

Background

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10 Myths About KORUS and Free Trade Agreements

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Abstract: *Would free trade between the U.S. and South Korea be good or bad? Opponents of the proposed trade agreement between the two countries (KORUS) make frightening arguments about the agreement, claiming everything from lost jobs and U.S. sovereignty to special privileges for foreign investors. Some opponents claim KORUS would not expand free trade, while others claim free trade is simply bad for the U.S. Heritage Foundation trade policy expert Bryan Riley debunks 10 myths about KORUS, and explains why anyone who supports freedom has no reason to oppose this agreement.*

Opponents of the proposed U.S.–South Korea Free Trade Agreement (KORUS) have raised several concerns about the trade deal. Many of their claims also apply to pending agreements with Colombia and Panama, but since KORUS is the only agreement that President Barack Obama has agreed to, it has received the most attention. Following are 10 myths about KORUS espoused by its opponents:

Myth #1: KORUS Does Not Expand Free Trade.

The Real Story: One “Dear Colleague” letter circulated in Congress suggested that free trade theorists Adam Smith and David Ricardo must be rolling over in their graves to see KORUS called a free trade agreement. Fortunately, there have been no reports of unrest at the Scottish or English gravesites of either Smith or Ricardo so far. Indeed, in one of the most influential books on economics ever written, *On the*

Talking Points

- The proposed U.S.–South Korea Free Trade Agreement (KORUS) is facing heavy criticism from its opponents. The most popular claims circulating in political circles are not based on evidence—they are myths.
- The top 10 myths include falsehoods about lost jobs and sovereignty in the U.S. Some claim that KORUS will not expand free trade in the U.S.; others claim that free trade is bad anyway.
- Like any agreement, KORUS is not perfect. However, it would reduce trade barriers between the U.S. and South Korea—moving the United States closer to the free-trade vision espoused by the great freedom-lovers and free-traders Adam Smith and David Ricardo.
- KORUS should be opposed only by those who want government to have the authority to cut off trade, dictate individual investment decisions, and seize private property.

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Principles of Political Economy and Taxation, Ricardo cites Smith thusly:

When a nation binds itself by treaty...to exempt the goods of one country from duties to which it subjects those of all others, the country, or at least the merchants and manufacturers of the country, whose commerce is so favoured, must necessarily derive great advantage from the treaty.¹

A paraphrased update of Smith's quote for 2011 in the case of KORUS:

When South Korea exempts the goods of the United States from duties to which it subjects those of other countries, the United States, or at least the merchants and manufacturers of the United States, whose commerce is so favored, must necessarily derive great advantage from the agreement.

KORUS would eliminate almost all barriers to trade between the United States and South Korea, which is exactly the policy advocated by Adam Smith, David Ricardo, and the vast majority of economists who have followed in their footsteps.

Myth #2: KORUS Was Written by Unelected Trade Bureaucrats.

The Real Story: KORUS will not take effect unless it is approved by a majority of elected Members of the U.S. House of Representatives, then by a majority of elected U.S. Senators, and then by the elected President of the United States. The insinuation that there is something undemocratic about the agreement because the person who typed it up was not an elected official is absurd.

However, it is accurate to observe that unelected citizens play an important role in U.S. trade policy. Representatives from the Missouri Farm Bureau, the Small Business Exporters Association, the American Society of Civil Engineers, the National Association of Counties, the National Cheese Institute, the California Fig Advisory Board, Texas A&M University, Burger King, the American Hotel and Lodging Association, and about 400 other groups provided formal input to U.S. trade negotiators.²

After the initial agreement was reached, the official private-sector Advisory Committee for Trade Policy and Negotiations concluded: "We believe the agreement meets the negotiating objectives laid out in the Trade Act of 2002, and believe it to be strongly in the best economic interest of the United States."³

Myth #3: KORUS is Too Long and Complicated.

The Real Story: The original agreement is more than 1,000 pages long, which seems excessive to free-traders who would prefer a one-sentence law eliminating all barriers to trade between the United States and South Korea. But there are some good reasons that KORUS is somewhat lengthy.

Nearly half of the agreement—444 pages—simply lists all the U.S. and South Korean tariffs and the date each tariff will be eliminated.⁴

The rest of the agreement addresses issues such as: What happens if a dispute arises over whether one of the countries is in compliance with KORUS? How do importers determine if a product is made in South Korea or the United States, and therefore eligible for duty-free treatment? What if a South Korean company wants to invest in a U.S. manufac-

1. David Ricardo, *On the Principles of Political Economy and Taxation*, 3rd Edition (London: John Murray, 1821), Chapter 25, at <http://www.econlib.org/library/Ricardo/ricP6.html#Ch.25>, *On Colonial Trade* (January 28, 2011). Adam Smith's full quote: "When a nation binds itself by treaty, either to permit the entry of certain goods from one foreign country which it prohibits from all others, or to exempt the goods of one country from duties to which it subjects those of all others, the country, or at least the merchants and manufacturers of the country, whose commerce is so favoured, must necessarily derive great advantage from the treaty."
2. Office of the U.S. Trade Representative, "Advisory Group Reports on the KORUS FTA," May 1, 2007, at http://ustraderep.gov/Trade_Agreements/Bilateral/Republic_of_Korea_FTA/Reports/Section_Index.html (February 14, 2011).
3. The Advisory Committee for Trade Policy and Negotiations, "The U.S.–Korea Free Trade Agreement (KORUS)," April 26, 2007, at http://ustraderep.gov/assets/Trade_Agreements/Bilateral/Republic_of_Korea_FTA/Reports/asset_upload_file518_12764.pdf (February 14, 2011).
4. Office of the U.S. Trade Representative (USTR), "KORUS FT: Final Text," June 30, 2007, at <http://www.ustr.gov/trade-agreements/free-trade-agreements/korus-fta/final-text> (February 14, 2011).

turing facility without worrying about the U.S. government expropriating its investment? Suppose Universal Pictures wants to export *Despicable Me* DVDs without risking the possibility that a South Korean company will make thousands of illegal bootleg copies? Such questions cannot be answered in a single sentence or paragraph.

Since a one-sentence free trade agreement is not on the table, the relevant question is whether the proposed KORUS expands free trade. It unquestionably does. Whether the number of pages in the agreement is too big, too small, or just right, every page will be available online for public review and feedback before Congress votes on it. That is a model for how legislation should be considered.

Myth #4: KORUS Requires the United States to Submit to U.N. Tribunals.

The Real Story: The mechanism in KORUS to resolve trade disputes is voluntary and non-binding, and has nothing to do with U.N. tribunals. Suppose that after the trade agreement takes effect, South Korea bans U.S. potato imports. A representative from South Korea, a representative from the United States, and a representative from a mutually agreed-upon third country could meet to determine whether South Korea is violating the terms of the agreement.

Neither country would be required to participate in the panel or to abide by its findings. However, a country could be penalized if the panel found it to be in violation of KORUS. The most likely penalty would be to allow the victimized country to increase tariffs on the offending country's products. Although that may not sound very free-trade-ish, in practice, the threat of retaliation helps persuade participants in free-trade deals to abide by the agreements and keep their trade barriers low.

Myth #5: KORUS Undermines the U.S. Constitution and Preempts U.S. laws.

The Real Story: KORUS strengthens the freedoms the Constitution was established to protect.

The historical basis for free trade in the United States traces back at least as far as the Boston Tea Party in 1773, when colonists dumped 342 chests of tea into Boston Harbor rather than pay import duties. A few years later, the colonies accused England of "cutting off our trade with all parts of the world" and declared their independence.⁵

Following the Revolutionary War, this country's founders wrote the commerce clause of the Constitution to establish a U.S. free trade zone. As Judge Robert Bork and historian Daniel Troy have observed, the Founding Fathers wanted to protect citizens from politicians in the states who were engaging in destructive trade wars that threatened the new republic's survival:

In the wake of the American Revolution, neither the Continental Congress nor the states acting on their own could respond effectively to the external and internal trade disputes that threatened the new country's prosperity and peace.⁶

Economist Walter E. Williams explains how the commerce clause was drafted to fix this crisis:

A key failing of the Articles of Confederation was the propensity of states to erect protectionist trade barriers. When the Framers met in Philadelphia in 1787 and wrote the constitution that governs us today, they addressed that failure and through the commerce and the privileges and immunities clauses that created a national free-trade zone. Thus, the original purpose of the commerce clause was primarily a means to eliminate trade barriers among the states.⁷

5. Declaration of Independence, July 4, 1776, at http://www.archives.gov/exhibits/charters/declaration_transcript.html (January 20, 2011).
6. Robert H. Bork and Daniel E. Troy, "Locating the Boundaries: The Scope of Congress's Power to Regulate Commerce," *Harvard Journal of Law and Public Policy*, Vol. 25, No. 3 (June 22, 2002), p. 850, at <http://www.constitution.org/rev/bork-troy.htm> (February 14, 2011).
7. Walter E. Williams, "Commerce Clause Abuse," George Mason University, October 30, 2003, at <http://econfaculty.gmu.edu/new/articles/03/abuse.html> (February 14, 2011).

The national free-trade zone that was proposed in 1787 and the U.S.–South Korea Free Trade Agreement that is pending in 2011 each were designed to protect the freedom of individuals to engage in mutually beneficial trade.

Myth #6: KORUS Provides Special Privileges to South Korean Investors.

The Real Story: The “special” foreign investor privileges cited by KORUS critics are not very special. Under KORUS, someone from South Korea who invests in the United States, or someone from the United States who invests in South Korea, can request international arbitration instead of relying on local courts to determine if their rights have been denied. KORUS acknowledges the role of property rights in a free society:

Neither Party may expropriate or nationalize a covered investment either directly or indirectly...except...with due process of law and Article 11.5.1 through 11.5.3 [and] on payment of prompt, adequate, and effective compensation.⁸

If that language sounds familiar, it is because it is borrowed from the Fifth Amendment to the U.S. Constitution:

No person shall be...deprived of...property, without due process of law; nor shall private property be taken for public use without just compensation.⁹

KORUS allows a company that believes its property has been stolen by a foreign government to appeal to a neutral international panel for arbitration. If the most football-crazed fans from Auburn and Oregon can understand why referees from the Southeastern and Pac-10 football conferences should not officiate at the Bowl Championship Series, surely legislators can understand that if a company believes its property has been stolen by a foreign government, it should not be forced to expect justice from courts run by the very government that allegedly stole its property in the first place.

Contrary to what some critics have alleged, KORUS does not authorize “U.N. tribunals” to resolve investment disputes. It relies on the common practice of referring investment disputes to the World Bank’s International Centre for Settlement of Investment Disputes (ICSID), which the United States has participated in since 1966, or to a panel that would follow U.N. Commission on International Trade Law (UNCITRAL) arbitration rules, which the United States agreed to in 1968. This process is already used for most U.S. free trade agreements in addition to America’s 40 bilateral investment treaties (BITs).¹⁰

There is no such thing as a U.N. investment tribunal. UNCITRAL explains what arbitration under its rules means:

Although UNCITRAL and its Secretariat have prepared legislative and contractual

8. USTR, “KORUS FT: Final Text,” Chapter 11: “Investment.” Complete text: “Neither Party may expropriate or nationalize a covered investment either directly or indirectly through measures equivalent to expropriation or nationalization (expropriation), except: (a) for a public purpose; (b) in a non-discriminatory manner; (c) on payment of prompt, adequate, and effective compensation; and (d) in accordance with due process of law and Article 11.5.1 through 11.5.3.” Under Articles 11.5.1 through 11.5.3, the U.S. and South Korean governments must offer citizens who invest in their countries “fair and equitable treatment,” “the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world,” and “full protection and security” for their investments.
9. Constitution of the United States, Amendment V, at http://www.archives.gov/exhibits/charters/bill_of_rights_transcript.html (February 14, 2011). Complete text: “No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.”
10. U.S. Department of Commerce, Trade Compliance Center, at http://tcc.export.gov/Trade_Agreements/Bilateral_Investment_Treaties/index.asp (February 14, 2011).

provisions and rules relating to international commercial arbitration and conciliation, it is not within UNCITRAL's mandate, as set out by the General Assembly, to become involved in individual cases. UNCITRAL and its Secretariat do not act as an arbitral tribunal, administer arbitration proceedings, or otherwise perform any function related to individual arbitration proceedings, or any other system of public or private dispute settlement.¹¹

In the 44 years that the United States has participated in the ICSID, American investors have won millions of dollars in compensation from foreign governments, but no foreign investor has ever successfully challenged the United States.¹²

Myth #7: KORUS Allows Foreign Investors to Raid the U.S. Treasury.

The Real Story: Under KORUS, if the United States nationalized a factory owned by Hyundai, then South Korea could appeal to an international panel for compensation from the U.S. government. The same would apply if South Korea's government expropriated property from General Motors, owner of that country's third-largest carmaker.

Protection of investment rights is one of 10 economic freedoms ranked each year in The Heritage Foundation's *Index of Economic Freedom*.¹³ It is in each country's self-interest to protect foreign investors from the threat of expropriation.

There are many reasons why foreign companies invest in the U.S., not the least of which is the knowledge that the threat of expropriation is insignificant. Agreements like KORUS protect U.S. citi-

zens who invest abroad from thieves like Hugo Chávez.¹⁴ They also encourage more job-creating foreign investment in the United States.

Making sure that South Korean investors have the right to compensation if their investments are seized could be described in two ways:

1. Granting South Korean firms new rights to raid the U.S. Treasury, or
2. Granting South Korean firms the right to create jobs for U.S. workers without the risk of uncompensated expropriation.

The second description is much more accurate than the first.

Myth #8: KORUS Encourages International Investment, Leading to Job Losses through Offshoring and Outsourcing.

The Real Story: Foreign investment in the United States has created millions of U.S. jobs, and U.S. investment abroad generates hundreds of billions of job-creating dollars for the American economy. Reasons to expand the freedom of people to invest their money where they choose include:

1. **The United States is a magnet for direct and indirect foreign investment.** In 2009, the value of foreign assets in the United States exceeded the value of U.S. assets abroad by \$2.7 trillion.¹⁵ Millions of Americans benefit from companies based in other countries that invest in the United States. According to the Organization for International Investment, 5.6 million Americans work for foreign-owned companies.¹⁶
2. **U.S. investment abroad does not represent a net drain on our economy.** In 2009, Americans

11. United Nations Commission on International Trade Law, "FAQ-UNCITRAL and Private Disputes/Litigation," 2011, at http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration_faq.html#arbitration (February 14, 2011).

12. International Centre for Settlement of Investment Disputes, ICSID homepage, at <http://icsid.worldbank.org/ICSID/Index.jsp> (February 14, 2011).

13. Terry Miller and Kim R. Holmes, *2011 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2011), at <http://www.heritage.org/index>.

14. Associated Press, "Chavez Orders Expropriation of Owens-Illinois," October 25, 2010, at <http://www.cbsnews.com/stories/2010/10/25/world/main6991745.shtml> (February 14, 2011).

15. U.S. Bureau of Economic Analysis, "Table 1: International Investment Position of the United States at Yearend, 2008 and 2009," at http://www.bea.gov/international/xls/intinv09_t1.xls (February 14, 2011).

16. Organization for International Investment, "Insourcing Facts," at <http://www.ofii.org/resources/insourcing-facts.html> (February 14, 2011).

earned \$585 billion from their foreign investments.¹⁷ U.S. foreign investment generated more dollars for the U.S. economy than any category of U.S. exports.

The American economy is more likely to thrive when Americans remain free to invest their money wherever they want, and the government's role is limited to maintaining an environment that is attractive to all investors.

Myth #9: KORUS Would Flood the U.S. with Imports and Destroy U.S. Jobs.

The Real Story: This is what the advocacy group Public Citizen recently said about the impact of trade on employment: "The EPI [Economic Policy Institute] found that implementation of the Korea FTA would boost the U.S. trade deficit with Korea by \$13.9 billion over the next seven years. This rise in the trade deficit, in turn, would cost the U.S. economy about 159,000 net jobs."¹⁸ Many other groups have made similar claims. But, in fact, not one, including EPI, has found that KORUS would cause a single net job loss, let alone 159,000. To the contrary, EPI has explained that trade deficits do not necessarily reduce the total number of U.S. jobs: "As the trade deficit grows, dollars piled up by our trading partners come back to the U.S. economy, and this increases the supply of funds available for U.S. business and households to borrow."¹⁹ According to EPI, KORUS would cause 159,000 U.S. jobs to be "displaced," not lost. Job displacement includes a person moving from one job to another, and is not to be confused with job loss. For example, 10,000 people leaving their jobs as burger-flippers to

become surgeons could be considered 10,000 displaced U.S. jobs.

Public Citizen's 2008 statement on how international trade affects employment was correct: "Trade affects the composition of jobs, not the total number."²⁰

Myth #10: Free Trade is Bad for the United States.

The Real Story: Numerous critics have asserted that free trade hurts the United States. But economic theory and evidence from around the world show that people benefit when governments allow them to trade more freely.

Surveys of professional economists repeatedly show overwhelming support for free trade. One 2006 poll of economists found that supporters of eliminating U.S. tariffs and other trade barriers outnumbered opponents by an 11-to-one margin.²¹ Most economists support the elimination all U.S. trade barriers regardless of what other countries do. With KORUS, the economy would also benefit from reductions in South Korean tariffs, which are 546 percent higher than the average U.S. tariff rate.²²

According to data in the *Index of Economic Freedom*, countries with lower trade barriers tend to have less poverty, less income inequality, and higher average income levels than countries with higher trade barriers.²³

Advocates of Freedom Should Support Free Trade Agreements

Although the proposed U.S.–South Korea free trade agreement is not perfect, it would reduce or

17. U.S. Bureau of Economic Analysis, "U.S. International Transactions Accounts Data, Table 4: Investment Income, 2009," at http://www.bea.gov/international/bp_web/simple.cfm?anon=71&table_id=21&area_id=3 (January 27, 2011).

18. Public Citizen, "Reporters Memo: Survey of Studies on Potential U.S. Economic Effects of Korea Trade Deal Shows Rising Deficits and Job Losses, 2010 'Supplemental Deal' Does Not Alter These Outcomes," January 6, 2011, at <http://www.citizen.org/documents/reporters-memo-on-econ-effects-of-korea-trade-deal-jan-2011.pdf> (February 14, 2011).

19. Josh Bivens, "Trade, Jobs, and Wages," Economic Policy Institute *Issue Brief* No. 244, May 6, 2008, at <http://www.epi.org/publications/entry/ib244/> (February 14, 2011).

20. Public Citizen, "Debunking USTR Claims in Defense of NAFTA: The Real NAFTA Score 2008," at http://www.citizen.org/trade/article_redirect.cfm?ID=17640 (February 14, 2011).

21. Robert Whaples, "Do Economists Agree on Anything? Yes!" *The Berkeley Economic Press*, November 2006.

22. The World Bank, "World Trade Indicators 2009/10," at <http://info.worldbank.org/etools/wti/3a.asp> (February 14, 2011).

23. Miller and Holmes, *2011 Index of Economic Freedom*.

eliminate most barriers to trade and investment between the two countries, putting the United States closer to the free trade ideal recommended by Adam Smith and David Ricardo. The agreement would strengthen individual freedom and property rights in the United States and in South Korea. KORUS, along with the pending Colombia and Panama trade agreements, will likely be opposed by

those who want a powerful central government with the authority to cut off trade, dictate individual investment decisions, and seize private property. Everyone else should support them.

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