

Understanding the Korea-United States Free Trade Agreement

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Abstract

In recent years, the Republic of Korea has been fervently executing free trade agreements (FTAs) with many different countries. This FTA-based trade policy serves to solidify Korea's position as a major exporting country while also encouraging foreign direct investment by partnering FTA members. On March 15, 2012, Korea entered into the largest and most comprehensive FTA ever with the United States (KORUS FTA). Despite almost five years of negotiating to hammer out details on implementation, there is still much contention that surrounds the KORUS FTA. This paper provides a historical overview on the conception of the KORUS FTA, examines key provisions and concessions made by Korea in granting the United States access to the Korean automotive industry, discusses how the KORUS FTA will negatively impact weaker domestic industries, and highlights the controversy surrounding the investor-state dispute (ISD) settlement provision of the KORUS FTA.

I. Introduction

During the past fifty years, removing trade and tariff barriers in an effort to move towards trade liberalization has been the central focal point of many international trade negotiations. Many co-

untries today use free trade agreements (FTA) to accomplish this goal.¹⁾ A free trade agreement, commonly referred to as the FTA, is a reciprocal often bilateral arrangement between two or more countries where the participating nations

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1) Free trade agreements (FTAs) account for 84percent of all Regional Trade Agreements (RTAs). RTAs are a major feature of today's multilateral trading system (Crawford and Fiorentino, 2005, pp.1-3).

agree to remove certain trade barriers such as tariffs and duties for the benefit of the FTA partner (Oliveros, 2005). Pushing for more FTAs was viewed as one critical way of improving a country's declining trade environment owing to the recent global financial crisis, and to reinforce the country's economic-growth momentum.²⁾

In recent years, the Republic of Korea (Korea) has also given priority to creating free trade areas by negotiating such FTAs with selected countries. In fact, Korea created its first FTA roadmap in 2003, which was later revised in 2004. Based on this roadmap, Korea has been fervently pursuing FTAs with over 20 countries. If it proceeds as scheduled, approximately 88% of Korea's foreign trade will be attained through the FTA system (Lee, 2008). According to the Korean Minister for Trade, the general recognized objectives for pursuing FTAs is to 1) penetrate foreign markets, 2) attract foreign investments and technology, 3) cope with the multiplying FTAs among other countries and regions, 4) to over-

come the weakening multilateral trading system of the World Trade Organization (WTO), 5) establish an international production network, and 6) create regulatory reforms by opening the domestic market.³⁾ Given the history of Korea's active export strategy that resulted in Korea becoming heavily reliant upon overseas markets to achieve economic growth and stability, utilizing of FTAs will further solidify this position. In fact, according to data provided by the World Bank, in 2010, exports accounted for 52% of Korea's GDP.⁴⁾

Of the numerous FTAs that Korea has signed, one prominent FTA that has been both scrutinized as well as lauded for its potential benefits is that of the Korea-United States Free Trade Agreement (KORUS FTA). Korea's eighth FTA, the KORUS FTA officially took effect on March 15, 2012.⁵⁾ Designed to eliminate

2) Refer to Baldwin and Rieder (2007); Holmes (2005); Raff (2004); and the World Trade Organization, Committee on Regional Trade Agreements (2002) for a general discussion on the economic effects of FTAs.

3) Bark, T., Korea's FTA Policy, KORUS FTA and East Asian Economic Integration [Power-Point slides]. Retrieved from <http://www.iie.com/publications/papers/bark20120516ppt.pdf>, 2012.

4) The World Bank, World Development Indicators Database, Exports for goods and services (% of GDP). Retrieved from <http://data.worldbank.org/indicator/NE.EXP.GNFS.ZS/countries>, 2012.

5) Prior to the KORUS FTA taking effect, Korea's existing FTA partners were Chile, Singapore, European Free Trade Association

tariffs and other trade barriers in order to facilitate a liberalized environment of trading in goods and services, the significance of the KORUS FTA cannot be understated-it is the largest FTA Korea has signed to date.

Likewise, the KORUS FTA is also of great significance to the United States since it represents the second-largest FTA for the United States in terms of value of trade affected, next to the North American Free Trade Agreement (NAFTA), which was signed in 1992 (Cooper, 2011). Furthermore, the KORUS FTA is the United States' first FTA with a major Asian economy.

Despite the potentially significant impact the KORUS FTA is expected to have on the Korean economy, businesses, and the average Korean consumer, few are actually aware of its content. The purpose of this Paper is to fill that gap by providing an overview of the KORUS FTA, highlight provisions within the KORUS FTA that relate to the automotive industry given that it was a contentious issue in negotiations, discuss criticisms of the KORUS FTA, and conclude by highlighting issues that will re-

quire re-examination and resolution post-KORUS FTA.

II. The Korea-United States Free Trade Agreement (KORUS FTA)

1. Creating the KORUS FTA

Korea is the seventh largest trading partner to the United States, ranking ahead of larger economies such as France, Italy, and India.⁶⁾ The role that the United States market plays to Korean exporters is also significant-the United States is Korea's third largest trading partner.

On February 2, 2006, Korea and the United States launched into negotiations with the intent of entering into a free trade agreement. Korea had numerous reasons for wanting the KORUS FTA: 1) secure the largest and most advanced market in the world; 2) diversify Korea's trade relations into areas outside North-east Asia; 3) introduce more competition into the domestic market; 4) reform do-

(EFTA), ASEAN, India, EU, and Peru.

6) Bureau of East Asian and Pacific Affairs, Background Note: South Korea, Retrieved from <http://www.state.gov/r/pa/ei/bgn/2800.htm>, 2011.

mestic regulations and institutions; 5) enhance the competitiveness of Korea's services industries; and 6) induce more foreign direct investment (Bark, 2012).

It is evident that Korea's motivations for the KORUS FTA were not about accessing, but rather, "securing" its presence in the U.S. market and inducing foreign direct investment into Korea. It is worth noting that since 2006, Korea's foreign investment in the United States has exceeded U.S. direct investment in Korea. Between 2006 and 2010, Korea invested \$13 billion more in the United States than the United States did in Korea.⁷⁾ Additionally, when combined, Hyundai Motor America and Kia Motors America, Inc. together support more than 78,000 U.S. jobs and reflect investments of over \$1.7 billion and \$1 billion, respectively.⁸⁾

On June 30, 2007, Korea and the United States signed a comprehensive bilateral free trade agreement, referred to as the Korea-United States Free Trade Agreement (KORUS FTA). It took both

nations almost five years to negotiate the details regarding the legal and regulatory changes necessary to implement the KORUS FTA. All negotiations came to a close in December 2010 when the United States and Korea reached successful resolution of all outstanding issues.

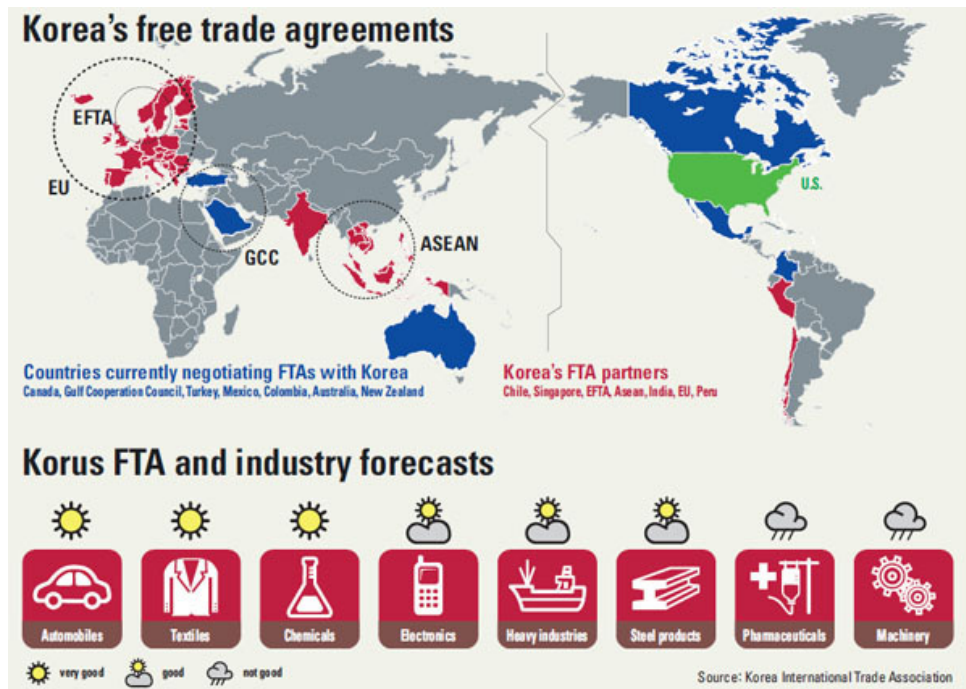
Once the United States Congress (October 12, 2011) and Korea's National Assembly (November 22, 2011) ratified the KORUS FTA, in accordance to Article 24.5.1 of the Agreement, the KORUS FTA officially became effective in Korea and the United States as of March 15, 2012.

As depicted in [Figure 1], the Korea International Trade Association (KITA) forecasted that with the exception of the pharmaceutical and machinery industries, the KORUS FTA was expected to generally be beneficial to all other industries in Korea. It is interesting and even telling, to note that KITA does not make any predications regarding the effects the KORUS FTA will have on weaker industries such as the Korean agricultural, forestry, and fishing industries.

In its final form, the KORUS FTA provides that tariffs on almost 80 percent of U.S. exports to Korea of consumer and industrial products will become duty

7) Embassy of the Republic of Korea, The Facts About the Korea-U.S. Free Trade Agreement, Retrieved from <http://www.uskoreaconnect.org/files/publications/facts-about-the-korea-us-fta.pdf>, 2011.

8) Ibid.



[Figure 1] KORUS FTA Forecast

free on March 15, 2012, and that tariffs on 95% of industrial and consumer goods between the two countries are expected to be eliminated within five years of implementation. Most remaining tariffs will be eliminated within ten years (Lee, 2009). The KORUS FTA also addresses non-tariff measures in investment, intellectual property, services, competition policy, and other areas.⁹⁾

The KORUS FTA is expected to revitalize Korea's trade relations with the

United States by generating billions of dollars in increased trade and investment between the nations as well as boost economic growth and job creation in both nations. However, a congressionally mandated study by the United States International Trade Commission (USITC) concluded that investment and trade between the two countries would only increase modestly (U.S. GDP increase of approximately 0.1%) as a result of the KORUS FTA.¹⁰⁾ By contrast, a report published

9) Ibid.

10) United States International Trade Commi-

by the Korea Institute for International Economic Policy (KIEP) indicated that the KORUS FTA will increase Korea's GDP by 5.7% and create 350,000 jobs over the next ten years. Moreover, the KORUS FTA is expected to promote diversification of export products through increased participation of small and medium-sized enterprises (SMEs).

2. KORUS FTA Provisions

The KORUS FTA consists of a preamble, a main body of 24 chapters, and annexes, including the text of the Agreement signed on June 30, 2007, and diplomatic notes exchanged on February 10, 2011, covering a wide range sectors, including manufactured goods, services and investment, government procurement, intellectual property rights, labor, and the environment.

3. Paving the Way for the Automobile Industry

Of the many issues that were discus-

sed in negotiations, the most difficult and often times, contentious issues for negotiators centered on the automotive industry. On the one hand, Korean automobile manufacturers were seeking to solidify their market presence by increasing their market shares of the U.S. automotive industry. On the other hand, U.S. car manufacturers wanted Korea to eliminate policies and practices that were arguably discriminatory against U.S. auto imports. Depicted in <Table 1>, Korea and the United States were able to reach a compromise regarding the phasing out of tariffs on automobiles.

As depicted in <Table 1>, the United States will eliminate its 2.5% tariff on passenger cars after the first four years of the KORUS FTA. In exchange, Korea will reduce its current 8% tariff to 4% for passenger cars. In light of the tariff phasing out schedule, it is highly likely that the initial year after the implementation of the KORUS FTA there will see an increase in the number of passenger cars imported from the United States.

In addition to the aforementioned tariff reductions, under the KORUS FTA, Korea will also revise its engine displacement tax regime so that there would be fewer categories and that the tax that

ssion (USITC). U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects. Investigation No. TA-2104-24. USITC Publication 3949. 2007.

<Table 1> Tariff Elimination Schedule¹⁴⁾

Car Type	Korea	United States
<i>Passenger Cars</i>	Immediate reduction of its tariff from 8% to 4%, with remaining tariff eliminated in year 5.	Postpone elimination of 2.5% tariff for four years.
<i>Light Trucks</i>	Immediate elimination of its 10% tariff.	The 25% tariff will remain until year 7. In year 8, the tariff will be reduced to 16.6%. In year 9, the tariff will be 8.3% and then eliminated in year 10.
<i>Electric Cars</i>	Immediate reduction of its 8% tariff to 4%, with the remaining tariffs to be phased out in four equal annual stages.	A tariff of 2.0% for year 1, which will be reduced by 0.5% annually thereafter until such complete elimination of the tariff by year 5.

would be applied to most cars manufactured in the United States is the same as it is applied to South Korean-made cars.¹¹⁾

Regarding environmental standards, the KORUS FTA provides that U.S. manufacturers will be deemed compliant with Korean environmental standards during the years of 2012 to 2015, if their emissions are within 19 percent of Korean requirements. This lenient rate applies to each U.S. car manufacturer that sold no more than 4,500 units in the 2009 base year. As it stands, this rate will cover General Motors, Ford, and Chrysler.¹²⁾

Another noteworthy provision of the KORUS FTA relates to safety standards. As long as cars meet U.S. federal safety standards, Korea will recognize and/or accept U.S. safety regulations for imported U.S. cars if the number of imported cars does not exceed 25,000 vehicles per auto manufacturer. Given that the annual average of U.S. cars exported to Korea has averaged between 5,000 to 7,000 cars, this provision is essentially recognizing U.S. standards.¹³⁾

The KORUS FTA also has a safeguard measure that applies exclusively to automobiles. Under this provision, Korea will

11) USTR, "Exchange of Letters between U.S. Trade Representative Kirk and Korean Trade Minister Jong-Hoon Kim," 2011; and USTR, "Agreed Minutes on Regulations," 2011.

12) USTR, "Agreed Minutes on Regulations," 2011.

13) Ibid.

14) USITC. U.S.-Korea FTA, pp. 3-79 (Box 3.4). See also H.R. 3080-112th Congress: United States-Korea Free Trade Agreement Implementation Act., 2011.

make its regulatory process more transparent to ensure that new regulations do not create unnecessary barriers to trade. Additionally, Korea will give automobile companies 12 months to comply with significant regulatory changes before new requirements become effective.

One unique characteristic of the KORUS FTA is found in a provision that would essentially allow the United States temporary protection of its market to counter harmful import surges. This special provision grants the United States the ability to impose extra duties if there is an unexpected import surge for up to two years. In exercising its rights granted by this provision, the United States could impose safeguard measures for ten years beyond the full elimination of tariffs (White House 2010). However, it is highly unlikely that this will occur given that Korean car manufacturers are already a well-established presence within the U.S. automotive industry. In fact, most Korean car manufacturers already have their own local production plants based in the United States.

Regarding the manner in which disputes arising from the KORUS FTA may be resolved, there are several available options, in addition to the special dispute

settlement provisions under the foreign investment chapter and other chapters of the KORUS FTA.¹⁵⁾ Under the KORUS FTA, the United States and Korea will designate contact points to facilitate bilateral communication and set up a Joint Committee to supervise the implementation and operation of the KORUS FTA and play a part in settling the dispute. However, if the Joint Committee is unable to resolve the issue within 30 days, the Committee will submit the dispute to a panel. This panel will have 120 days to draft a preliminary report and determine whether a FTA-inconsistent measure materially affects the sale, offering for sale, purchase, transportation, distribution or use of originating goods of a party. If the panel finds that the violating party has not conformed with its KORUS FTA obligations, Annex 22A of the KORUS FTA contains a snap-back provision, whereby the United States is permitted to suspend or “snap-back” tariff concessions on Korean passenger cars should Korea be found in non-conformity with, or causing nullification or impairment of its obligations under the

15) H. R. 3080-112th Congress: United States-Korea Free Trade Agreement Implementation Act, 2011.

KORUS FTA, in a way that materially affects the sale, purchase, or distribution of American vehicles in Korea.¹⁶⁾

4. Criticisms of the KORUS FTA

There has always been much debate when it comes to free trade agreements. There are the proponents who contend that FTAs are beneficial in that they work to eliminatetrade barriers to a certain degree. However, FTA opponents point out that such agreements are at best preferential agreements that are discriminatory: they reduce trade barriers for members of the trade agreements but not for the nonmembers. Consequently, rather than spurring on progress, FTAs may be viewed as undermining a nation's ability to make further multilateral trade liberalization (Bhagwati, 2008).

In the case of Korea, it is clear that Korea joined the FTA bandwagon for fear of losing out on the "opportunities" that seemed to avail themselves to other countries caught up in the FTA frenzy. All of these countries are trying to keep up with the worldwide regionalism effort while simultaneously plotting a global-

ization strategy (Bhagwati, 2008). As a practical matter, many countries enter into FTAs in order to secure access to the world's largest markets and attract more foreign direct investment (Fiorentino, 2006). Similarly, when examining Korea's motivation for entering into the KORUS FTA, it is evident that it was not about gaining reciprocal access to the U.S market, which it already had.

Korea of today has a much more prominent status and role in the area of international trade. A member of the Organization Economic Cooperation and Development (OECD), Korea is classified as a high-income economy by the World Bank and an advanced economy by the International Monetary Fund.¹⁷⁾ Moreover, it is a somewhat undisputed fact that many Korean exporters already have a significant competitive presence in the areas of consumer electronics and automobiles. Therefore, in light of these facts, it is puzzling that Korea made seemingly more concessions than was necessary when granting the United States access to the Korean automotive industry. Ko-

16) KORUS FTA Final Text, Annex 22A.

17) Embassy of the Republic of Korea, The Facts About the Korea-U.S. Free Trade Agreement, Retrieved from <http://www.uskoreaconnect.org/files/publications/facts-about-the-korea-us-fta.pdf>, 2011.

rea's focus on securing its presence in the U.S. market while also encouraging direct U.S. investment and technology-coupled with boosting the overall competitiveness of the Korean services industries resulted in Korea losing sight of the bigger picture (Lee, 2005). There could be severe repercussions as to how the tariff concessions given to the United States play out in the Korean automotive industry.

What is unprecedented in the KORUS FTA and therefore, the most criticized component of the KORUS FTA, is that the KORUS FTA differentiates itself from other FTAs that the United States has entered by its strong enforcement provisions. The snap-back provision related to automobiles in the KORUS FTA essentially grants the United States the ability to enforce its rights and hold Korea accountable for its commitments by snapping back U.S. tariffs on passenger cars to their pre-arrangement levels if Korea is found to have not lived up to its commitments under the KORUS FTA. Albeit understandable as to why the United States would want to include such strong enforcement measures, this snap-back provision becomes problematic since this same courtesy or right is not exten-

ded in kind to Korea.

In an effort to tout the KORUS FTA and gain momentum for the successful and seamless implementation of the KORUS FTA, much has been written to highlight how Korea will become much more competitive while also boosting its economic growth through the process of removing trade barriers and opening its markets. Nonetheless, as with any FTA implemented, there are also the negative effects that will hit different sectors of the Korean economy as a result of the KORUS FTA. These effects will be felt most by the weakest domestic industries. Specifically, the Korean agricultural, forestry, and fishing industries will be drastically impacted given that nearly 600 imported items will now enter into the Korean consumer market tariff-free (Lee, 2005). As a practical matter, it is a daunting and perhaps, even cruel task for the average Korean farmer who owns approximately one hectare of cultivated land to compete with an American farmer who owns, on average, more than 200 hectares of land.

Government plans to provide nearly 22 trillion won in subsidies may assist such industries by helping to protect against immediate income loss by the

farmers and fishermen; however, such lending programs are in no ways a viable long-term solution. Moreover, having synchronized multilateral FTAs may minimize the burden experienced by the weaker industries. However, any successes associated with having such synchronized multilateral FTAs will not be felt until years later. Immediate attention needs to be directed towards creating and implementing programs and various initiatives that are focused on restructuring these weaker industries. In other words, to strengthen the weaker industries, education and guidance on immediately viable export opportunities needs to be relayed and emphasized.

Lastly, Chapter 11, Section B of the KORUS FTA that relates to investor-state disputes (ISD) has proven to be a major point of contention for those opposed to the KORUS FTA. Chapter 11 of the KORUS FTA sets out rights and obligations aimed at facilitating investment by citizens of the United States and Korea in each other's countries. The ISD provision found under chapter 11 provides for binding arbitration of investment disputes by making it possible for U.S. investors to bring their disputes with the Korean government to an inter-

national arbitration panel instead of a local Korean court. Consequently, an investor may submit a claim under various arbitral mechanisms, including the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) and the ICSID Rules of Procedure for Arbitration Proceedings, the ICSID Additional Facility Rules, United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules, or, if the disputants agree, any other arbitration institution or rules.¹⁸⁾ Both the United States and South Korea are parties to the ICSID Convention and may thus avail themselves of the Convention and its procedural rules.¹⁹⁾

The Supreme Court submitted an opinion to the Korean government in 2006 requesting that the ISD provision in the KORUS FTA be re-examined because it “could give rise to extreme legal chaos” (Jung, 2012). In its opinion, the Supreme Court points out that the ISD provision infringes upon the sovereignty of Korea

18) International Centre for Settlement of Investment Disputes (ICSID), a body established under the Convention located in Washington, D.C. For further information, see the ICSID website at <http://icsid.worldbank.org/ICSID/Index.jsp>.

19) KORUS FTA, Art. 11.16.3.

and the judicial authority of the Korean court system in that it could interfere with government policies and regulations, with less room for the judiciary to participate in such disputes. Secondly, allowing U.S. investors the option of turning to an international arbitration panel seems to grant such investors greater rights while violating the equal rights of Korean citizens who do not have this option. Thirdly, inclusion of judiciary rulings as one of the subject matters of an arbitration request could destabilize the Korean legal system. To support this argument, the Loewen case is cited as an example, in which an arbitration panel reviewed U.S. trial proceedings and rulings.²⁰⁾ Although the arbitration panel dismissed the case, this case made it clear that judiciary rulings were subject to review by the arbitration panel.

Both Korea and the United States have agreed to hold additional negotiations on the ISD issue within 90 days of its effective date of March 15, 2012. If the ISD provision is deleted from the KORUS

FTA, this will give Korea the ability to exclude this clause in its FTA negotiations with other countries such as China. However, failure to remove this provision from the KORUS FTA could work to infringe upon Korea's legal sovereignty or undermine its trading policies and FTA structures with other countries.

III. Conclusion

In light of the ever-increasing number of FTAs that have been, and that continue to be executed throughout the world, countless opportunities would be lost by not pursuing an FTA-oriented trade policy. It is with this understanding that Korea created its FTA roadmap and recently enforced the largest and most comprehensive FTA of its kind for Korea-the KORUS FTA. Appreciation of the full benefits offered by the KORUS FTA can only be had against the backdrop of all the other benefits offered by Korea's existing mix of FTAs, which include massive markets of the European Union and ASEAN. The combination of these markets will provide (ready) Korean businesses with unparalleled access to the world's largest consumer markets.

20) In the Loewen case, Loewen a Canadian funeral home conglomerate, received a 1995 Mississippi State Court jury verdict ordering it to pay \$500 million in damages. In response, Loewen filed an ISD suit, claiming violation of the North American Free Trade Agreement.

To reap such benefits, the Ministry of Foreign Affairs and Trade (MOFAT) has stated the following:

The Government of the Republic of Korea will help its people and companies reap as many benefits as possible from the FTA by providing them with relevant information in the swiftest and most accurate manner possible. Also, it will make every effort for a seamless implementation of the additional assistance package for the sectors presumably vulnerable to the FTA.”²¹⁾

While countries like the United States and Korea believe that the creation of FTAs will serve as a catalyst to spur progress in the multilateral negotiation setting, there is still nonetheless a measure of doubt, skepticism, and criticism surrounding the KORUS FTA. Other than strengthening and solidifying an already strong economic relationship between Korea and the United States, the process of harmonizing the KORUS FTA with other FTAs may prove to be difficult given the disparate provisions and standards used (Dent, 2007). Consequently, ca-

reful examination of all of Korea’s existing FTAs would be a prudent step to take as well as warranted prior to proceeding with any new FTA.

As cliché as it sounds, the truth is that only the future knows the answer to the much debated question as to the exact impact the KORUS FTA will have on trade, economic, and social conditions between Korea and the United States. Moreover, the actual ripple effects of the KORUS FTA upon the individual Korean consumer and businesses, whether positioned in the traditionally competitive or weaker national industries, have yet to be observed. As Korea works to complete FTAs with other countries, it would serve Korea well to resolve, or at the very least, address the aforementioned criticisms surrounding the KORUS FTA.

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