Korea-U.S. Free Trade Agreement (FTA): Problematic Foreign Investor and Financial Deregulation Provisions

INVESTMENT

- **The Korea FTA text includes the Bush FTA model of extraordinary foreign investor rights and their private "investor-state" enforcement. This is especially threatening in this FTA. Korea is a capital exporter and there are roughly 80 Korean corporations with around 270 establishments now in the United States. These entities would obtain new rights to demand taxpayer compensation through challenges of U.S. state and federal laws in foreign tribunals were the Korea FTA passed with its current text.**

- Investor-state enforcement – in which a foreign corporation is empowered to directly challenge U.S. laws as trade pact violations before foreign tribunals to demand compensation – is not appropriate for an agreement between two developed countries with well established rule of law and sound domestic court systems. The ostensible purpose of the mechanism is to provide U.S. investors a stable investment environment, and the ability to adjudicate problems with foreign investments in countries that do not provide reliable domestic judicial systems. But such a provision is not even arguably necessary between two stable democracies with well-functioning court systems. The U.S.-Australia FTA – also between two developed countries – did not include private enforcement of its foreign investor provisions.

- The Korea FTA's Investment Chapter 11 includes the private investor-state enforcement of an array of extraordinary substantive FTA-granted property rights with respect to financial services and other investments. Combining investor-state private enforcement with the Korea FTA's expansive foreign investor and financial service rights would provide Korean firms operating in the United States greater rights than provided to domestic firms and investors under U.S. law as interpreted by the U.S. Supreme Court. This would violate Congress' requirement that FTAs provide foreign firms "no greater rights."

- The Korea FTA's foreign investor rights that private investors operating here could enforce against the U.S. government in foreign tribunals extend to an expansive array of business activities, including some not subject to regulatory takings claims under U.S. law. The FTA's definition of investment includes: investment agreements between a government and a foreign firms with respect to natural resources, certain procurement construction activities and more; investment authorizations; enterprises; shares, stock, and other forms of equity participation in an enterprise; bonds, debentures, other debt instruments, and loans; futures, options, and other derivatives; turnkey, construction, management, production, concession, revenue-sharing, and other similar contracts; intellectual property rights; licenses, authorizations, permits, and similar rights conferred pursuant to domestic law; and other tangible or intangible, movable or immovable property, and related property rights, such as leases, mortgages, liens, and pledges.

- Many Democrats have raised concern both about the expansiveness of FTAs' substantive new property rights, such as the right to obtain compensation for indirect expropriation ("regulatory takings"), and the investor-state enforcement system which allows foreign corporations and investors to directly sue governments for compensation outside of domestic court systems under FTA rules rather than domestic property law. The Korea FTA text includes the same problematic terms that have led to past opposition. For instance, in a Dear Colleague letter, New Democrat

Coalition member Jane Harman and other Californians warned: "We wanted to draw your attention to the … threat that the investor rights rules in the Central America-Dominican Republic Free Trade Agreement (CAFTA) pose to important state and local laws and regulations that protect the environment and public health. Like Chapter 11 of NAFTA, the investor rights provisions of CAFTA give foreign corporations the power to demand payment from the U.S. when public interest protections affect a company's commercial interests… U.S. trade negotiators failed to heed the lessons of NAFTA in their negotiation of the investor rights rules in CAFTA. We hope you will join us in opposing CAFTA."[1]

- Given past U.S. FTAs with investor-state enforcement have been with developing countries, the prospect for challenges of U.S. laws was somewhat limited by the existence of relatively few foreign investors from such countries operating within the United States. In contrast, the Korea FTA would be the first FTA since NAFTA with a major capital exporter that includes investor-state arbitration. This creates a considerably greater likelihood that U.S. state and federal laws would be challenged in foreign tribunals, exposing U.S. taxpayers to potential large new liabilities and threatening to undermine important public interest policies. According to Uniworld, the leading proprietary source on Foreign Direct Investment, there are roughly 80 Korean corporations with around 270 establishments now in the United States.[2]

- To date, Canada under NAFTA has been the only other developed, capital exporting country with which the United States has had such an investment agreement. Canadian firms' use of NAFTA's investor-state system to attack U.S. environmental, health and other policies in foreign tribunals provides an important lesson for why the Korea FTA should not include investor-state enforcement. All NAFTA investor-state cases against the United States have been initiated by Canadian firms. The United States has to date dodged the bullet on the six NAFTA investor-state challenges by Canadian firms in which final rulings have been issued, mainly thanks to an array of errors by the challengers. (For instance, in the Loewen case, the tribunal ruled in favor of the firm on the merits, but the Canadian firm's bankruptcy lawyers reorganized the firm as a U.S. corporation, thereby destroying diversity of jurisdiction.) However, in some of these cases substantial amounts of U.S. tax dollars were wasted defending lengthy cases that would not have been allowed in domestic courts. Billions in outstanding cases remain to be concluded. This includes a $340 million challenges to the 1998 U.S. Tobacco Settlement, billions in damages sought over U.S. limits on Mexican domiciled trucks access to U.S. roads, and a Canadian drug firm disputing a patent issue that went all the way to the U.S. Supreme Court.[3]

- Inclusion of the investor-state chapter was of special concern to the National Conference of State Legislatures, which wrote:

  > "Since South Korea is a sophisticated and developed trading partner, NCSL does not believe that an investor-state chapter should be negotiated into the U.S.-Korea FTA for fear that similar abuses may arise. Until we have further refined the FTA investor-state language to protect state sovereignty and federalism, we fear that it may be more dangerous to include revised yet still flawed investor-state language in the U.S.-Korea FTA than to forego the provision all together."[4]

- The Korea FTA's "denial of benefits" language provides a loophole that could allow the Korean subsidiaries of U.S. firms to use their status as "Korean entities" to challenge U.S. laws in foreign tribunals. While this provision must be rewritten in future agreements, with respect to the Korea FTA, eliminating or restricting investor-state enforcement could help alleviate this threat.

- **The TRADE describes important amendments to the substantive investor rights provided in past FTAs that should be included in future FTAs. However, given the Korea FTA has already been negotiated and signed, there are certain minimum fixes that are needed. At this juncture, to avoid attacks against legitimate public interest laws and new exposure for U.S. taxpayers to liabilities arising from such cases, and if a U.S.-Korea FTA is to maintain an investor-state mechanism, a requirement must be added that foreign investors exhaust domestic remedies before being empowered to use the FTA's enforcement system.**

FINANCIAL SERVICES

- **The Korea FTA's Financial Services chapter reflects the pro-deregulation mentality that helped foster the worst financial crisis since the Great Depression. It conflates liberalization of the financial sector and deregulation, simply banning many forms of regulation even when rules are applied equally to domestic and foreign firms. The FTA's Financial Services chapter also reads in provisions from the Investment Chapter, including allowing private investor attacks on domestic regulation and forbidding capital controls – which now even the International Monetary Fund notes can be important tools in avoiding speculative, destabilizing inward and outward capital surges.**

- **Including the past deregulatory model in the Korea FTA is especially problematic. Congress has just passed far reaching new financial regulations that could conflict with the FTA limits. And the regulatory implementation of this law would occur after the FTA went into effect, meaning it could be subject to the FTA's constraints. Further, there are at least ten Korean financial firms now established in the United States that could use the private enforcement rights provided in the FTA to attack the new policies.**

- The Bush-negotiated Korea FTA, more than other bilateral agreements, has been justified for its explicit role in pushing financial services liberalization and deregulation. The Korea FTA financial services chapter contains problematic deregulation lock-in provisions that are similar to those included in the other Bush FTAs. These provisions, negotiated well before the financial crisis, do not represent a change of course from the failed policies of the past that helped fuel the crisis.

- According to fact sheets on the pact published by the Bush administration, "The Financial Services Chapter of the United States-South Korea Free Trade Agreement ("KORUS FTA") is a groundbreaking achievement, providing more extensive provisions related to financial services than ever before included in a U.S. FTA."[5] Citigroup's Laura Lane, corporate co-chair of the U.S.-Korea FTA Business Coalition, stated that "it is the best financial services chapter negotiated in a free trade agreement to date."[6] Does anyone really want to support financial services policies celebrated by an administration and company that wrecked the economy?

- The Korea FTA includes the limits on financial sector regulation found in other Bush-negotiated FTAs. Like the WTO, CAFTA and the Peru FTA, the Korea FTA commits its signatory countries to refrain from limiting the size of financial institutions, imposing firewalls between the sort of financial services one firm may offer, banning toxic derivatives, or controlling destabilizing capital flights and floods. While the underlying U.S. financial reregulation legislation will be passed before the FTA would go into effect, the regulations implementing the new policies will be implemented thereafter – and thus become subject to investor-state challenges. Also, the underlying bill would be subject to government-government challenges. At the time that the U.S. Congress has worked to reregulate the financial sector, implementing a trade agreement negotiated pre-crisis that imposes constraints on regulation with the world's 15th largest economy (whose financial firms are operating here) is a breach of faith with the American public.

- The Korea FTA's Financial Services chapter reads in provisions from the FTA's investment chapter, including the right for foreign investors to directly enforce various provision of the FTA related to financial services through the investor-state system. As noted above, the loophole in the "denial of benefits" provisions in the agreement could allow Korean subsidiaries of U.S. (or Chinese or European) banks and securities firms to challenge U.S. laws in foreign tribunals.

- Also, because Korea is a capital exporter, Korean financial firms are established in the United States and would obtain new rights to attack U.S. regulatory policy. The Export Import Bank of Korea (EMIMBANK), Hana Bank, Div. Hana Financial Group Inc., The Korea Development Bank, Korea Exchange Bank, Pusan Bank, and Woori Financial Holdings have banking operations in the United States. CJ Corp., KTB Securities Co. Ltd., Kyobo Life Insurance Co, Ltd., and Samsung Fire and Marine Insurance Co., Ltd. have insurance or securities establishments in the United States. Woori, one of Korea's top banks, is the top Korean financial institution operating in the United States, and its U.S. subsidiary bank holding company, Woori America Bank, has recently undertaken a Federal Reserve Board approved merger.[7] It is FDIC-insured, and regulated by the State of New York. It is not a member of the Federal Reserve. It has participated in one of the FDIC's Transaction Account Guarantee Program in 2009.[8] If the FTA were to go into effect, Woori America Bank would be empowered to directly challenge state or federal laws that it considered equivalent to even indirect expropriation.

- The Korea FTA Financial Services chapter also reads in the investment chapter's rules that forbid countries to limit transfers of capital. Yet, even the IMF has revisited its past opposition to capital controls. Recently, Korea implemented certain capital control measures to avoid being exposed to the devastating destabilization it suffered during the 1997 Asian financial crisis. This includes limits on foreign exchange practices that could conflict with the FTA rules, yet such safeguards could help avoid rapid, severe outflows of capital that can lead to regional or global crises.

- The Korea FTA also includes "prudential measures" language which fails to protect financial stability measures. The Korea FTA prudential measures "defense" is much less deferential to regulators than that found in NAFTA, but is identical to other FTAs pushed by the Bush administration. It reads: "a Party shall not be prevented from adopting or maintaining measures for prudential reasons, including for the protection of investors, depositors, policy holders, or persons to whom a fiduciary duty is owed by a financial institution or cross-border financial service supplier, or to ensure the integrity and stability of the financial system. *Where such measures do not conform with the provisions of this Agreement referred to in this paragraph, they shall not be used as a means of avoiding the Party's commitments or obligations under such provisions*." This self-cancelling language undermines the use of the defense to actually protect a financial regulation: a country would only need to use this provision if its domestic policy did not conform with the agreement. In other words, a country would only be challenged because it undermined an obligation that a foreign firm or government believed was provided in the pact. To restate, this circular defense measure does not provide a reliable safeguard.

- The Korea FTA also includes new limits on governments' abilities to protect consumers' confidential information. In March 2006, prior to the formal U.S.-Korea negotiations, the Coalition of Service Industries (CSI) stated that one of its primary objectives in the negotiation related to data processing services: "Korean laws make it difficult for foreign companies to outsource and offshore activities. These laws often relate to privacy (private data protection law and real name law)… These regulations should be modified to permit companies to follow their global operating models for outsourcing and offshoring provided they have existing practices to protect consumer information." A provision unique to the Korea FTA reads: "Transfer of Information: Each Party shall allow a financial institution of the other Party to transfer information in electronic or other form, into and out of its territory, for data processing where such processing is required in the institution's ordinary course of business."

- **The TRADE Act describes important amendments to the financial services rules of past FTAs that should be included in future FTAs. However, the Korea FTA has already been negotiated and signed. Therefore, at this juncture, the administration must improve the Korea FTA's language providing safeguards for countries' prudential financial measures. This is the minimum fix necessary to avoid attacks against critical policies needed to restore global economic stability.**

MORE ON KOREAN FIRMS OPERATING IN THE U.S. THAT WOULD BE EMPOWERED TO USE FOREIGN TRIBUNALS TO ENFORCE FTA TERMS AGAINST THE U.S. GOVERNMENT

Please visit http://www.citizen.org/documents/KoreancompaniesintheUS.pdf to see a chart of Korea firms in the United States, their industries and their location by congressional district. Some of the Korean firms now invested in the United States that have been engaged in regulatory disputes in the past would have standing to challenge state and federal regulations were the Korea FTA to pass. These include:

- ***Hynix*** is among the 20 largest *chaebol* in Korea, was originally a part of the Hyundai *chaebol,* and its U.S. subsidiary Hynix Semiconductor Manufacturing America was once the largest private employers in the Eugene, Oregon area.[9] It also has operations in San Jose, California. In 2006, nearly three dozen U.S. states – including Oregon and California – sued Hynix and several other corporate defendants, whom the states accuse of conspiring "to rig the market for [dynamic random access memory microchips, or DRAMs], working together to keep prices artificially high. They victimized individual consumers, governmental agencies, schools and taxpayers." The damages sought by the states could be in the hundreds of millions of dollars.[10] Because Oregon joined the plaintiffs in the price-fixing case, environmental and consumer groups in Eugene called for elimination of the $58 million in property tax breaks that Hynix received. "It seems that if a company if doing illegal activity that is harming people in Oregon, the state of Oregon shouldn't be giving that company tax breaks," said Bern Johnson of the Environmental Law Alliance. But a spokesperson for Hynix's Eugene operation argued that it "is immune to all issues related to price fixing" because its Korean parent company "is a legally separate entity." In fact, the Eugene plant is a wholly owned subsidiary of Hynix in Korea. And this was not the first time there have been moves to remove Hynix's tax breaks, which it enjoyed by virtue of its location in Eugene's "enterprise zone." When the company was charged with employee discrimination in 1999, the county government investigated whether this was sufficient cause for revocation of the tax breaks, which require companies to comply with all local, state and federal laws. More recently, the enterprise zone laws were loosened and Hynix was able to retain the tax breaks.[11] Hynix also come under fire for its application for a license to nearly triple its emissions of hydrogen fluoride (HF), a toxic air pollutant and acid rain contributor that the U.S. government describes as "severe pulmonary irritant." This request enflamed local opinion following the rapid successive deaths from pulmonary fibrosis of three people that lived near the Eugene plant.[12] In 2008, the Hynix parent company – citing "short- and long-term market conditions, which include a steep reduction in the price of memory chips worldwide and accelerated technological migration towards next-generation production standards" – closed down its Eugene facility, but it claimed that it may use the property for some other purpose.[13] As of June 2010, the property was still vacant.[14]

- ***PMX Industries*** is a wholly owned subsidiary of Korea's Poongsan Corporation and is based in Cedar Rapids, Iowa.[15] The Iowa operation is a brass and copper rolling mill that employs special alloy processing methods.[16] The company has given substantial amounts of soft money contributions to Republican congressional campaigns,[17] and its employees have given over ten thousand dollars to political candidates and committees, mostly Republicans.[18] PMX is intimately involved with U.S. government policies, both as a supplier to the government and as a recipient of a variety of tax subsidies.
  - In 2005, PMX was one of the first companies to sign onto then- Gov. Tom Vilsack's income tax credit scheme for Iowa companies that utilize Iowa-grown soybean oil-based metalworking fluids.[19]
  - In 2006, it followed much of the rest of the copper industry and implemented and passed a hike in input costs to its customers through a series of surcharges.[20]
  - That same year, Sen. Tom Harkin (D-Iowa) secured $2 million in funding for PMX's research costs in the Department of Defense appropriations bill.[21]
  - In 2007, it was announced that PMX would be supplying half of the copper alloy strip for the U.S. Mint's special $1 presidential coins.[22]
  - This continues on many years of hundreds of millions of dollars in federal contracts – much of them awarded on a non-competitive basis – that PMX receives.[23]
  - The Korean subsidiary has also been substantially involved in regulatory issues in Iowa. In 2004, PMX led a successful corporate effort to overturn the local utility board's cross-subsidization of poorer customers by charging richer customers higher utility rates. A PMX spokesperson said of the rate plan that "Being competitive is not possible when we have to subsidize another area,"[24] and even when the utility board agreed to the companies' demands, complained about the pace of the policy change.
  - An Iowan environmental organization cited PMX Industries as one of the top six emitters of cancer-causing chemicals, developmental toxicants, and reproductive toxicants into Iowa waterways, based on 2007 Environmental Protection Agency data.[25]
  - PMX has asked the Iowan congressional delegation to oppose the cap-and-trade climate change bill.[26]

- ***USS-Posco*** is a joint venture of U.S. Steel and the Pohang Iron and Steel Company (Posco), a Korean government-created steel producer (now privatized), that is one of the world's largest. USS-Posco has had substantial run-ins with local government in regards to its Pittsburg, California facility. In the summer of 2006, the Pittsburg City Council considered a bill to transfer leases held by the steel and other companies from a California State Lands Commission to the city.[27] But Posco was implicated in a related bill that would have condemned part of the company's property as a blighted area. Posco was in the middle of negotiations to sell the area, which had experienced problems with soil toxicity, to a firm that wanted to develop an industrial park on the site. The company was opposed to the legislation, as it would have made the company liable for any clean-up of the site irrespective of the sale to the developer, according to local experts.[28] The company is also trying to recycle and treat the water it uses in its manufacturing processes and thus avoid the cross-hairs of local officials and environmentalists as it relates to California's water shortage problem, which developers blame on "political roadblocks."[29]

ENDNOTES

[1] Dear Colleague letter from Reps. Jane Harman (D-Calif.), Mike Honda (D-Calif.), Hilda Solis (D-Calif.), Henry Waxman (D-Calif.), July 20, 2005.

[2] For a full list, see http://www.citizen.org/documents/KoreancompaniesintheUS.pdf

[3] See http://www.citizen.org/documents/NAFTA%20Investor-State%20Cases%20May%202010-2.pdf

[4] http://www.strtrade.com/advisories/wti/2007/march/29/ncsl_investor-state.pdf

[5] See http://www.ustr.gov/sites/default/files/uploads/factsheets/2008/asset_upload_file972_15191.pdf

[6] See USITC, "U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects," Investigation No. TA-2104-24, September 2007. Corrected printing March 2010, at 4-10. Available at: http://www.usitc.gov/publications/pub3949.pdf.

[7] http://www.federalreserve.gov/boardDocs/press/orders/2003/20030804/attachment.pdf

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[9] "Hynix announces $250-million Eugene plant investment," Gov. Ted Kulongoski (D-Ore.) Press Release, Aug. 29, 2006.

[10] Avrum D. Lank, "Wisconsin to join lawsuit against computer chip makers," *Milwaukee Journal Sentinel,* July 14, 2006.

[11] Sherri Buri McDonald, "Hynix price fixing leads to tax break questions," *The Register Guard,* (Eugene, Ore.), Oct. 13, 2006; Sherri Buri McDonald, "Watchdog challenges Hynix tax breaks," *The Register Guard,* (Eugene, Ore.), Dec. 13, 2006.

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[15] Poongsan Microtec Corporation. "Affiliates," Available at: http://eng.poongsanmicrotec.co.kr/index.html?page=webc/webc&offset=17

[16] PMX, "What We Do," Available at: http://www.ipmx.com/about/what.html

[17] http://opensecrets.org/indivs/search.asp?key=4xb8k&txtName=PMX&txtState=(all%20states)&txtAll=Y&Order=N

[18] http://opensecrets.org/indivs/search.asp?key=qypgb&txtState=(all%20states)&txtEmploy=PMX&txtAll=Y&Order=N

[19] "Gov. Vilsack signs landmark bill giving companies tax incentive to switch to soy-based metalworking fluids," Gubernatorial Press Release, June 6, 2005.

[20] Meghann McDonell, "PMX following copper surcharge trend to keep up with high prices," *American Metal Market,* June 7, 2006.

[21] "Sen. Harkin announces defense investments for Iowa," Senate Press Release, July 17, 2006.

[22] Terry Hillig, "Firm banks on new coin," *St. Louis Post-Dispatch,* March 19, 2007.

[23] According to procurement database at http://www.fedspending.org/fpds/fpds.php?company_name=PMX&sortp=r&detail=0&datype=T&reptype=r&database=fpds&fiscal_year=&submit=GO, accessed July 7, 2010.

[24] Dave DeWitte, "Marion, Iowa customers demand Alliant Energy end electric-rate disparities," *The Gazette* (Cedar Rapids, Iowa), June 4, 2004; Dave DeWitte, "Iowa Utilities Board assigns Alliant Energy timetable for equalizing rates," *The Gazette* (Cedar Rapids, Iowa), Dec. 15, 2004.

[25] Environment Iowa, "Wasting Our Waterways: Toxic Industrial Pollution and the Unfulfilled Promise of the Clean Water Act," Fall 2009, Available at: http://www.environmentiowa.org/reports/clean-water/clean-water-program-reports/wasting-our-waterways-toxic-industrial-pollution-and-the-unfulfilled-promise-of-the-clean-water-act

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