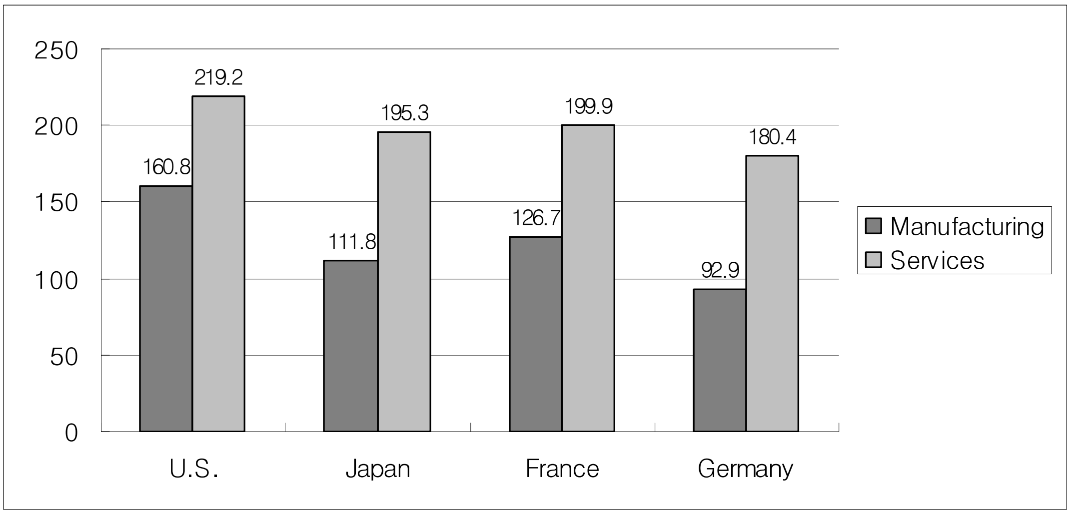
[4] International Monetary Fund (IMF).

[Figure 6] Comparison of productivity as of 2000 (Korea=100)




*Source*: Korea Productivity Center (KPO).

### B. Kor-U.S. FTA as a Panacea for the Flawed Growth

Those troubles are all new to Korea who led its economic development with relatively equal distribution of wealth and income, and with potential for more development. In this sense, it can be safely said that Korea entered a whole new development phase that can be titled as the ‘second phase of development’. Remind that the second phase is characterized by ‘jobless growth’, or ‘growth that fails to make people feel that they are actually benefiting from growth.’ Many scholars, politicians, and businessmen were concerned and warned that if these problems were not addressed, Korea would eventually break away even from this flawed development track.

It was in this complicated situation when the Roh Mu-hyun government took out the FTA with the U.S. The Roh government suggested that the Kor-U.S. FTA be a panacea for the troubled economy and went forward to insist that it will function as a new momentum for continued and strengthened economic development for the future.

Initially, the Kor-U.S. FTA came as a shock not only to Korean people but also to the world, especially to Asian countries. In 2003 and 2004, the first two years of the Roh government's term, the government's trade policy evolved on two basic principles. First, it actively participated in the multilateral Doha Development Agenda (DDA) negotiations. Secondly, it pursued free trade agreements in two directions: it negotiated essentially "exploratory" free trade agreements with smaller countries that had a great deal of previous experience with free trade agreements and posed little threat to Korea's vulnerable agricultural sectors. As a result, Korea signed on free trade agreements with Chile, Singapore, the European Free Trade Association (EFTA) and the Association of South East Asian Nations (ASEAN) except for Thailand[5]. The Roh government also pursued more "strategic" free trade agreements with a view toward promoting peace and

[5] Thailand was excluded because she was more protective for her agricultural sector than other countries expected. Negotiations with Thailand are still going on.

prosperity in Northeast Asia. A Korea-Japan FTA was given a top priority, and the possibility of a Korea-China FTA was cautiously explored. In this trade policy, the Kor-U.S. FTA was regarded as a long-term project.

Accordingly, only few people paid an attention to it when President Roh announced that the government would pursue a free trade agreement with the U.S. in the President's New Year's Speech in mid-January in 2006. But, it is in six weeks that it was realized. On February 3, 2006, the two governments of Korea and the U.S. officially announced the launching of the negotiations for the FTA. Even at that time, some conservatives who had blamed the Roh government for being anti-American did not believe that the Roh government had a real intention to pursue a FTA with the U.S. The Kor-U.S. FTA was this sudden. It was by that time when people started to raise questions of 'what made the President swiftly change his trade policy', and more importantly 'why the Kor-U.S. FTA is needed at this time?'

The Roh government's answers to these questions are investigated in the next section. To briefly summarize: the Kor-U.S. FTA will be a 'panacea' that can treat all the troubles the Korean economy confronts, and furthermore it will work as an 'alchemy' that will turn the troubled economy which is get caught in between the developing and developed worlds to a 'real' developed country. Note that 'why and how the Korean economy fell into the above described troubles' and in relation to it, 'how she shall deal with the challenges' are big issues that need to be widely discussed. Nonetheless, in this paper, these issues are put aside. Instead, it focuses only on how the Korean government relates these troubles to the Kor-U.S. FTA.

## Ⅲ. CRITICISM OF ASSUMPTIONS FOR THE KOR-U.S. FTA

There are a number of reasons the Roh government presented in order to explain the seemingly abrupt pursuit of the Kor-U.S. FTA. This paper summarizes these reasons into three assumptions as followings: (A) In addressing the troubled economy, Korea needs a new development strategy different from previous ones; (B) the new development strategy should incorporate policies to promote goods exports and to advance Korea's services sector; (C) tightening of Korea's economic relation with the U.S., that is the Kor-U.S. FTA, will function as a package of development policies to serve all the purposes suggested in the assumption (B). In the section Ⅲ, these assumptions are investigated in details.

**A. Korea Needs a New Development Strategy?**

*Assumption A: Korea is in need of a new set of development policies in dealing with both domestic and international challenges to continue economic development and make it sustainable.*

Inside challenges can be explained by 'potential growth rates' that are projected to keep decreasing from 4.3 percent in 2010s to 1.4 percent in 2040s[6]. As is mentioned above, low investments and savings rates are considered a key challenge to the Korean economy. Lagging in job growth and high unemployment rates add another strain to the economy.

Population aging is one of the most pressing issues considering that Korea has not much resource other than human resources. Korea already entered the group of "aging" societies and is anticipated to join the group of "aged" societies in mid-2010. Population growth rates, which have been decreasing since 1970's, are expected to be zero (0) in 2021 and turn to negative in the following year, and keep decreasing to reach negative 1.8 percent in 2050. Consequently, labor force is projected to keep decreasing while ratio of economically inactive population aged

[6] Ministry of Finance and Economy(MOFE) of Korea.

65 and over to the total labor force aged 15~64 to skyrocket from 10.8 percent in 2000 to 72.2 percent in 2060.

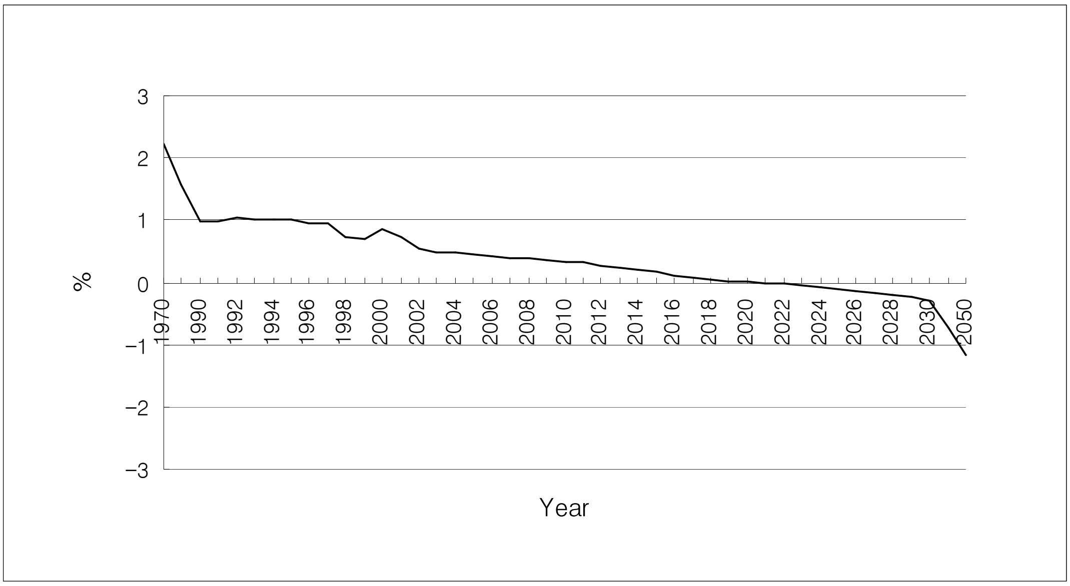
Indeed, Korea has got to do something to address all the problems, unless it wants to get caught in a trap of decreasing growth rates.

[Table 1] Forecasts for potential growth rates

| Years | 2010s | 2020s | 2030s | 2040s |
|---|---|---|---|---|
| Potential growth rates (%) | 4.3 | 2.9 | 1.8 | 1.4 |

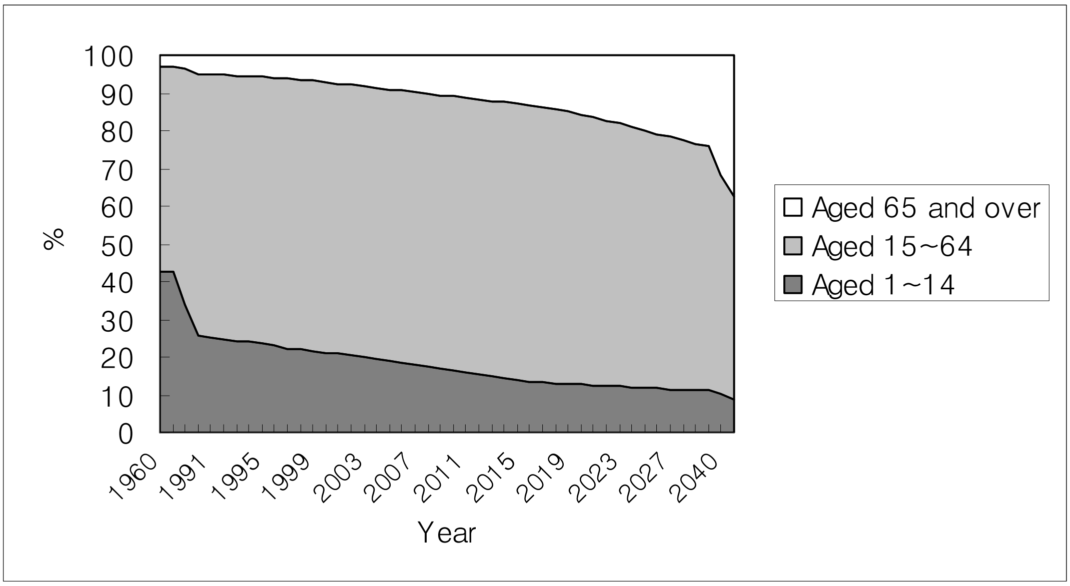
*Source*: The Ministry of Finance and Economy (MOFE) of Korea, "Evaluations on 3 Year's Economic Management of the Chamyeo (means 'participatory') Government and its attendant Challenges", 2006.

[Figure 7] Population growth rates (2008~2050 data are forecasted)




*Source*: National Statistical Office (NSO) of Korea.

[Figure 8] Population age composition (2008~2050 data are forecasted)




*Source*: National Statistical Office (NSO) of Korea.

[Table 2] Ratio of inactive population aged 65 and over to the total labor force aged 15~64

| Year | 2000 | 2005 | 2010 | 2015 | 2020 | 2025 | 2030 | 2035 | 2040 | 2045 | 2050 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| % | 10.8 | 12.7 | 15.4 | 18.4 | 22.4 | 29 | 36.9 | 45.8 | 55.7 | 64.3 | 72.2 |

*Source*: Organization for Economic Cooperation and Development (OECD), OECD Fact Book 2007, 2007.

At the same time, outside challenges, which are essentially connected to the domestic challenges, do not put the Korean economy under less strain. Rather, outside challenges, well known to the public as ‘global outsourcing’ or ‘transfer of factories to overseas’, make the problems much more complicated. Newly developing countries such as China and India, armed with ‘cheap labor’, have benefited from the new rules of game in the global market. By any measure it is a substantial problem to Korea. Korea is neither a cheap developing country that can sell inexpensive goods to the global market nor a fully developed country that is able to provide high-tech goods and quality services at higher prices. In the sense, Korea is a sandwich country that badly needs a breakthrough if it wants to keep its past fame as an ever-developing economy.

The Roh government initially tried to solve the challenges it faced in two directions: (a) tightening of its economic ties with other Asian countries including China while economically and/or politically serving as a ‘balancer’ in the region; (b) investing more in human resources and social welfare system so that the foundations of economic growth are to be strengthened. The government even coined a term “Sahoe Chaeggim Gugga” (means ‘socially investing nation’ or ‘government that invests in human resources’) as an ideal picture of the government.

To the puzzlement to people, after less than 3 years’ trying to become the advertised ‘socially investing nation’, the government swiftly switched in an entirely different direction: (a) tightening of its economic ties with the U.S., inevitably alienating other Asian countries, and even making China feel threatened; (b) re-adopting the 'growth first, distribution later' development philosophy of the old days.

What has changed? There is not much to say about it, since it is still an enigmatic question both to those who support the Roh government and those who are against the government. It is just assumable that the Roh government completely changed its economic philosophy and accordingly altered its role in nation-level economic development. Roughly speaking, the Roh government changed its own identity from as an active developmental state (though its roles are defined different from those in the Park Jeong-hee regime) to as a classical night-watch state that is active only in market liberalizations and deregulations. To put it differently, the Roh government's newly adopted policy principle was to 'let nation-level development policies die, and make the market substitute them'. This argument will be dealt with in the followings.

**B. The New Strategy Must Incorporate More Exports?**

*Assumption B: Korea's new development strategy shall involve strategic methods to promote 'more exports' because Korea's past economic growth* *has been dependent primarily on trade with the outside world; and the new strategy shall make the services sector left behind in the global market exposed to the fierce competition so that it is forced to drive itself toward self-innovation, because the services sectors are the true source of sustainable development for Korea.*

Indeed, it is true that Korea's past success in economic development owed largely to exports. Yet, when its past development processes are looked back on, Korea never made a fetish of exports only. Quite the opposite, as most economic and development literatures widely agreed on.

On the domestic level, active involvement of the Korean government in the development processes and its delicately carried-out industrial policies were recognized as major driving forces for rapid industrialization and sound development of the economy. More important were the contents and directions of the government's industrialization and development policy. Since the 1960's, Korea had adopted the export-promoting industrialization policies to utilize the international markets and to improve its competitiveness in the markets. At the same time, Korea strategically had protected infant industries, such as shipbuilding, steel, and telecommunications, until they grew enough to serve as a main driving force for furthering growth.

On the international level, open multilateral trading regime contributed to the expansion of Korean exports and eventually to the rapid development of the Korean economy. Korea could increase its exports as developed countries liberalized their markets through multilateral trade liberalization negotiations. This combination of open international markets and strategic protection of the Korean market for infant industries together made the glorious success story of the "Miracle on the Han River."

One cannot and should not insist that for further development, Korea has to do the same as in the past described above. First of all, Korea is not the underdeveloped country mourning over the scars of war any longer, meaning its development strategy should reflect on its changed economic status and conditions. And, as was already mentioned, situations in the global market have greatly changed since the 1980's. A number of developing countries, especially China, began to play as meaningful competitors of Korea. Also, as other countries competitively pursued regionalism, the Korean economy was warned that Korea's traditional share in global export markets might shrink unless the economy finds out a breakthrough. Remind that regional economic arrangements are basically discriminatory in a sense that only member countries get preferential treatments. Pro-FTAS emphasized that Korea, being left out of regionalism at the time, need do adopt epoch-making policies to address these issues.

Nevertheless, exactly in the same manner, one cannot and should not echo that the Korean economy cannot survive without more exports because its development was heavily indebted to trade in the past. Although increased exports sound very nice, it is not something blindly pursued because more exports by itself cannot make a development goal. Rather, it needs to be incorporated in a bigger picture of development strategy, so that it can contribute to the higher development goals. Also, before certain trade policies are introduced, various other factors need to be taken into account in relation to exports promotion, including exchange rates, terms of trade, trade disputes and so on.

Now, let us turn to the services sector, in specific. As was discussed above, it is true that Korea's services sector has been left behind in the global market, and balance of services trade, though it had been negative since 1990, has more exacerbated after the 1997 financial crisis. Certainly, if Korea's services sector develops to the level of the developed world, it would benefit the Korean economy. But, again, "services sector upgrade" projects needs to be incorporated in a bigger development picture. There are many things to be considered, for example, balancing of policies to promote manufacturing industry and policies to services industry.

In relation to the advancing of the services sector, it is most widely propagandized by the Roh government that the benefits of the Kor-U.S. FTA includes ‘improvement in economic efficiency, especially in services sector’. Unfortunately, it is the Korean government’s ‘hope’ at best. No development literature says an economy shall adopt ‘external shock’ as a major policy tool to develop its own industry. Besides, the traditional economic theories echo that in the free trade world, if your services sector is inferior to that of your competitor, you are supposed to specialize in something else, say manufacturing sector. Also, it is worth noting that the final text of the Kor-U.S. FTA shows that the critical service sectors, that the government has insisted need to upgraded, such as legal services, are not actually liberalized.

On top of that, it needs to be paid an attention that Korea’s trade volume kept growing even after the 1997 financial crisis, though there were some periodical fluctuations. Also, the shares of trade in GDP continued to grow, too. In 2004, trade volume amounted to more than 40 percent of GDP for the first time in history of

Korea. Although the Roh government emphasized in pro-FTA talks that exports growth came to a stalemate, it was only in relation to the U.S. market. As a whole, Korea's exports both in volume and weight have been growing when the free trade agreement with the U.S was non-existent[7].

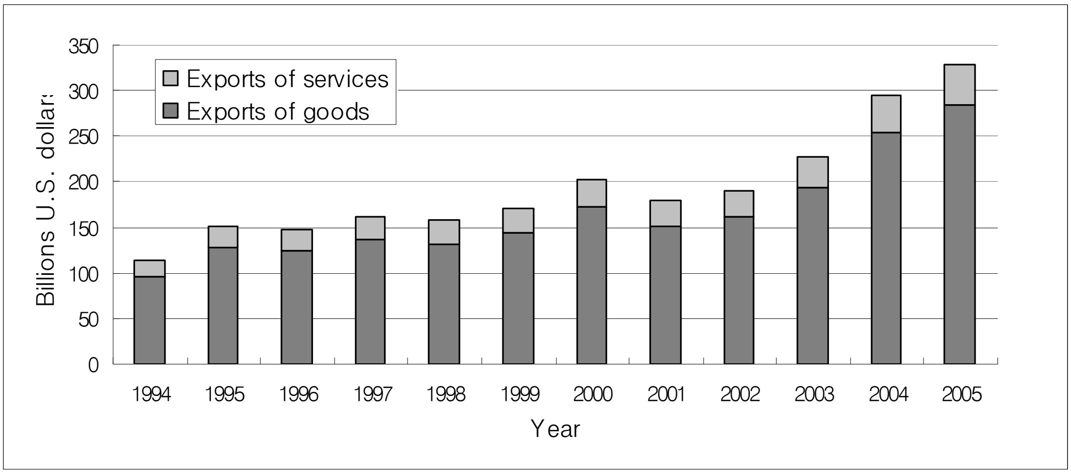
It can not be overemphasized that Korean economy's pressing problem is not that its exports performance has been poor, that is not true as statistics show, but that although exports have been robustly growing despite of fiercer competitions in the international market, recently plummeting won/dollar exchange rates and skyrocketing oil prices, it has not translated into domestic demand. It is symbolic that when Samsung and Hyundai export more than 100 millions of cell phones and 1 million of automobiles in a year (since 2005), Korea's national economy as whole suffers from slowdown in domestic demand and high unemployment. Also it needs to be noted that when Chaebols has grown as global players, small and medium enterprises has been trapped in a vicious circle of low investment and low growth. Indeed, the famous 'export-driven growth' and 'trickling-down effect' vanished in the development story of the Korean economy.

In short, the Korean economy suffers not because it exports less than the past but because although exports are robustly growing, it is enjoyed by only a few

[7] It by no means implies that the Kor-U.S. FTA is of no use in promoting exports. This argument needs more elaborations.

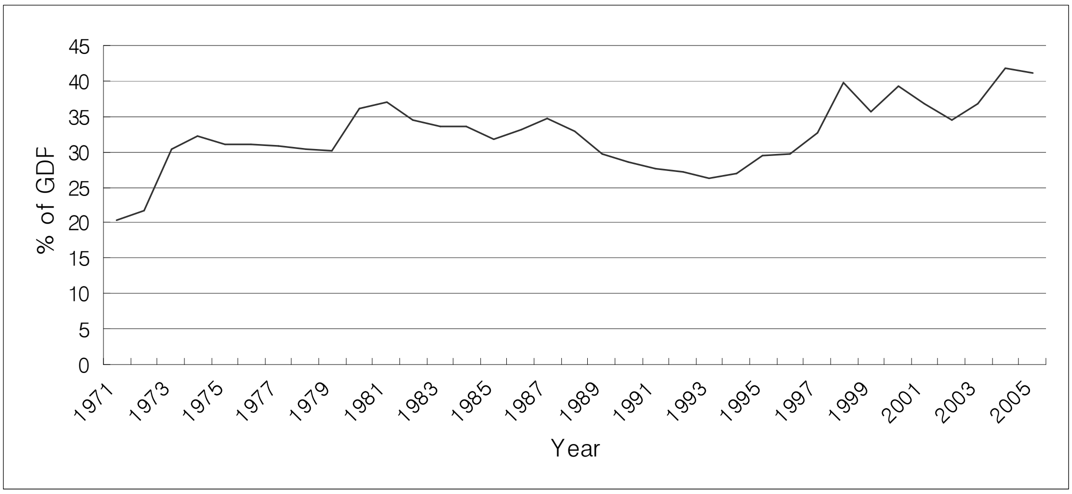
and there are too many left-behinds. Therefore, the second argument that the Kor-U.S. FTA is needed because the Korean economy needs more exports is entirely misleading.

[Figure 9] Exports of goods and services




*Source*: Organization for Economic Cooperation and Development (OECD), OECD Fact Book 2007, 2007.

[Figure 10] Trade in goods and services as a percentage of GDP




*Source*: Organization of Economic Cooperation and Development (OECD), OECD Fact Book 2007, 2007.

### C. Tightening of Korea's Tie with the U.S. is the Answer?

*Assumption C: Korea must restructure its economic system to be more competitive in high-tech industries and service sectors, and to improve its overall economic efficiency. For these objectives, it's best to pursue a free trade agreement with U.S. among other trade partners.*

The third assumption is simple: Free trade agreement with the U.S. will provide the best solution to all the above mentioned troubles the Korean economy is currently facing. Reasons that the government suggests are many[8], but for the purpose of simplifying the argument, let's suppose all the advertised benefits of the Kor-U.S. FTA will be realized. Then, the question is: "Still, is having a tighter economic relation with the U.S. a good thing in the mid-term and long-term development prospective?"

The answer is negative. It is because even if those economic benefits are realized as a result of the Kor-U.S. FTA, it may not be the end of the story. The U.S. economy itself is at stake and it does not show the sign of a favorable turn. It can

[8] For the purpose of simplifying the arguments, political considerations are put aside in this paper.

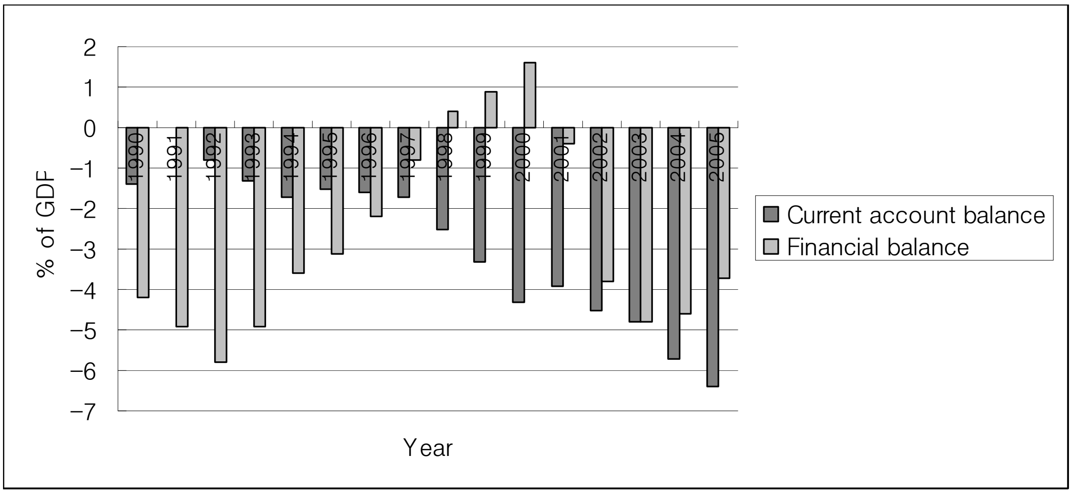
be said that tightening Korea's relation with this troubled economy cast another strain on the Korean economy.

In order to understand what it implies, it is a must to understand the notorious "twin deficits" of the U.S. economy that have not shown any sign of alleviation. Since 1990, current account deficit and financial deficit of the U.S. have been negative, and in recent 5 years of the second term of the George W. Bush' administration, it has enormously exacerbated to over 10 percent of GDP. How this heavily indebted country can survive is the world's troublesome, and it needs to be understood in relation to the Kor-U.S. FTA.

The way the U.S. survives regardless of the huge debts is all inter-wined with other economies through so-called "dollar-recycling" process: Countries, mostly Asian countries, export cheap goods to the U.S. and the U.S. people buy them even on debt [generation of current account deficit]. Countries send U.S. dollars they earn through exports back too the U.S. by buying the U.S. bonds, and then the U.S. government spends the dollars in securing financial deficits [securing of financial deficit]. But, the U.S. government again borrows money from foreign countries because of tax cut, wars, etc. [re-generation of financial deficit]. Because the dollars the U.S. government spends stimulate the economy, the U.S. people again go to shopping to buy imports goods [re-generation of current account deficit]. This dollar recycling process is far from sound debt management, but it has miraculously worked for the U.S. economy and the global economy for recent 10 years[9].

The Kor-U.S. FTA is only to strengthen this abnormal dollar-recycling situation, placing Korea as the “stake country” propping up this unsound system.

[Figure 11] Current account and financial balances of the U.S.




*Source*: Organization for Economic Cooperation and Development (OECD).

In fact, we don’t have to look into the U.S. grave economic situations and all. As is clear in any economic literature, it is risky to put all the eggs in one basket. In this multi-power governing world, diversification of economic relations to many different economies including China is a must. And it was what the Roh

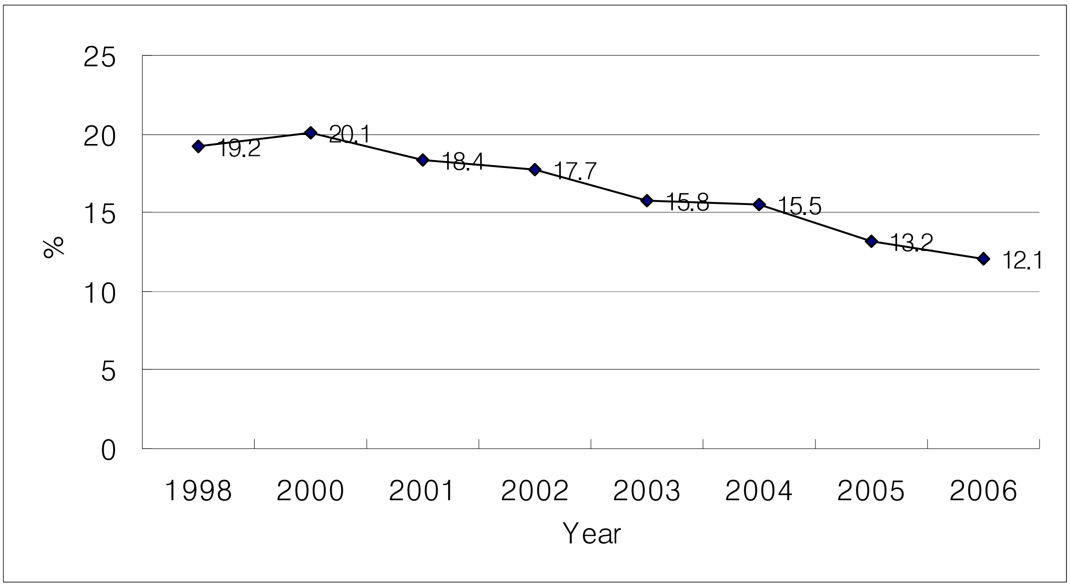
[9] It is because the U.S. economy has benefited from ‘seigniorage’. But the situation is changing. EURO has grown, Japanese Yen has gotten back its past power, and other currencies are growing, too. Many predicts that the time is not far when other countries will stop buying the U.S. bond..

government sought in the early term before pursuing the Kor-U.S. FTA.

Recall the experience of Mexico that signed on the FTA with the U.S and Canada in 1993. The FTA titled as “North America Free Trade Agreement (NAFTA)” entered into force on January 1, 1994, and shortly tightened the economic relation between Mexico and the U.S. But it was only Mexico whose economy is smaller and less developed than the U.S. economy that started to suffer from “economic coupling.” It means if there is little downturn of the U.S. economy, its impacts on the Mexican economy is relatively huge. For instance, in 2001~2002 when the U.S. economy fell into stagnation, the Mexican economy almost lose its GDP by 1 point percent. Remind that there are many signs that the U.S. economy is again falling into the stagnation at a time when the Korean government is trying to tie its economic relation with the U.S. economy even stronger than any other country did in the past.

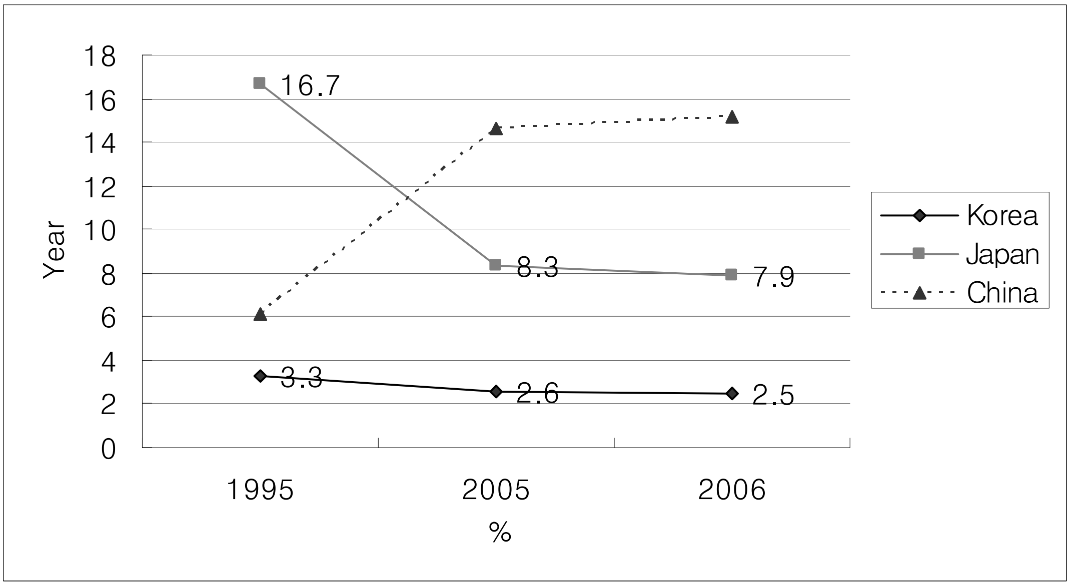
In this sense, it is too early to judge but it ‘might’ be a good thing that Korea’s dependency rates on trade with the U.S. has decreased since 2000, and its share in the U.S. imports market diminished from 3.3 percent in 1995 to 2.5 percent in 2006. Still, Korea’s exports are growing and current account balance remains positive.

[Figure 12] Korea's dependency rates on trade with the U.S.




*Source*: The Ministry of Finance and Economy (MOFE) of Korea.

[Figure 13] The U.S. imports market shares: Korea, Japan, and China




Source: The Ministry of Finance and Economy (MOFE) of Korea.

## Ⅳ. INVESTIGATION OF THE KOR-U.S. FTA TEXT

In the section Ⅲ, the three assumptions behind the government's explanation of the pursuit of the Kor-U.S. FTA were criticized. In the section Ⅳ, we'll leave from the fictitious world of assumptions for the real world. Since the FTA negotiations were reached upon agreement on June 30, 2007, it is possible to look into the results of the agreement. Again, the paper focuses on the Kor-U.S. FTA as a development policy. In a broader sense, the pursuit of the Kor-U.S. FTA is not merely one trade policy that is part of whole economic/development policy package, but the agreement itself is a package. Recall that President Roh Mu-hyun declared several times "the FTA with the U.S. is a must for next generations to prosper."

Two major arguments are to be presented in this section to show that Kor-U.S. FTA will not make the best development policy package for Korea: (A) The Kor-U.S. FTA is expected to bring less tangible benefits to the Korean economy than is expected; (B) The Kor-U.S. FTA in essence limits the government and other public entities' rights and abilities to adopt, implement, modify, evaluate and when necessary annul development policies.

### A. Less Tangible Benefits for the Korean Economy

The Kor-U.S. FTA itself has been propagandized by the Roh government almost as a synonym of economic growth. That is, if the FTA enters into force, GDP will grow, more jobs will be created, and the system of the Korean economy will be upgraded so as to prop up further growth. To strengthen these arguments, the government has quoted and advertised the results of research on the economic effects of Kor-U.S. FTA that was performed by the Korea Institute of Economic Policy (KIEP). To sum up its results: the Kor-U.S. FTA will bring in 7.75 point percent of GDP growth and 3.3 point percent of job growth over approximately next 10 years from when the pact takes effect[10].

First of all, it is necessary to recognize what kind of economic model is used to draw such results. It is the Computable General Equilibrium (CGE) model that the KIEP adopted to simulate the broad economic effects of the Kor-U.S. FTA. The CGE model provides an economy-wide framework for analysis that takes into account the interdependencies that exist both within and between countries. The framework is essentially microeconomic in character. When the CGE models incorporate data covering the sectoral production, trade, and employment of the

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[10] KIEP(2006).

components countries together with measure of import tariffs and other forms of trade barriers, it is possible to simulate the economic effects of various patterns of trade liberalization. The utility of the CGE model as a tool to estimate economic impacts of trade liberalization has been well recognized in the academic arena[11].

Nonetheless, the limits of the CGE model must not be overlooked. It is important to understand that the CGE modeling simulation results provide indications of the potential economic changes involved. They are not meant to be empirical forecasts or predictions of the changes because they are not derived from econometric methods that can yield statistically based estimations. Furthermore, because they are microeconomic in character, CGE models of necessity abstract from the macroeconomic forces at work at the aggregate level in individual countries. As a consequence, it may be very difficult to compare CGE modeling results with the actual changes that occur in the economic variables over given periods of time. A further important consideration is that CGE models used to analyze the effects of trade liberalization may differ because of the assumptions that characterize their framework, although the commonly assumed economic structure is standard: perfect competition, constant returns to scale, and fully employed factors that can move freely across sectors but not across international

[11] Alan V. Deardorff and Robert M. Sterm(1990).

boundaries[12].

This is why various other CGE modeling results say all different stories about the effect of the Kor-U.S. FTA: McDaniel and Fox(2001) estimated that as of 2005 the Kor-U.S. FTA would increase Korean economic welfare by 0.69 percent point of the GDP. Choi and Schott(2001, 2004) summarized that Korea's economic welfare would rise by 0.91 percent point of the GDP and 2.41 percent point of the GDP, respectively in two researches. Lee and Lee(2005) analyzed that Korea would enjoy 0.42~2.27 percent point of the GDP if the FTA enters into force. Finally, in Schott, Bradford, and Moll(2006), Korea's welfare is estimated to increase by 0.6~6.6 percent point of the GDP. The numbers derived are all positive because of the CGE modeling's nature, but all of them are lower than that of the KIEP.

In essence, it is meaningless to try to decide which result is the best estimate of the impacts of the Kor-U.S. FTA on the Korean economy. Rather, this paper tries to explain expected returns of the Kor-U.S. FTA to Korea will be less than estimated, based on the actual negotiation results of the agreement. The paper investigates four areas, which are (a) trade in goods, (b) trade in services, (c) foreign

[12] In my point of view, any CGE model is supposed to yield results that are not plausible at all because of its reliance on fictitious assumptions which can never be realized in the real economy.

investment, and (d) intellectual property.

**Trade in Goods**

By nature, the Kor-U.S. FTA is expected to increase Korea's exports to the U.S. It is because when the free trade agreement enters into force, U.S. tariffs levied on imports goods made in Korea are to be eliminated to zero (0) or reduced in the due period of time. But it alone cannot justify a bilateral free trade agreement because if it's the case, Korea's best trade policy must be to open the economy to as many economies as possible.

Also, what is clear is that if the FTA increases Korea's exports to the U.S. market, it increases imports from the U.S. to the Korean market, too. What matters is net change in current account balance, not just change in exports volume. Unfortunately yet obviously, more imports from the U.S. are not expected to be offset by even more exports to the U.S. It is primarily because the weighted average tariff on the U.S. goods is 5.7 percent point higher than that on the Korean goods[13]. It implies that the U.S. will export more to Korea than Korea will do to the U.S. when the FTA enters into force, and most related researches publicly

[13] Korea Customs Service (KCS).

available say so[14].

[Table 3] Tariff: Korea vs. the U.S. as of 2004

| | Korea | U.S. | Difference |
|---|---|---|---|
| Average tariff | 11.9% | 4.9% | 7.0point % |
| Weighted average tariff | 7.2% | 1.5% | 5.7point % |

*Source*: Korea Customs Service (KCS).

In most cases, the differences of tariffs between two countries are incorporated in a CGE model. But, when looking into the specific results of the negotiations on tariff and non-tariff barriers elimination, there are many others that are missing in the model but need to be paid attention.

Above all, the automobile industry, which has been referred as the greatest "winner" of the Kor-U.S. FTA on the Korean side will not gain much from the agreement. According to the tariff eliminations schedule of the U.S., tariffs on most of Korea's automobiles and related commodities is to be removed from current 8 percent to zero (0) immediately or within 3 years after the FTA enters into force[15]. But by that time, Hyundai Motor and Kia Motors, two Korean auto makers, will have finished building their assembly lines in the U.S. and their total output is

[14] Refer to KIEP(2006).

[15] Annex 2-B: Tariff Elimination.

expected to exceed the total exports to the U.S. market. It means that they don't need preferential tariff treatment exclusively given to the free trade agreement countries, because what they produce is "made in the U.S."

In case of textiles and apparels industries, another "winner" of the FTA on the Korean side, many of commodities is not expected to enjoy preferential FTA tariff treatment because the Kor-U.S. FTA adopts the U.S.'s unique "yarn-forward" rules of origins[16]. When these stricter origins rules[17] are applied, many of textiles and apparels goods of Korea, whose origins can be decided as 'Korea' when other general rules of origins are applied, are classified into "made in China" or made in somewhere else other than Korea.

All other major export commodities of Korea including semi-conductors, steel and chemistry products already enjoy zero (0) or pay very low tariffs[18]. White electronics such as refrigerator, laundry mat, TV sets have already been made in the U.S.-Mexico border "Maquiladora" industrial region that enjoys the NAFTA's preferential tariff treatment. Again, what they produce is not "made in Korea" but either "made in Mexico" or "made in the U.S.," and therefore won't benefit from

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[16] Annex 4-A: Specific Rules of Origin for Textile or Apparel Goods, and Chapter 6 Rules of Origins.

[17] According to the official text, yarn-forward rules of origins defines "wholly finished and formed" textile and apparel goods as those whose "production process and finishing operations, beginning with the extrusion of filaments, strips, film, or sheet, including drawing to fully orient filament or slitting a film or sheet into strip, or the spinning of all fibers into yarn, or both, and ending with a finished yarn or a filed yarn."

[18] Korea Customs Service (KCS).

the Kor-U.S. FTA.

In addition, Korea did not success in winning anything substantial in trade remedy negotiations. U.S. notorious trade remedy measures such as 'zeroing' survived the negotiations, and Korea failed to make the U.S. to adopt 'lesser-duty rule' and 'non-cumulation' that are generally accepted rules in the global trade arena when lost revenue due to dumping is calculated[19]. To make matters worse, the official text prescribes that two parties can apply a 'safeguard' measure 'only once'[20], which any previous FTA had not adopted. Remind that Korean industries have continuously reported that what substantially hamper their exports to the U.S. are the country's unique non-tariff barriers such as anti-dumping measures, counter-veiling duties and safeguards, not tariff barriers. The estimated amount of damage incurred by U.S. trade remedy measures is 27.2 billion dollars during 1981~2005, and it amounts to 6.8 percent of the total exports to the U.S.[21]

In the meantime, imports from the U.S. will be expected to grow substantially. Agricultural products of U.S. mega-agribusiness corporations are on the front, threatening Korean farmers who have been suffered from globalization. In

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[19] Chapter 10 Trade Remedies.

[20] 'Article 10.2: Conditions and Limitations' makes it clear that "Neither Party may apply a safeguard measure more than once against same good."

[21] The Ministry of Commerce, Industry and Energy (MOCIE) of Korea.

particular, the Korean beef market, once the third-largest market for U.S. beef[22], was opened as a preliminary condition to launch the negotiations, regardless of existing threat of mad cow disease (Bovine Spongiform Encephalopathy), though the government insisted several times the beef market opening was nothing to do with the Kor-U.S. FTA. Despite the market opening, the U.S. beef importers could not sell their beef products in Korea because they could not meet the agreed imports conditions that only beef without bone from cattle less than 30 months of age. Accordingly, the U.S. Congress and the U.S. Trade Representative have insisted that 'without full opening of the Korean beef market, there would be no Kor-U.S. FTA.'[23] And the Korean government has continuously eased the beef imports and quarantine restrictions.

Another 'loser' of the Kor-U.S. FTA on the Korean side is Korea's pharmaceutical industry. It is because the FTA adopts a number of measures including "Patent Linkage" to extend the patent period, which is favorable to the U.S. pharmaceutical industries, together with various measures such as "Independent Review Process" to make it difficult for Korean pharmaceutical companies to produce generics at cheaper prices[24].

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22 USTR(2006).

23 Wendy Cutler, the U.S. chief negotiator of the Kor-U.S. FTA repeatedly declared on October 16, 2007 that "For the Kor-U.S. FTA to get approval from the U.S. Congress, Korea must open its beef market fully."

24 Refer to Chapter 5 Pharmaceutical Products and Medical Devices, and Chapter 18 Intellectual

Actually, there are many more losers other than agriculture and pharmaceutical industries. Most notably, precision machinery and chemistry, and parts industries need to be paid attention in relation to Korea's future development policies. Those three industries have been spotlighted as core high value-added industries Korea shall develop strategically for future growth. But because Korea's competitiveness in these industries is absolutely lower than that of the U.S. and other developed countries, those industries are considered to be infant industries not strong enough to survive open competition and therefore to be protected. In terms of industrial policy, the Kor-U.S. FTA can be a 'misleading' policy to threat these strategically important yet weak industries[25]. Regarding on this criticism, the Roh government repeats that same argument it uses in services-sector related debates: 'Once those industries are forced to compete with those of the U.S., they will advance themselves to survive.'

**Cross-border Trade in Services**

Another strain will be put on cross-border trade in services[26]. The Roh government

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Property Rights.

[25] Actually, whether these industries survive and develop enough to compete with the developed world was one of very controversial issues that were debated in the Korea-Japan FTA discussions. At that time, many worried that Japan that has comparative advantage in those industries would threat Korea's strategic industries.

[26] It is only 20 years ago when services were first incorporated in the trade issues. And its relevant

has explained that the Kor-U.S. FTA will shock the services sector of Korea, and consequently upgrade the sector's level. According to the government, it is because when the Kor-U.S. FTA enters into force, Korea's services sector shall advance its services quality enough to compete with world's top class services of the U.S., and the U.S. services sector will expand into Korea's domestic market and transfer its developed services techniques. Unfortunately, the latter argument is not right. One of the core principles of the Kor-U.S. FTA regarding on cross-border trade in services is to forbid the U.S. corporations to be bind to any obligations including initiating and transferring of techniques[27]. Meanwhile, the former argument was already criticized in the section Ⅲ. Traditional trade theories say that trade helps countries achieve development by promoting the sectors of the economy where individual country possesses a comparative advantage, whether in terms of labor efficiency or factor endowments. When manufacturing and services productivities of Korea are set at 100 respectively, those of the U.S. are calculated as 160.8 and 219.2[28]. It implies that the Kor-U.S. FTA is deemed to result in Korea specializing in manufacturing where there is Korea's comparative advantage whilst the U.S. specializing in services[29]. It is exactly the opposite the government's objective to

rules are first established only mid-1990, and they are still controversial.

27 Chapter 12 Cross-border Trade in Services.

28 Korea Productivity Center (KPC).

29 Within manufacturing, Korea is supposed to specialize in wide-use manufacturing while the U.S. in high-tech and high-class manufacturing. The government has insisted that the FTA will be one

pursue the Kor-U.S. FTA.

In addition, professional services, that many experts have insisted should be liberalized among all other services for the sake of its own development in the global competitive market and of Korean consumers' benefits, were relatively well protected under the FTA text. Legal services, accounting and auditing services, tax accounting services are all included in the reservation list[30]. The Roh government insisted that it is because the government had its own unilateral liberalization plans which are already going through the process. This argumentation is at best crude, because then all other services sector can be opened to the global competitive market without the enforcement of the Kor-U.S. FTA[31].

Another argument to be criticized is that many deregulation measures in services sector that are stated in the FTA text, that the government calls an "opportunity of advancement," will function as a critical promoter for development of services sector. This argument is not right, either. It is like to say that 'because the Korean government is not capable of adopting deregulation policies for itself, it should bind all the policies to an external trade pact so that they can be compulsory.' The World Bank and the IMF have made wide use of these kinds of

and the only chance for Korea to specialize in high-class manufacturing, to beat China and India.

[30] Refer to Annex Ⅰ Non-conforming Measures for Services and Investment (reservations to existing measures) and Annex Ⅱ Non-conforming for Services and Investment (reservations to future measures).

[31] Besides, some literatures such as Song(2007) have insisted that what the government calls the unilateral liberalization plans are actually disguised forms of protective measures for those sectors.

liberalization and deregulation conditionality linked to loans and rescue finances to developing countries to secure and lock-in their reforms and restructurings, but any independent sovereign country adopts these 'lock-in' measures in initiating a policy[32]. If Korea needs a certain deregulation policy for development of services sector, it can and must adopt it on its own.

Situations of financial services are a bit different from those of other services[33]. All the negotiation results for Korea are evaluated to be in line with so-called the "Northeast Asian Financial Hub" project and other related financial policies including the introduction of the 'Capital Market Unification Law' that will enter into effect coming 2009[34]. It implies the Kor-U.S. FTA is cautiously designed to promote and lock-in the ongoing financial liberalization policies of the Roh government. The FTA and the government's financial polices share the very basic idea that getting rid of any barrier that gets in the way of investors, whether foreign or domestic, and their investment is always good for the economy[35].

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32 It is a bit controversial at the moment but it is fair to say that thanks to the democratization of Korea in 1987, Korea now has a self-control power over its own reforms and restructurings.

33 Chapter 13 Financial Services.

34 Hong(2007).

35 It will be discussed more in the following 'Investor-State Dispute (ISD)' section.

### Foreign Investment

Another rationale for the Kor-U.S. FTA is that it will enlarge the volume of foreign investments into Korea that has been suffering low domestic investments and savings. At glance, it seems a rational argument. It is because the text of the Kor-U.S. FTA adopts the strongest protective measures for foreign investment (i.e. introduction of the investor-state dispute settlement mechanism) and contains few obligations levied on the investment into Korea (i.e. ban on performance requirements)[36]. Also, the FTA text incorporates many incentives for the U.S. investors to consider commercial presence inside Korea[37].

Nonetheless, it needs to be recalled that there is no evidence that more foreign investment automatically translates into growth for a national economy. As was clearly shown in the Lone Star's case, foreign investment can be misused for foreigners to make financial profits in one country and swiftly leave the country without considering its impacts on the economy, rather than to make profits through sound investment leading to production and job growths that help the economy. It is a well-known fact that since financial market liberalization began during the Lee Yong-sam's reign, approximately half of foreign investments into

[36] Refer to Chapter 11 Investment and Chapter 13 Financial Services.
[37] Hong(2007).

Korea proved to be short-term investment portfolios aiming for financial profit at securities markets or marginal profit derived from hostile M&As[38]. In Mexico's case, after the NAFTA entered into force in 1994, approximately 70 percent of foreign investment flowed into stock markets, while only 30 percent of foreign investment was directly invested in factories, machines and equipments[39].

Of course, it is not an issue in this paper what should be characteristics of 'good' foreign investment. However, it cannot be overemphasized that if the Korean government has a policy objective to attract more foreign investment, it should go hand in hand with a broader policy objective and its relevant incentive/punishment measures to make foreign capital translate into 'real' development of the country. Unfortunately, it is hard to find this kind of well-formulated policy scheme in relation to foreign investment in the final text of the Kor-U.S. FTA.

Furthermore, it should be noted that substantial amount of what foreign investment get in a country is actually coming back to its originating country in forms of profits and dividend, rather than to be re-invested in the invested country. And the FTA text is makes it clear that nothing can prevent foreign investors from

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[38] Lee(2006).
[39] Noh(2006).

brining their money back home[40]. Mexico's case again suggests an implication. During the 1990s when foreign investment skyrocketed supposedly thanks to embarking of the NAFTA, 55.6% percent of foreign direct investment into Mexico drained back to the U.S. in forms of profits and dividends[41].

**Intellectual Property Rights (IPR)**

It is an international agreement that the level of intellectual property right (IPR) protection is to balance the incentives necessary to encourage future innovations against the desire to provide wide access to those products in a competitive market. Nevertheless, when the Kor-U.S. FTA text in relation to intellectual property rights is investigated, it seems clear that the 'incentives' side of IPR protection was over-represented. The text includes the strongest protective measures for intellectual property rights. For example, after 2 years from when the agreement goes into effect, the term of a protection of a work, performance, and a phonogram is extended to 70 years after the author's death, from current 50 years after death[42]. Because the pact affirms "the existing obligations with respect to each other under

[40] Chapter 11 Investment.
[41] Noh(2006).
[42] Article 18.4 Copyrights and Related Rights.

the TRIPs (Trade Related Intellectual Properties) Agreement"[43] and at the same time adopts some new measures that go beyond the TRIPs agreement, the Kor-U.S. FTA is called a 'TRIPs plus' agreement when it comes to IPR.

Needless to say, the results shall be asymmetry for two parties. Most of the strong IPR protective measures included in the text will serve to benefit the U.S. knowledge-based industries, notably its world's top class entertainment and pharmaceutical industries, while do damage on the Korean economy whose knowledge-based industries' competitiveness is incomparably weaker. Note that approximately 60 percent of the U.S. imports are coming from knowledge service industries, and Korea is second-largest imports market (17%) for the U.S. knowledge services[44]. The World Bank made it clear in its annual report in 2002 that when full application of TRIPs is applied, the greatest winner will be the U.S. and the biggest loser Korea. The report says, "Korea would register the largest net outward transfer of some $15.3 billion because of the large rise in volume of patents registered there." The report goes on to say, "overwhelmingly the United States would gain the most income in terms of static rent transfers, with a net inflow of some $19.1 billion per year. U.S.-headquartered firms owned numerous patents in many countries that were required by TRIPS to strengthen their

[43] Article 18.1 General Provisions.
[44] OECD(2005).

intellectual property protection, while U.S. law was subject to little change."[45] It did not come as a surprise when the USTR Industry Advisory Committee on Intellectual Property Rights said in the report on the Kor-U.S. FTA to the President and the Congress on April 27, 2007, "(we) applaud Korea for agreeing to higher level of protection, by incorporating in the agreement all the obligations set forth in the WIPO Copyright Treaty and WIPO Performances and Phonograms Treaty (WPPT)."[46]

Even the Korean government recognized that the Kor-U.S. FTA would incur substantial damage to the economy. 11 government-run institute, headed by the Korea Institute for International Economic Policy (KIEP), estimated that the amount of damage was to be average 150 billion ~ 380 billion Korean won (17 million ~ 43 million U.S. dollars) each year for next 10 years. But, IPR-related organizations and industries insisted the amount of the damage shall be much larger. 'Korean Alliance against the Kor-U.S. FTA', the coalition of over 400 civil organizations in Korea that oppose to the Kor-U.S. FTA, estimated the damage on the IPR-related sector should be as much as 2.2 trillion won a year for next 10 years.

What is worse, the IPR-incurring damage will be discriminatory in terms of

[45] World Bank(2002).
[46] USTR(2007).

those who are affected. It is because the economically and socially weaker tend to be more vulnerable when it comes to strengthening of the IPR protection. While Chaebols and large companies are capable of bearing the raised IPR standards, small and medium companies and individuals aren't. The most hardly hit group will be patients who suffer from an incurable disease because of high price of medicines that otherwise could be lowered.

Still, if all the damage is for the benefit of the whole economy and adequate redistribution and social protection polices go in hand in hand with the raising of the IPR standards, even the 'TRIPs plus' FTA can be justified. Unfortunately, given the current level of IPR-related industries of Korea that remain weaker in the international market, the Kor-U.S. FTA will only result in the 'Kicking-away-the-ladder' effect on the Korea's IPR-related industries. More importantly, the highest level of IPR protections shall be a fundamental obstacle when Korea as a national economy pursues to transform into a knowledge-based economy. Many of development economics texts say that the more advanced an economy gets, the more important knowledge as a production factor becomes. It is contradictory the Roh government insist that the FTA will help Korean economy transform to more advanced knowledge-based economy whilst adopting the strongest IPR protective measures that shall hamper the development of knowledge-based industries.

### B. Undermining of Policy Space

In the previous section, it was suggested that the Kor-U.S. FTA text presented little substantive evidences that the FTA will result in growth in GDP and employment, but it showed tangible threats that it shall undermine potentials for Korea's further economic development.

More importantly, the Kor-U.S. FTA itself undermines the rights and capabilities of the Korean government and other public entities to implement, practice, modify, evaluate and when necessary annul its development policies. It came in many different forms in the text of the FTA. In the following, four factors will be considered: (a) Unilateral liberalization commitments; (b) Negative listing and ratchet principle; (c) 'Future' most favored nation (MFN) treatment; and (d) Investor-state dispute (ISD).

#### Unilateral Liberalization Commitments

The text of Kor-U.S. FTA includes a number of unilateral liberalization commitments on the Korean side. Below are the examples of what Korea promised to do to the U.S. if the agreement enters into effect:

-"By the date the Free Trade Agreement enters into force, Korea will amend Article 3 of the *Enforcement Decree of the Postal Service Act* to expand the exceptions to the Korean Postal Authority's monopoly to include all international document delivery services."[47]

-"Korea Post shall not issue new products, including variable life insurance, non-life insurance, and retirement insurance."[48]

-"Each party shall provide its authorities responsible for the enforcement of its national competition laws with the authority to resolve their administrative or civil enforcement by mutual agreement with the subject of the enforcement action."[49][50]

-"Korea also agrees on the objective of shutting down Internet sites that permit unauthorized downloading (and other forms of piracy) of copyright works, including so-called webhard services, and providing for more effective enforcement of intellectual property rights on the Internet, including in particular with regard to peer-to-peer(P2P) services."[51]

-"Korea will amend relevant laws and regulations to provide for a public comment period of no less than 40 days and will revise Article 14.1 of the Regulation on Administration of Legislative Affairs to remove the requirement to conduct

47 Confirmation letter attached to the Chapter 12 Cross-border Services in Trade.
48 Confirmation letter attached to the Chapter 13 Financial Services.
49 Chapter 16 Competition-related Matters.
50 The subject of the article is 'Each party', not 'Korea', yet it affects only Korea. It is because this institution called 'consent order' is already in the U.S.'s legal system while in Korea there is no corresponding institution. Whether 'consent order' shall be adopted or not had long been controversial in Korea.
51 Confirmation letter attached to the Chapter 18 Intellectual Property Rights.

> interagency consultations before the publication of proposed regulations for public comment."[52]

That the Korean government itself has vigorously pursued to deregulate and open the market is one thing, but to make it mandatory in form of a bilateral agreement is another thing. It is not a matter of whether 'to leave it to the market mechanism' policy or 'to let it be under the control of the government' is a better policy. Rather, it is important to recognize that the Korean government promises to the 3rd party to implement many policies that need to make a change on Korea's current laws[53]. If a certain policy the Korean government currently pursues is not inside the scheme of a bilateral agreement, the government still has a grip on this policy and is able to give a change to it when the higher development objectives and accompanying strategies are changed. In this sense, the Kor-U.S. FTA seriously limits policy space for future development policies.

**Negative Listing and Ratchet Principle**

Another problem in relation to policy space is that the services/investment market

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[52] Letter attached to the Chapter 21 Transparency.

[53] The Korean government did so without getting permissions from the National Assembly, thereby violating its legislative rights.

opening method the Kor-U.S. FTA adopts follows so-called ‘negative listing system’. In the negative listing system, services/investment areas and its relevant measures that a party want not to be applied by the FTA must be specified in the list titled ‘non-conforming measures’ list. What it implies is critical. If one area and its relevant measures are not listed in the text or if there is a new area that is created after the FTA enters into force, it is considered to be automatically liberalized. It severely challenges the Korean government’s ability to develop a new industrial area as part of nation-level development policies. Note that the multilateral WTO agreements and many other FTAs including the Korea-European Union (EU) FTA the government is currently negotiating adopt ‘positive listing system’, in which only opening areas and its relevant measures need to be listed.

For sure, even after the FTA goes into effect, some of Korea’s critical polices are protected under the Annex Ⅰ and Annex Ⅱ called ‘reservations to existing measures’ and ‘reservations to future measures’, respectively. The Roh government has insisted that in the FTA negotiations with the U.S., it succeeded in protecting the government’s basic policy rights by listing every single critical policy and is relevant measure in theses two lists. For example, media-telecommunication mixed area, which nobody knows at the time of negotiations how this area will be developing but everybody agrees that it will be one of future strategic industries, is listed in the reservation list[54].

But it is too early to say that the two lists will provide enough protections because the first reservations list Annex Ⅰ has a fundamental limitation that is called the 'ratchet principle'. Ratchet principle means the government cannot put stricter limitation on the areas and measures listed in Annex Ⅰ.

For instance, Korea's Screen Quota system was listed in the Annex Ⅰ[55]. At a glance, the government's right to deal with policies related to screen quota is reserved, but what it actually means that the Korean government cannot extend the current quota (73 days a year) even when the government decides to extend it to promote Korean movie industry. Furthermore, once the government reduces the quota to below 73 days a year, say 37 days a year, it cannot extend the quota back to over 37 days 'for good'. In this way, the government's policy space to deal with changing domestic/international environments keeps shrinking.

Another example is Korea's current restriction on a foreigner's share of the facilities-based public telecommunication services supplier, which is also listed in the Annex Ⅰ. The annex says, "a foreign government, a foreign person or a deemed foreign person may not in the aggregate hold more than 49 percent of the total voting shares of a facilities-based supplier of public telecommunications

[54] Annex Ⅱ Non-conforming Measures for Services and Investment.
[55] Annex Ⅱ.

services."[56] It means the Korean government cannot raise the ceiling shares to above 49 percent. At the same time, it means that once the government lowers the ceiling shares, say to 30 percent, it cannot raise it 'for any reason' 'for good'[57].

All these imply that Korea will be left with smaller space for autonomous development policies once the Kor-U.S. FTA enters into force.

**'Future' Most Favored Nation (MFN) Treatment**

The Kor-U.S. FTA's unique problem is that "most favored nation (MFN) treatment" shall be applied only to the free trade agreements the two signatories will be signing on 'in the future,' not to previously signed agreements before the Kor-U.S. FTA. The MFN treatment is one of basic FTA principles that a signatory nation shall provide the other signatory nation with no less than the most favored treatment given to the 3rd nations. Without this treatment, the FTA loses its meaning, because the very reason one country seeks for a bilateral FTA is it can get preferential treatment from the other country.

But in case of the Kor-U.S. FTA, somehow the Korean government agreed

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56 Annex Ⅱ.

57 In addition, the reserved measure was followed by another commitment for an unilateral liberalization: "No later than two years after this Agreement enters into force, Korea shall permit: (a) a deemed foreign person to hold up to 100 percent of the total voting shares of a facilities-based supplier of public telecommunications services organized under Korea laws, other than KT and SK Telecom Co., LTD."

that this MFN treatment shall not apply to the other previous free trade agreements that the two countries signed on with other 3rd countries. On one hand, it means that all the preferential treatments that have given to 15 countries including Canada and Mexico, the biggest trade partners of the U.S., will not be given to Korea. It shows the expected benefits of the FTA on the Korean side will be significantly diminished.

However, this is only small part of the problem. So far, Korea signed on six FTAs with relatively small economies. And party because of this, the government is rigorously seeking for FTAs with many other countries including EU[58], China, and Japan. It goes without saying that all these FTAs will be affecting the Kor-U.S. FTA. If there is one more liberalization measure or one more deregulation commitment included in these FTAs, it is automatically incorporated into the Kor-U.S. FTA. It means Korea will have lesser and lesser space for its own development policies. In essence, the Kor-U.S. FTA is designed to automatically grow toward more market liberalizations/deregulations and less government power in terms of pursuing development policies.

[58] Right after the Kor-U.S. FTA was signed on, the Korean government announced the launch of the Kor-EU FTA, and the negotiations are expected to be finished as early as late 2007 or early 2008.

**Investor-State Dispute (ISD)**

This is not the end of the story. It is critical to understand hat the biggest threat of the Kor-U.S. FTA in relation to one country's autonomous development policies lies in so-called 'investor-state dispute (ISD)' that is incorporated in the chapter 11 Investment of the FTA text. Investor-state dispute is a mechanism in which a foreign investor is allowed to submit a foreign nation (not only the administration but also the legislature and the judicature) to arbitration a claim when he/she believes and insists that its specific policy bleaches the expected return of his/her investment in that nation[59]. This mechanism was originally introduced in many bilateral investment treaties for the purpose of protecting foreign investors from unexpected political upheavals or land redistribution that can harm foreign investors' investment. But recently it has developed from a protective method to an attacking tool that investors are attracted to use whenever they judge a policy or policies get in the way of their making profits[60].

[59] The Kor-U.S. FTA text adopts the definition of 'investment' in its broadest sense. The text describes investment as "every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation gain or profit, or the assumption of risk. And its forms that an investment may take include "(a) an enterprise; (b) shares, stock, and other forms of equity participation in an enterprise; (c) bonds, debentures, other debt instruments, and loans, (d) futures, options, and other derivatives; (e) turnkey, construction, management, production, concession, revenue sharing, and other similar contracts; (f) intellectual property rights; (g) licenses, authorizations, permits, and similar rights conferred pursuant to domestic law; and (h) other tangible or intangible, movable or immovable property, and related property rights, such as leases, mortgages, liens, pledges."

[60] Hong(2006).

There are two-direction effects of the investor-state dispute on the development policy. One is that a foreign investor can directly make a certain policy obsolete by winning the arbitration. Basically every single policy can be the prey of ISD, but in particular, public polices related to public health, safety, the environment, labor, which by nature are supposed to interfere with foreign investment and which are very basic policies for sound development, are expected to distinguish as the number of ISD arbitration increases[61]. Also, real-estate related polices and taxation polices which are two crucial polices related to Korea's development strategy are at stake, because those policies are not fully protected from possible attack of the ISD in the text[62]. In addition, if a country loses in the ISD arbitration, the amount of compensation charged to the nation will be substantial so that it eats up finances put aside for economic development.

The other is so-called 'chilling-effect'. The foreign investor can thwart a certain policy in an initiation stage merely by giving a hint to the foreign nation that "I will make use of ISD if the policy is implemented and thereby affects my

[61] UNCTAD(2004) reported that "International Investment Disputes arising from investment agreements are on the increase, at times involving tens of millions of dollars (…) They cover a wide range of economic activities and various types of foreign involvements, and relate to key provisions in investment agreements."

[62] Refer to the Chapter 11 Investment. According to the text, "real estate price stabilization polices (…) do not constitute indirect expropriation" but there are exceptions "for rare circumstances." Also, "the determination of whether a taxation measure, in a specific fact situation, constitutes an expropriation requires a case-by-case, fact-based inquiry that considers all relevant factors relating to the investment."

investment." In other word, the very presence of the ISD will make the government and public entities hesitate to adopt a certain policy because it is afraid that it might get caught in the ISD arbitration and pay a lot of money which otherwise can be used in implementing the policy . In this way, the space for development policies will be shrinking.

## Ⅴ. CONCLUSION

Korea has been the great example of how a nation could mix domestic endowments and changing global economies for a poor country to develop into a rich country with relatively low inequality. By signing on the Kor-U.S. FTA, the Korean government officially declared that the days of government-driven development policies are gone. It gives way to market openings, competitions and deregulations as substitutes for the basic policy tools for further development.

But the Kor-U.S. FTA is a questionable development policy package, because it is based on wrong assumptions and argumentations on the Korean economy and its development direction. It was not ungrounded when the Roh government thought that Korea needed a new development strategy to address the troubled economy, namely 'jobless growth.' But it was followed with a great number of sweeping assertions including 'more exports' to the U.S. market to beat China, 'external shock therapy' for the development of services sector. Besides, there is no substantive evidence that tightening Korea's economic relation with the U.S. will provide the sound and sustainable development for Korea.

Moreover, the Kor-U.S. FTA will function as a lock-in instrument that enforces the Korean government and other public entities not to pursue autonomous and independent development polices. When unilateral liberalization commitment, the negative listing system applying to services/investment market liberalization and the ratchet principle, future most-favored-nation (MFN) treatment, and investor-state dispute (ISD) are combined, there is not much space left for Korea's future development policies.

The contribution of this paper is not large. However, it is the first paper that deals with the Kor-U.S. FTA in terms of its implications for Korea's development strategy. Without a clear blue print of what is Korea's next development strategy and policies including industrial policies, letting the Kor-U.S. FTA replace of them is quite dangerous. If Korea wants to pursue free trade agreements for further economic development, the first rationale to be given is not that other countries are doing so, but that it is incorporated in the bigger picture that shows Korea's future economy.

Korea's next step will be closely observed by many developing countries in the world. Unfortunately, Korea is now going into an historical experiment, instead of making its own development strategies. The key questions to remain to be answered are how to picture Korea's future economy and find its unique development polices.

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