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Aggressive Regionalism in Korea-U.S. FTA: The Present and Future of Korea's FTA Policy

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< Abstract >

The Korea-U.S. FTA is a result of a paradigm shift from traditional regionalism, which deals mostly with customs-border issues, to aggressive regionalism that codifies a whole-scale problem-solving process. By addressing a series of age-old bilateral trade disputes, such as the automobile trade imbalance, unethical business practices in pharmaceuticals and medical devices, and effective protection of copyrights, and new global or regional issues, such as the non-implementation of WTO panel decisions and South and North Korea’s economic cooperation, the FTA establishes stable, permanent principles and binding rules for trade between Korea and the United States.

It appears that the aggressive regionalism approach reflected in K-US FTA will continue to play an important role in Korea’s future FTA policy. When negotiating FTAs, Korea will take a problem-solving approach to trade remedy issues, unfair business practices, sanitary and food safety issues, and economic engagement policies towards North Korea. As Korea becomes part of more FTAs, transaction costs caused by fragmented FTAs will become an economic issue. By actively adopting the accumulation system for the rules of origin and harmonizing varying rules among and linking to other FTAs, Korea may be able to reduce the costs of active regionalism; however, achieving multilateral regionalism will be a long-term task for Korea.

Keywords: Aggressive Regionalism, Korea’s FTA Policy, Korea-U.S. FTA, Costs of FTAs, Rules of Origin

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I. Free Trade Agreements (FTAs) as a Problem-Solving Process

Several authors use the term *aggressive legalism* to describe a WTO country’s use of WTO’s substantive rules to counter what it considers the unreasonable acts, requests, and practices of a major trading partner. In the 1980s and 1990s, Korea and Japan shifted their WTO policy and jumped “on the aggressive legalism bandwagon.” This use of WTO’s substantive rules to settle disputes between trading partners is considered an appropriate way to settle trade disputes between WTO countries, and Gao suggests that China should use these rules to protect its legitimate trade interests.

This policy of aggressive legalism, based on “a conscious strategy where a substantive set of international legal rules can be made to serve as both ‘shield’ and ‘sword’ in trade disputes among sovereign states,” is reflected in the growth of regionalism in this era of proliferating FTAs. Countries negotiating an FTA plan to use treaty rules as a whole-scale problem-solving process. That is, they intend to use regional trade agreements to counter any unreasonable acts, requests, and practices of their trading partners. As a result, they want to include internal measures in FTAs that are not usually covered in international treaties. This new trend may be called *aggressive regionalism*, and the Korea-U.S. FTA (K-US FTA) offers a good example of this aggressive use of problem solving mechanisms.

Chapter II identifies major problems that occurred during the K-US FTA negotiations, and it shows how Korea and the United States resolved these problems by codifying legally binding provisions. Aggressive regionalism and implications for Korea’s future FTA policy are examined in Chapter III. As Korea is conducting, or will actively pursue, FTA negotiations with many countries (including ASEAN, Canada, China, the EU, India, and Japan), this analysis may help these countries and their trade negotiators understand aggressive regionalism, in general, and Korea’s FTA policy, in particular.

II. Major Problems in Korea-U.S. Trade and Their Resolution in the K-US FTA

A. Dealing with the Automobile Trade Imbalance

Korea and the United States, two long-time allies, dealt with many problems when they negotiated their FTA. The largest problem involved an imbalance in automobile trade.

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3See Gao, ibid.
4Ibid.
5See Pekkanen, supra note 2.
Before the FTA negotiations, Korea exported approximately 700,000 automobiles to the United States, and the United States exported approximately 5,000 automobiles to Korea. According to prevailing American views, Korean trade barriers that included high tariffs on U.S. automobiles created this trade imbalance. During FTA negotiations, Korea agreed to eliminate the 8% tariff on U.S. passenger vehicles, 10% tariff on U.S. trucks, and 3 to 10% tariff on almost all U.S. auto parts. These cuts have given U.S. automobile and auto parts manufacturers a price advantage in the Korean market.

Non-tariff barriers were also addressed. During FTA negotiations, Korea agreed to amend its Special Consumption Tax and Annual Vehicle Tax and reduce existing maximum tax rates based on engine size. This cascading set of taxes disproportionately affected U.S. automakers because U.S. vehicles tend to have relatively larger-sized engines than Korean vehicles. Korea agreed to reduce the Special Consumption Tax from 3 to 2 stages and the Annual Vehicle Tax from 5 to 3 stages.

The Korean government also agreed not to impose any new engine displacement taxes or taxes based on categories of vehicles, and it stated that it would provide an 80% refund on its Subway Bond Tax for purchasers of new automobiles, which was another tax considered to be a barrier to U.S. automobile imports. In order to implement these reforms, Korea will have to amend several of its key tax laws.

During the FTA negotiations, Korea made several commitments in the area of technical regulations for vehicles. In particular, the Korean government agreed not to apply emission standards that were higher than the standards used by California and agreed to use lower standards than the California standards for small-volume manufacturers. Manufacturers who sell fewer than 4,500 vehicles a year in Korea will be exempt from any of these emission standards. K-US FTA exempts imported motor vehicles from any new or amended Korean regulations related to self-certification for safety standards for at least 2 years after the regulations or amendments come into effect, and these standards would only apply under certain conditions. These exemptions were designed to benefit U.S. auto manufacturers who are expected to sell fewer automobiles in the Korean market than Japanese or European manufacturers.

In addition, Korea and the United States negotiated an innovative and unique mechanism for resolving bilateral trade disputes related to automobiles. If the agreement’s expedited dispute settlement panel finds that a party has not complied with its obligations in the agreement’s auto provisions, it can authorize the other party to reimpose import duties

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7In 2006, Korea exported 695,134 vehicles to the United States, and approximately 554,000 of these vehicles were made by Korean companies. The United States was only allowed to export 5,732 vehicles to Korea, and approximately 4,000 of these automobiles were made by GM, Ford, and DCX (UAW, Korea Free Trade Agreement Continues Unfair Auto Trade Imbalance, [http://www.uaw.com/dclink/factautotrade.pdf](http://www.uaw.com/dclink/factautotrade.pdf)).

8Article 2.12.1 and 2.12.2.

9Article 2.12.3.

10Article 2.12.4.

11Confirming Letter of Specific Autos Regulatory Issues, K-US FTA.

12Ibid.

13This process will reduce the amount of time used to make decisions using most dispute settlement mechanisms by 50%. See Annex 22-A (Alternative Procedures for Disputes Concerning Motor Vehicles), K-US FTA.
on the defaulting party’s automobiles. This is the so-called snap-back mechanism. Reimposed duties may be levied until the party at fault complies with all the auto provisions.\textsuperscript{14} Another panel decides if the party at fault has met its FTA obligations and rescinds the duties.\textsuperscript{15} This mechanism will be removed from the agreement 10 years after the FTA comes into effect if it is not used to settle a trade dispute involving automobiles.\textsuperscript{16}

K-US FTA also established an autos working group to address regulatory issues that may arise and review potential new regulations affecting auto manufacturers in each country. In this provision, both countries must be involved in developing new regulations related to automobile imports.\textsuperscript{17}

In addition to its autos-specific provisions, K-US FTA also addresses standards and technical barriers to trade (TBTs) and many other regulatory practices. On top of national treatment and the principle of necessity stated in WTO Agreements, this FTA includes provisions to ensure transparency in the development and implementation of technical regulations and related conformity assessment procedures. In these provisions, Korea and the United States agreed to publish the criteria used to recognize conformity assessment bodies and explain the objectives of new automobile regulations and how they will achieve these objectives.\textsuperscript{18}

Korea and the United States also agreed to
1. notify the other country about new regulations, even if they are based on international standards;
2. allow at least 60 days for written comments on proposals;
3. make all comments about new regulations public; and
4. publish a notice about proposed and final regulations in a single official journal, and include responses to significant comments and explanations about any revisions made to the regulations.\textsuperscript{19}

In short, K-US FTA has stronger, more comprehensive provisions related to the automotive sector in the areas of taxes, tariffs, standards, and technical barriers than any other trade agreement. Compliance with these FTA provisions is guaranteed by the powerful dispute settlement mechanism that ensures U.S. automakers and auto parts manufactures can fairly compete in the Korean market and restores balance to the automobile trade between the two countries.

\textbf{B. Problems of Trade in Pharmaceutical/Medical Device}

The K-US FTA negotiations about pharmaceutical issues are another example of these two countries attempting to solve mutual problems that may touch on even deeper sovereign issues. According to the outcome of a series of tough negotiations, both states agreed to take measures to prohibit unethical business practices in the trade of pharmaceuticals and medical devices. U.S. multinational pharmaceutical companies were

\begin{itemize}
\item \textsuperscript{14}Ibid.
\item \textsuperscript{15}Ibid.
\item \textsuperscript{16}Ibid.
\item \textsuperscript{17}Annex 9-B (Automotive Working Group), K-US FTA.
\item \textsuperscript{18}Article 9.5, K-US FTA.
\item \textsuperscript{19}Article 9.6, K-US FTA.
\end{itemize}
allegedly troubled by the close business relationship between Korean pharmaceutical companies and medical facilities/people, such as hospitals and doctors. On the other hand, Korean drug companies claimed that U.S. multinational manufacturers were lobbying Korean medical people in countries such as China, where U.S. anti-trust laws are not effective. Both sides complained about kickbacks, bribery, and improper inducements for purchasing and prescribing local or U.S. drugs or medical devices in Korea. As a result of a successful compromise, Korea and the United States agreed to prohibit unethical business practices nationally and globally.

1. Each Party shall adopt or maintain appropriate measures to prohibit pharmaceutical product or medical device manufacturers and suppliers from providing improper inducements to health care professionals or institutions for the listing, purchasing, or prescribing of pharmaceutical or medical device products eligible for reimbursement under health care programs operated by its central level of government.

2. Each Party shall adopt or maintain appropriate penalties and procedures to enforce the measures that it adopts or maintains in conformity with paragraph 1.

C. Protection of Copyrights

The protection of intellectual property rights (IPRs) was another challenge faced during the K-US FTA negotiations. Traditionally, IPRs protection is a national responsibility governed by an obligation to protect IPRs. K-US FTA, however, explicitly and specifically explains how to do it. In a side letter attached to the agreement, Korea agreed to prevent illegal copying and distribution of copyrighted works on university campuses and precise enforcement methods are prescribed:

Korea agrees to take the following actions as soon as possible, but no later than six months after the date this Agreement enters into force:

1) continue to implement policies that work to promote the use of legitimate materials by students, lecturers, bookstores, and photocopy shops on university campuses, and develop and implement further such policies, if necessary. Within this framework, seek cooperation and information from all universities, and consider the need for follow-up action;

2) enhance training activities in the territory of Korea on book-piracy enforcement, thereby raising awareness among enforcement personnel of illegal book printing activities as well as commercial scale operations of illegal reproductions of copyrighted works;

3) enhance enforcement activities with respect to underground book piracy operations; and

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20See article 5.1 (“the Parties affirm the importance of...ethical practices by pharmaceutical and medical device manufacturers and suppliers and by health care providers on a global basis in order to achieve open, transparent, accountable, and reasonable health care decisionmaking”).

21Article 5.5 (Ethical Business Practices), K-US FTA.
4) develop and pursue public education campaigns to raise general awareness in the public sector of illegal book printing activities as well as commercial scale operations of illegal reproductions of copyrighted works.  

D. Implementation of Dispute Settlement Panel Decisions

It is fair to say that WTO’s dispute settlement procedure (DSP) has been quite successful; however, this nascent success is tainted because countries do not always implement panel decisions. A study that examines 333 total consultation requests made from the start of the WTO Agreement until October 2005 shows that the genuine success rate is 67%. Although the success rate in the first half of the WTO Agreement is 72%, it drops to 63% (see Table 1-1) in the second half of the Agreement. More troublesome is the fact that the United States, the founder and largest supporter of the DSP system, has become the most frequent defaulter (see Table 1-2). Taken captive by special-interest politics in Congress, the U.S. Government has found it difficult to implement all panel decisions (see, for example, US-FSC, US-1916 Act, US-Byrd Amendment, US-Copyright Act, US-Section 211, and US-Japan Hot-Rolled Steel).

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22 Side Letter on Copyright Protection, Korea-US FTA.
24 Ibid., p. 1047.
25 Ibid., pp. 1047–1070.
26 United States-Tax Treatment for Foreign Sales Corporations’, WT/DS108. A U.S. foreign sales corporations (FSC) tax measure was found to be an export subsidy by a WTO panel. Initially, the U.S. Congress revised the FSC law, but the amended act was found to be incompatible with panel rulings. In May 2003, the DSB authorized the EC to retaliate against certain U.S. exports. In October 2004, the U.S. Congress enacted another FSC law, but it was also found inconsistent by another WTO panel in September 2005.
27 United States-Anti-dumping Act of 1916, WT/DS136 (complaint by the EC), WT/DS162 (complaint by Japan). The U.S. 1916 Anti-dumping Act essentially provides a private right of action for a criminal offence and a treble-damage provision to counteract intentional dumping on the U.S. market. These elements of the act and an absence of procedural safeguards mandated by the WTO Anti-dumping Agreement were found inconsistent in the case. The U.S. administration introduced several bills designed to repeal the 1916 Act. After these bills failed to become law, a WTO arbitral panel issued an award in February 2004 for retaliation. In December 2004, the United States repealed the amendment with the Deficit Reduction Act.
28 United States-Continued Dumping and Subsidy Offset Act of 2000, WT/DS217 (complaint by Australia, Brazil, EC, Chile, India, Indonesia, Japan, Korea, and Thailand), WT/DS234 (complaint by Canada and Mexico). Under the Byrd Amendment Act, anti-dumping/countervailing duties collected by U.S. Customs were distributed to the companies that asked for anti-dumping/countervailing investigations. This was found to be inconsistent with WTO rules. In January 2004, the United States agreed to extend the implementation period of panel decisions with some of the complaining countries, and other countries asked for authorization to retaliate. In April 2005, the EC and Canada retaliated, and they were followed by Japan in August 2005. As a result of these actions, the U.S. Congress repealed the amendment with the Deficit Reduction Act on February 1, 2006.
29 United States-Section 110(5) of US Copyright Act, WT/DS160. A U.S. statutory provision that allowed certain retail establishments to avoid payment of royalties otherwise due to copyright holders was ruled inconsistent with the Agreement on Trade-related Aspects of Intellectual Property Rights. By inventing a new temporary compensation method, the U.S. administration was able to negotiate
Table 1-1: Change of Implementation Rate in WTO DSP Enforcement System

<table>
<thead>
<tr>
<th>Rate criteria</th>
<th>Overall implementation rate (%)</th>
<th>Implementation rate (May 1996–May 2000) (%)</th>
<th>Implementation rate (June 2000–present) (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>DS number</td>
<td>67</td>
<td>72</td>
<td>63</td>
</tr>
<tr>
<td>Individual dispute</td>
<td>61</td>
<td>69</td>
<td>54</td>
</tr>
</tbody>
</table>

Table 1-2: 28 (25) Implementation Problem Cases: Closed or Open

<table>
<thead>
<tr>
<th>Retaliation cases 10(8)</th>
<th>Inadequate implementation cases 10(9)</th>
<th>Delayed or disputed implementation 8(8)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Closed (including de facto closed)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Brazil–Aircraft</td>
<td>Australia–Salmon</td>
<td>U.S.–India steel plate</td>
</tr>
<tr>
<td>Canada–Aircraft II</td>
<td>Canada–Milk/dairy</td>
<td>Chile–Price band</td>
</tr>
<tr>
<td>U.S.–1916 Act (2)</td>
<td>Australia–Automotive Leather</td>
<td>EC–Pipe fittings</td>
</tr>
<tr>
<td></td>
<td>Mexico–HFCS</td>
<td>U.S.–Lumber prelim</td>
</tr>
<tr>
<td></td>
<td>EC–Bed linen</td>
<td>CVDs</td>
</tr>
<tr>
<td></td>
<td>Japan–Apples</td>
<td>Korea–Commercial vessels</td>
</tr>
<tr>
<td></td>
<td>Thailand–Steel</td>
<td></td>
</tr>
<tr>
<td></td>
<td>U.S.–Lead bars</td>
<td></td>
</tr>
<tr>
<td>Open</td>
<td></td>
<td></td>
</tr>
<tr>
<td>EC–Hormones</td>
<td>U.S.–CVDs on EC products</td>
<td>U.S.–Copyright Act</td>
</tr>
<tr>
<td>EC–Bananas</td>
<td></td>
<td>U.S.–Havana Club</td>
</tr>
<tr>
<td>U.S.–FSC</td>
<td></td>
<td>U.S.–Japan hot-rolled steel</td>
</tr>
<tr>
<td>U.S.–Byrd Amendment</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Facing this serious challenge, some commentators suggest using monetary fines or damages to settle trade disputes. According to this view, instead of amending domestic with Congress without suffering retaliation, and the EC could compensate its copyright holders in the meantime. The United States and the EC were unable to reach a permanent solution before the extended period for implementation ended in December 2004, and as a result, the EC resumed its pressure at the end of 2004.

30 United States-Section 211 Omnibus Appropriations Act of 1998, WT/DS176. This act was the result of legislation designed to punish Cuban interests by denying trademark protection if the trademark was abandoned by a trademark owner whose assets had been confiscated by Cuba. Through a series of extension arrangements, the United States and the EC agreed to extend the deadline of the implementation period from December 2002 until June 2005. Even though the extended deadline ended without results, the EC announced in July 2005 its decision not to request an authorization of retaliation at that stage, but it did reserve the right to request an authorization of retaliation in the future.

31 United States-Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan, WT/DS184. This case occurred as a result of the U.S. DOC’s exclusion of certain home-market sales to affiliated parties when calculating dumping margins. While the U.S. administration was working with Congress to change the statute, the United States and Japan agreed to extend the deadline of the implementation period from November 2002 to July 31, 2005. In July 2005, Japan decided not to request an authorization of retaliation at that stage, but it did reserve the right to request an authorization of retaliation in the future.

32 Choi, supra note 23 at 1048.

33 Ibid., at 1060.

laws that violate WTO rules, countries at fault would pay a certain amount of money to the injured country. Indeed, monetary fines have already been introduced into several FTAs recently concluded with the United States. For example, the U.S.-Chile FTA, U.S.-Singapore FTA, and U.S.-Australia FTA permit a non-complying party, when faced with retaliation, to pay an annual monetary assessment to the complaining country. K-US FTA includes this type of dispute settlement device:

The complaining Party may not suspend benefits if, within 30 days after it provides written notice of intent to suspend benefits or, if the panel is reconvened under paragraph 3, within 20 days after the panel provides its determination, the Party complained against provides written notice to the other Party that it will pay an annual monetary assessment.35

This use of fines is an attempt to meet new challenges by cooperating at a regional level, and it is another aspect of aggressive regionalism. The global marketplace is carefully watching this experiment.36

E. Outward Processing Exception for Kaesung Industrial Complex Problem

In general, FTAs require agreeing countries to produce the goods they trade with their partners in their own country. Notwithstanding this principle of territoriality, countries can agree to allow production outside of a country if the material is exported from that country and the finished product is re-imported into the country. These provisions are called the outward processing exception.

The Korea-Singapore FTA includes this exception. In this provision, this type of production is permitted if the total value of non-originating inputs does not exceed 40% of the value of the goods and the value of originating materials is not less than 45% of the value of the final goods.37

In the Korea-EFTA FTA, added value caused by outside production must not exceed 40% of the final product’s value, and the value of originating materials must be more than 60% of the total value of materials used in the production.38

The approach taken in K-US FTA is more cautious and even hortatory. As a result of recommendations by the Committee on Outward Processing Zones on the Korean Peninsula,
geographical areas will be identified as outward processing zones, and specific criteria for the eligibility and maximum threshold for value addition will be established. This provision depends on several conditions that include but are not limited to the following:

1. Progress toward the denuclearization of the Korean Peninsula.
2. The impact of the outward processing zone on intra-Korean relations.
3. The status of environmental standards, labor standards and practices, wage practices, and business and management practices in the outward processing zone compared to the situation in the rest of the local economy and international marketplace.

Although K-US FTA does not contain any concrete outward processing exception rules (unlike previous FTAs), it does establish a legal basis for further discussions if and when there are changes in the relationship between North and South Korea.

III. Analysis and Implications

A. The Case of Aggressive Regionalism

It is clear that the global community needs to move from the outdated concept of preserving sovereignty and decide how to allocate power in the international marketplace. Many international efforts have been made to find an optimal way to allocate power among sovereign economies. In this light, K-US FTA bases the allocation of power or authority on efficiency and mutual understanding among partner economies rather than insisting on the outdated doctrine of non-intervention in domestic affairs.

Korea has embarked on aggressive regionalism because it wants to upgrade its internal economic environment. If Korea simply wanted to reduce the cost of trade with a big economy, it would have been better off negotiating a FTA with China rather than with the United States because Chinese tariffs are much higher than U.S. tariffs.

Although Korean export industries have been doing well, the Korean economy has stagnated at a 4% growth rate, and the unemployment rate has increased to 3.7%. This situation shows that Korea’s economic problems have an internal, not an external, source.

Korea understood that its economic problems were internal, and it decided to eliminate domestic inefficiencies by forcing its system to compete with the U.S. economy, the most efficient economy in the world. Although the Korean government claims, for political reasons, that the largest benefit of K-US FTA comes from increased market access for its automobile and textile exports, it is counting on FTAs, including K-US FTA, to increase the efficiency of its economy in the future.

In retrospect, some of Korea’s FTAs had serious problems in terms of their level of liberalization and consistency with WTO rules. For example, in the Korea-Singapore FTA, 91.6% of products were subject to a tariff elimination schedule within 10 years, and most

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39Annex 22-B, Korea-US FTA.
40Ibid.
41Growth rates of Korean economy were 4.7% (2004) and 4.2% (2005) compared to 7.0% (2002), 8.5% (2000), and 9.5% (1999). Unemployment rates were 3.7% (2004, 2005) and 3.6% (2006). Source: Bank of Korea.
major agricultural products (including rice, apple, pear, onion, garlic, and beef) and fishery products were excluded from the schedule.

In the FTA with EFTA, only 86 to 88% of industrial and fishery products were subject to a tariff elimination schedule. Tariffs on agricultural products were only eliminated for products currently traded between the two sides.

This back-down trend in terms of trade liberalization is highlighted in the Korea-ASEAN FTA. Most sensitive agricultural products were excluded from the schedule. As quid pro quo, ASEAN states excluded Korean cars, car components, electronic machines, metals, and cigarettes, which are major Korean export items, from the FTA. As a result of these exceptions, Thailand refused to sign the FTA as a protest.

In K-US FTA, Korea and the United States agreed to eliminate tariffs on all industrial products and quickly remove 94% of them (within a 3 year period). Only some agricultural products, such as rice, oranges (produced during harvesting season), soybean/potatoes (for human consumption), milk powder, and honey, were subject to tariffs. Therefore, Korea’s original aim, which was to achieve high-level liberalization and improve the efficiency of its economy, was accomplished by K-US FTA.

In the past, the only objections to trade liberalization came from import substitution-oriented interest groups, such as farmer’s association, poultry producers groups, and labour unions. These groups systematically organized supporting groups and efficiently conducted a campaign of public propaganda. On the other hand, export-oriented groups, including associations of large export companies, remained silent and became free riders on the government’s trade liberalization policies. As a result, consumer associations and many NGOs sided with the import substitution-oriented interest groups and forced the Korean government to compromise on its trade liberalization plans in order to produce policy results.

Once K-US FTA negotiations were officially launched, however, export-oriented groups in Korea started to support high-level FTAs. As a result, the government was able to pursue a liberalization of trade and solve the trade problems between Korea and the United States.

B. Implications for Korea’s Future FTA Policy and for the World

a. Further Problem-Solving Approaches

It appears that this aggressive regionalism approach will continue to be Korea’s FTA policy. Now that Korea has established high-level trade liberalization with the most efficient economy in the world, it will not hesitate to use this FTA to solve domestic or foreign problems. Although K-US FTA is a mechanism for solving many of its trade problems, its future FTA negotiations will need to deal with the increasing number of trade remedy measures taken against its exports. As the volume of trade between Korea and the world grows, dumping or export subsidy practices may occur more frequently, and as a result, there will be trade remedy measures. Korea will also have to find a way to avoid anti-dumping or anti-subsidy measures used for protectionist purposes. If it is unable to solve these types of problems, any gains from trade liberalization would substantially disappear. The upgrade of the current trade remedy system was a high-priority issue to Korea during FTA negotiations.
with the United States, and it will be an important issue in negotiations with other countries, including China.

China and New Zealand dealt with this issue when they negotiated their FTA. In this agreement, China and New Zealand agreed not to take any action pursuant to the WTO Anti-dumping Agreement “in an arbitrary or protectionist manner.”  

They also agreed to notify the other country when initiating an investigation “as soon as possible following the acceptance of a properly documented application from an industry.”

It is widely known that anti-dumping measures have often been used for protectionist purposes:

1. Frivolous petitions from domestic industries have been easily accepted by investigating agencies and investigated.
2. Producers or exporters subject to investigations were unaware of the petition before investigation started.
3. Investigations and outcomes were often tainted by an arbitrary application of standards and criteria by the investigation authority.

In these circumstances, China and New Zealand’s announcement not to take anti-dumping measures in an arbitrary or protectionist manner and provide early notification is an ambitious and challenging policy for solving chronic problems in the trade remedy system.

The China-New Zealand FTA prescribes that “neither party shall introduce or maintain any form of export subsidy on any goods destined for the territory of the other Party.” This agreement makes changes to the WTO subsidy and countervailing system (where certain export subsidies on agricultural products are not prohibited, but they are subject to a reduction commitment) as applied between the two countries and establishes a clearer framework for solving the problem of subsidies. This FTA allows a party to exclude the other party’s products from the safeguard action if these imports do not injure the country’s economy, and a party must immediately notify the other party when starting an investigation.

The New Zealand-Singapore FTA, on the other hand, tightened up the rules about dumping:

1. The *de minimis* dumping margin is raised from 2 to 5% and applies to new cases, refunds, and review cases.
2. The margin of dumped imports normally regarded as negligible is increased from 3 to 5%.
3. The timeframe to be used for determining the volume of dumped imports shall normally be at least 12 months.
4. The period for review and/or termination of anti-dumping duties is reduced from 5 to 3 years.

Unethical business practices in the pharmaceutical goods sector and other sectors also pose great challenges. Many commentators are concerned about non-transparent and unfair business practices in many Asian countries, including China and Japan, that often create non-tariff barriers. The protection of IPRs will also be a challenging issue in any Korea-China

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42 Article 62, China-New Zealand FTA.
43 Ibid.
44 Article 63, China-New Zealand FTA.
45 Article 64, China-New Zealand FTA.
46 Article 9, Singapore-New Zealand FTA.
trade negotiations. In this regard, China and Korea can learn from K-US FTA’s active, cooperative use of FTA rules to solve these trade issues.

Food safety will be another critical issue for Korea when it negotiates an FTA. Recently, Korea had difficulty establishing sanitary standards for American beef, and this struggle shows the political difficulties of combining the market liberalization of agricultural products with food sanitary issues in Korea. Setting out details for sanitary and phytosanitary rules and implementing arrangements under a FTA might provide a good solution. The China-New Zealand FTA is an excellent example for resolving this issue because it orders the two countries to conclude implementing arrangements and establish SPS rules. Indeed, the food sanitary and safety issue will be a challenging issue in any negotiations between Korea, an OECD country, and China, the largest agricultural producer in the world.

The outward processing exception clause under K-US FTA is directly related to the rules about the origin of products produced in the Kaesung Industrial Complex located in North Korea, a symbol of Korea’s engagement policy towards the North. This issue will be a high priority in Korea’s future trade negotiations with other countries. Given the close ties between North Korea and China, it may be possible to negotiate a specific exception clause similar to provisions in the Korea-Singapore or Korea-EFTA FTAs, which include a 40 to 45% or 40 to 60% formula. Going further, China and Korea may follow the whole-scale exemption clause in the China-New Zealand FTA that follows the Treaty of Waitangi. In this clause, China and New Zealand would recognize various economic cooperation activities between South and North Korea. In particular, China may agree to accept the provisions stated in the Agreement on Basic Relationship between South and North Korea, which establishes differential and favourable treatment for intra-Korea trade.

b. Benefit and Cost Approach of Multiple FTAs

It is true that an FTA provides countries with many benefits. In particular, to an export-oriented economy like Korea, increased market access to foreign export markets is

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47 Massive public demonstrations were held in Seoul after Korea and the United States signed a treaty on Import Health Requirements for U.S. Beef and Beef Products on April 18, 2008. Although the principle intention of the government in signing the treaty was to form an amicable environment within the United States for the early ratification of K-US FTA, many Koreans felt their government compromised public health by allowing the importation of age-old American beef that has the potential for BSE (Mad-cow disease). As a consequence, two rounds of additional negotiations were held between the two countries, and exporters and importers in both countries agreed voluntarily not to export and import certain age-old beef with governmental guarantees. For details, see Won-Mog Choi, Legal Analysis of Agreed Documents in Korea-U.S. Beef Negotiations and Policy Directions for Korea, International Trade Law No.82 (Ministry of Justice of Korea, August 2008).

48 See Article 77, China-New Zealand FTA. (More than 10 implementing arrangements are destined to be concluded.)

49 Supra notes 37 and 38.

50 New Zealand gives the Maori, a minority tribe living in New Zealand, differential and favourable treatment pursuant to the provisions of the Treaty of Waitangi. How to make the international community acknowledge this special arrangement is a politically sensitive issue. In the China-New Zealand FTA, a special provision exempts the arrangement from various duties, and disputes will be handled by a special arbitral tribunal. See Article 205, China-New Zealand FTA.

51 Agreed between the two governments in December 1991, and entered into force in 1992.
crucial. Although Korea also has to open its market to FTA partners, increased competition with more efficient foreign companies will increase efficiency in the goods, services, and investment sectors. Cheaper-priced imports will also benefit consumers.

The cost of FTAs, however, can be very high for Korea. In many cases, the cost is high because Korea must make industrial adjustments that include a transfer of labour from one sector to another in a traditionally inflexible economy. In addition, a complicated web of multiple FTAs may create a so-called spaghetti bowl cost and have a trade diversion effect on Korea. The inconsistencies between various elements of these agreements, such as different schedules for phasing out tariffs, different rules of origin, conflicting standards, exclusions, and differences in rules dealing with trade remedy, and other regulations and policies, can increase the cost of doing business for Korean firms and trade diversion effects.

If an exporting company has many FTAs, it may be able to claim FTA duty exemption wherever its goods are exported within this network. In spite of this benefit, different rules of origin must be satisfied for each export destination, which creates spaghetti bowl costs. Companies located in a spoke, on the other hand, must not only bear the spaghetti bowl costs, but also a spoke cost. It is known that a regional FTA hub country and its companies receive many benefits. Increased competitiveness by importing the most suitable raw materials from multiple spokes customs-free and expanding foreign direct investment inflow are some of the advantages. Also the hub country has many advantages when negotiating new FTAs and is in a better position to persuade its prospective partners to accept the conditions of its existing FTAs or other conditions favorable to itself. In a specific region, a hub country could also display its political and economic leadership. However, a hub-and-spoke structure is relatively inefficient compared to an integrated regional FTA because there is an increase in trade-related costs. A hub constructs a complex trade network with multiple spokes, and as a result, traders’ compliance costs increase. Also businesses at the hub will pursue rent-seeking behavior: That is, firms in a hub try to maintain monopolistic positions in the hub-and-spoke structure, hindering a competitor from one spoke from branching out to another spoke. There are also strong incentives for economies to try to become the hub in an attempt to dominate economies in their region, which can lead to discrimination and conflicts. The problem is that spoke countries must bear the costs associated with these advantages in the form of a spoke cost.

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52 In general, a proliferation of overlapping preferential trade agreements can create a spaghetti bowl effect.
53 In general, regional trade agreements can cause welfare losses for countries that are both members and nonmembers of the pact by diverting imports from low-cost nonmember sources to higher-cost member suppliers. In such cases, the cost difference borne by importing members is commonly known as a trade diversion effect.
55 Ibid.
56 Ibid.
57 Ibid.
58 Ibid.
59 Ibid., p. 87.
60 Ibid.
The Korean economy relies heavily on foreign source materials, and it exports its final products all over the world. As a result, the spaghetti bowl and spoke costs will become more damaging and unbearable as the Asian region negotiates more FTAs. Since the 1990s, spaghetti bowls have occurred in major regions around the world. In Asia, China’s approach to ASEAN for a FTA in 2001 triggered a domino effect and created so-called noodle bowl costs. In this situation, former beneficiaries of complexity tend to downsize and go offshore. Many firms in spokes harmed by this complexity tend to push governments to untangle FTAs. Naturally, regional policies aim to simplify the rules of origin and link FTAs to one another. How to multilateralize FTAs will soon become a major concern for Korea and the world.

c. Accumulation, Harmonization, and Linkage among FTAs

To achieve this policy, accumulation, which allows inputs from preferential trading partners to be used in the production of a final good without undermining the origin of the product, must be part of the rules about origin. There are three types of accumulation: (1) bilateral, (2) diagonal, and (3) full accumulation.

Most recent FTAs include a provision allowing bilateral accumulation. This allows goods from participating countries to be processed in a partner or beneficiary country as if the goods originated in that partner or beneficiary country on the condition that the processing goes beyond a minimal level. The accumulation provisions in a FTA involving Korea, therefore, would encourage the use of materials and parts originating in the countries involved in the FTA.

The second type of accumulation is known as diagonal accumulation. Diagonal accumulation operates in a preference group proposed by FTA parties. In this situation, materials or parts originating in one or more countries within the group may be further processed (provided it is more than minimal) in another country within the group, and these materials or parts are seen to originate in the country where they are processed. For example, shoes assembled in Korea from components originating in China and India may qualify as a good originating in Korea if China and India are designated a diagonal accumulation group. In particular, the commercial benefits of using this type of accumulation may be clearly demonstrated in case of the textile industry.

Full accumulation enables the work or production carried out in one country to be carried forward to another country and be counted as if it were carried out in the country that produces the final product: It allows a product produced in one country to be sent to another country for further processing and recognizes the final country as the point of origin. Under this system, fabric produced in Korea can use non-originating yarn, and the fabric created...


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from the yarn (not in itself a process conferring origin) will be considered a product that originated in Korea. Full accumulation would allow more fragmentation of production processes among FTA members and could stimulate increased economic linkages.

**Table 2: Rules of Origin in Existing Free Trade and Preferential Trade Agreements**

<table>
<thead>
<tr>
<th>A. Agreement Involving the EU</th>
<th>Change of Tariff Classification (principal, secondary level)</th>
<th>Value Added</th>
<th>Specific</th>
<th>Cumulation</th>
<th>Tolerance</th>
<th>Absorption</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU- Panama</td>
<td>Yes (4,2)</td>
<td>Yes - Import (50-30%)</td>
<td>50-30%</td>
<td>Yes</td>
<td>Bilateral Diagonal</td>
<td>Yes 10%</td>
</tr>
<tr>
<td>EU- GSP</td>
<td>Yes (4,2)</td>
<td>Yes - Import (50-30%)</td>
<td>50-30%</td>
<td>Yes</td>
<td>Bilateral Diagonal</td>
<td>Yes 10%</td>
</tr>
<tr>
<td>EU- Costa Rica</td>
<td>Yes (4,2)</td>
<td>Yes - Import (50-30%)</td>
<td>50-30%</td>
<td>Yes</td>
<td>Full</td>
<td>Yes 15%</td>
</tr>
<tr>
<td>EU- Chile</td>
<td>Yes (4,2)</td>
<td>Yes - Import (50-30%)</td>
<td>50-30%</td>
<td>Yes</td>
<td>Bilateral</td>
<td>Yes 10%</td>
</tr>
<tr>
<td>EU- Mexico</td>
<td>Yes (4,2)</td>
<td>Yes - Import (50-30%)</td>
<td>50-30%</td>
<td>Yes</td>
<td>Bilateral</td>
<td>Yes 10%</td>
</tr>
<tr>
<td>EU- South Africa</td>
<td>Yes (4,2)</td>
<td>Yes - Import (50-30%)</td>
<td>50-30%</td>
<td>Yes</td>
<td>Bilateral Diagonal (ACP Full)</td>
<td>Yes 15%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>B. Agreement: in the Americas and with US</th>
<th>Change of Tariff Classification (principal, secondary level)</th>
<th>Value Added</th>
<th>Specific</th>
<th>Cumulation</th>
<th>Tolerance</th>
<th>Absorption</th>
</tr>
</thead>
<tbody>
<tr>
<td>NAFTA</td>
<td>Yes (2,4,6)</td>
<td>Yes - Domestic (60-50%)</td>
<td>50-60%</td>
<td>Yes</td>
<td>Bilateral</td>
<td>Yes 7%</td>
</tr>
<tr>
<td>Canada-Chile</td>
<td>Yes</td>
<td>Yes - Domestic (50-25%)</td>
<td>75-60%</td>
<td>Yes</td>
<td>Bilateral</td>
<td>Yes 8%</td>
</tr>
<tr>
<td>US-Israel</td>
<td>Yes - Domestic (45%)</td>
<td>60%</td>
<td>Yes</td>
<td>Not App</td>
<td>Not App</td>
<td>Yes</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>C. Agreement: in Asia/Pacific and with Asian countries</th>
<th>Change of Tariff Classification (principal, secondary level)</th>
<th>Value Added</th>
<th>Specific</th>
<th>Cumulation</th>
<th>Tolerance</th>
<th>Absorption</th>
</tr>
</thead>
<tbody>
<tr>
<td>APEC</td>
<td>Yes - Import (60%)</td>
<td>60%</td>
<td>Full</td>
<td>Not App</td>
<td>Not App</td>
<td>Yes</td>
</tr>
<tr>
<td>ANZERTA</td>
<td>Yes - Domestic (50%)</td>
<td>50%</td>
<td>Full</td>
<td>Not App</td>
<td>Not App</td>
<td>Yes</td>
</tr>
<tr>
<td>Singapore-Japan</td>
<td>Yes (4,2)</td>
<td>Yes - Domestic (60%)</td>
<td>65%</td>
<td>Yes</td>
<td>Bilateral</td>
<td>No</td>
</tr>
<tr>
<td>New Zealand (ANZSCCP)</td>
<td>Yes - Domestic (40%)</td>
<td>60%</td>
<td>Yes</td>
<td>Not App</td>
<td>Not App</td>
<td>Yes</td>
</tr>
<tr>
<td>Singapore-UN</td>
<td>Yes (2,4,6)</td>
<td>Yes - Domestic (55-30%)</td>
<td>65-40%</td>
<td>Yes</td>
<td>Bilateral</td>
<td>Yes 10%</td>
</tr>
</tbody>
</table>

* Within Asean. Asean, CACM, SAARC only and subject to a 50 per cent value added requirement as the country of export.

* alternative rules for textile and clothing products, often in terms of weight rather than value

* up to a maximum of 15 per cent of the value of the product

* with the additional requirement that the last stage of manufacture be performed in the exporting country

* excluding automotive products

Source: WTO (2002) and individual agreements

The Pan-Euro-Med Accumulation Area allows for diagonal and full accumulation among many economies in the European and Mediterranean region. Countries in this region have already concluded a protocol to harmonize varying rules of origin (see Diagram 1).
It is important for Korea to include this approach in a FTA because its economy heavily depends on outsourcing materials and intermediate goods. The burden of production costs incurred by each restrictive rule of origin can be somewhat reduced by allowing less restrictive accumulation rules, such as diagonal or full accumulation. It is high time for Korea to consider these rules when negotiating FTAs or amending existing ones.

More fundamentally, Korea should gradually replace complicated requirements for changes in tariff classification and specific process criteria under FTA rules of origin with a single standard, such as a regional value content criterion. All the protectionist value of these requirements can be transformed into a certain degree of regional value by proper calculations, and having a single criterion in FTA rules of origin will greatly reduce transaction costs. Therefore, Asian countries, including Korea, need to decide how to achieve common regional values and transform source-of-origin criteria.

Simplification of FTA rules of origin involving Korea need to be combined with efforts to link to other FTAs. This linkage may occur if all the countries involved in an FTA agree to adopt a diagonal or full accumulation system and amend their respective FTAs. Harmonization of rules of origin can only occur if these countries unify their various rules
about origin. This process takes a large amount of time and effort, and therefore, it must be designed on a long-term basis.

This low-level linkage (i.e., linking multiple FTAs using accumulation and harmonizing the rules of origin) will enable countries to tackle higher-level linkage over the longer term. These higher-level linkages must deal with harmonizing the institutional or systematic provisions of FTAs that cover customs administration and trade facilitation, transparency, institutional provisions and dispute settlement, exceptions, trade remedies, technical barriers to trade, sanitary and phytosanitary measures, intellectual property rights, competition-related matters, electronic commerce, investment, and labor and the environment.

Ultimately, this endeavor may lead to the harmonization of market access provisions among FTAs involving Korea and solve the problems associated with government procurement, financial services, cross-border trade in services, textiles, and apparel, agriculture, and industrial goods (see Diagram 2). As more and more FTAs are harmonized and interlinked by higher-level linkages and accumulation in Asia, a pan-Asia FTA idea could eventually materialize (see Diagrams 3 and 4). This ambitious goal will require Korea to use forward-looking approaches and have courage when negotiating future FTAs.
Diagram 2: Level of Linkage among FTAs and their Sectors
Diagram 3: Linkage among FTAs in Asia

Diagram 4: Pan-Asia Linkage among FTAs
IV. Conclusion

K-US FTA is a result of a paradigm shift from traditional regionalism, which deals mostly with customs-border issues, to aggressive regionalism that codifies a whole-scale problem-solving process. By addressing a series of age-old bilateral trade disputes, such as the automobile trade imbalance, unethical business practices in pharmaceuticals and medical devices, and effective protection of copyrights, and new global or regional issues, such as the non-implementation of WTO panel decisions and South and North Korea’s economic cooperation, K-US FTA establishes stable, permanent principles and binding rules for trade between Korea and the United States.

It appears that the aggressive regionalism approach reflected in K-US FTA will continue to play an important role in Korea’s future FTA policy. When negotiating FTAs, Korea will take a problem-solving approach to trade remedy issues, unfair business practices, sanitary and food safety issues, and economic engagement policies towards North Korea. As Korea becomes part of more FTAs, transaction costs caused by fragmented FTAs will become an economic issue. By actively adopting the accumulation system for the rules of origin and harmonizing varying rules among and linking to other FTAs, Korea may be able to reduce the costs of active regionalism; however, achieving multilateral regionalism will be a long-term task for Korea.