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Before the Senate Finance Committee

"The U.S.-Korea Free Trade Agreement"

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Chairman Baucus, Members of the Finance Committee, I thank you for the invitation to testify today on behalf of the twelve and a half million working men and women of the AFL-CIO on the important topic of the U.S.-Korea Free Trade Agreement (KORUS FTA).

The United States economy remains mired in a jobs crisis, following the deepest recession in generations and decades of wage stagnation. Our current trade policy has rewarded and accelerated the offshoring of U.S. jobs, by granting multinational corporations extraordinary protections for their investments overseas, locking in low tariffs on U.S. products, and doing too little to end unfair trade practices abroad and to protect workers' rights and environmental standards.

The KORUS FTA is potentially the most economically significant U.S. trade agreement negotiated since NAFTA. South Korea is a dynamic industrial export powerhouse and a major trading partner, with a well-developed industrial strategy and a domestic market that is highly protected from imports through a variety of measures, including both tariff and non-tariff barriers. The KORUS FTA commits both countries to reducing their tariffs and some non-tariff barriers over a period of several years, but it also contains major new protections for multinational corporate investors in the areas of investment policy and services.

We appreciate and welcome the Obama administration's important initiative to renegotiate the auto market access provisions of the agreement in order to address, in part, one of the key concerns we had raised, namely the lopsided bilateral trade in assembled autos between the United States and South Korea. While the newly negotiated auto provisions delay the initial implementation of the auto and light truck tariff reductions and address some concerns about the potential misuse of safety standards, other market access problems remain with the agreement, especially with respect to auto parts and other industrial sectors.

Passage of the Korea trade agreement is often urged as part of the Obama Administration's plan to boost job creation through increasing exports. While the AFL-CIO strongly supports the goal of increasing net exports, we do not believe that passage of the Korea trade agreement is likely to

serve this end. Rather, addressing currency manipulation, especially by China, but by other trading partners as well, would be by far a more effective trade policy tool.[1]

The KORUS FTA incorporates the improved labor and environment provisions negotiated jointly by Democratic and Republican members of Congress and the Bush administration in the "May 10th Bipartisan Trade Deal."[2] While the "May 10th" changes improved the labor and environment provisions in particular, further improvements are needed, especially in the areas of enforcement and coverage.[3]

The net job impact on the United States of the Korea trade agreement is likely to be negative, in our view, given the enhanced protections for investors, the weak rule of origin, and the remaining non-tariff barriers and other market access obstacles.

Our Korean counterpart unions are also concerned that the agreement will accelerate outsourcing of parts production from Korea (due to the weak rules of origin) and will do little to address serious violations of international labor rights.

We urge Congress to oppose the KORUS FTA, as this is the wrong time to put at risk good jobs in our manufacturing sector, which is just beginning to add jobs after many years of devastating losses. And we hope to work with Congress and the Administration to address the broader U.S. trade policy model – to ensure that future trade deals can give higher priority to the concerns of workers, communities, and the environment – in the United States and in our trading partners.

I. Likely Jobs Impact

The Obama Administration claims that the KORUS FTA would support at least 70,000 jobs, based on projections by the U.S. International Trade Commission (see U.S.ITC, "U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects," Investigation No. TA-2104-24, March 2010). But the ITC estimates have been wildly optimistic in the past, missing the mark on the projected job impact of NAFTA and China's accession to the World Trade Organization, among others.

- The ITC projection does not take into account likely shifts in investment and offshoring that have occurred in most past trade deals.
- The ITC does not account for the potential impact of future currency devaluation.

[1] Note that this agreement fails to address South Korea's long history of currency manipulation. Given the negative effects of such manipulation on U.S. workers and businesses, the FTA should have included specific provisions allowing the use of safeguard or snapback duties to counter currency manipulation in the future.
[2] *See* USTR Fact Sheet "Bipartisan Trade Deal." May 2007. http://ustraderep.gov/assets/Document_Library/Fact_Sheets/2007/asset_upload_file127_11319.pdf.
[3] *For additional detail not provided in this testimony, please see our USTR submissions* "Comments Concerning Free Trade Agreement With the Republic of Korea," filed September 15, 2009, and "Comments Regarding the January 2011 Supplemental Agreement to the U.S.-Korea Free Trade Agreement," filed February 18, 2011.

- The ITC actually finds that the U.S. global trade deficit could increase after implementation of the KORUS FTA – which would lead to a net job loss.

- The ITC also projects growing trade deficits in several key manufacturing sectors, including textiles, apparel, and metal products.

In fact, Nobel Laureate Paul Krugman, a world-renowned expert on trade, criticized the general argument that trade deals are job-creating:

> If you want a trade policy that helps employment, it has to be a policy that induces other countries to run bigger deficits or smaller surpluses. A countervailing duty on Chinese exports would be job-creating; a deal with South Korea, not.

The Economic Policy Institute estimates that if past investment and offshoring trends hold, then a growing trade deficit with Korea could displace 159,000 U.S. jobs after implementation of the KORUS FTA, mostly in manufacturing.[4]

II. Labor Laws in South Korea

The KORUS FTA's labor chapter, which includes the "May 10th" amendments, represents a significant improvement over the "enforce your own laws" standard included in the previous trade agreements negotiated under President George W. Bush. However, we believe that the May 10th labor template needs further strengthening, as it contains several provisions that are subject to conflicting interpretations and could limit the scope of the parties' obligations. Further, the dispute settlement provisions, while still untested, could be clarified and strengthened to assure workers of an expeditious and effective remedy.

There is a commonly held misperception that labor and employment laws in South Korea fully guarantee the fundamental rights of workers. To the contrary, the International Labor Organization (ILO) has expounded in numerous reports the ways in which South Korea fails to comply with core labor rights in law and in practice. Today, workers are often fired for forming a union, and such workers by law are ineligible to remain union members. Trade unions are routinely denied registration for arbitrary reasons. Many employers have opted to use temporary "irregular" workers, under inferior wages and working conditions, often in open defiance of legal restrictions on hiring workers under these modalities. In manufacturing, workers are illegally hired as "dispatch" or subcontracted workers at wages and working conditions far inferior to directly employed workers. Recent legal changes regarding full-time trade union staff and minority union bargaining rights are also of major concern for Korean trade unions.

Workers undertaking peaceful strikes can still find themselves subject to substantial fines and imprisonment under the "obstruction of business" provision of the criminal code. Currently, there are roughly 20 members of the Korean Confederation of Trade Unions (KCTU)-affiliated unions in jail or prison for acts related to trade union activity. Ten migrant workers are also now

[4] Robert E. Scott, "Free Trade Agreement with Korea will cost U.S. jobs," Economic Policy Institute, July 1, 2010. http://www.epi.org/economic_snapshots/entry/free_trade_agreement_with_korea_will_cost_U.S._jobs/

in jail, apprehended in the course of a KCTU-sanctioned strike. The use of riot police by company managers in labor disputes is an all too common practice, leaving some workers severely injured.

Despite this reality, USTR has so far failed to press the South Korean government for a commitment to address any of these concerns. There is no "labor action plan" for South Korea. We believe one is sorely needed.

III. Rules of Origin

Benefits of the KORUS should accrue to the trade agreement partners—and, most importantly, to their workers—not to non-FTA countries. However, the AFL-CIO believes that the lax rules of origin negotiated for certain products, particularly autos and steel, will allow non-Parties to the KORUS FTA to accrue benefits that should be reserved for the Parties—turning this agreement from a bi-lateral one to a regional one.

We appreciate the Administration's decision to go back to the bargaining table and seek a better deal for U.S. auto assembly workers. Overall, it is our view that the supplemental agreement will provide additional protections for the U.S. auto industry and its workers, especially in the short term. The agreement will also lead to increased market access for U.S.-produced automobiles. However, because the Administration failed to address the rule of origin methodology, duty drawback provisions[5], or supply chain issues for autos and other goods, we remain gravely concerned that, overall, the KORUS FTA could result in significant job losses and continue the decline in well paying manufacturing jobs in the U.S. We are also concerned about the enforceability of the supplemental auto agreement, as it is not formally part of the trade agreement. These concerns are especially heightened if the U.S. Congress moves to ratify the agreement before the South Korean parliament acts.

Although the U.S. already grants duty-free treatment to many steel products on a most-favored nation basis, even to countries without preferential FTA access, the KORUS FTA could help countries in the region with booming steel capacity, such as China, circumvent antidumping and countervailing duty orders by shipping steel to Korea for minimal processing before export to the U.S. Such minimally processed steel would be treated as Korean under the trade agreement and receive duty-free access to the U.S. market. While the Department of Commerce has the ability to include such minimally processed steel from Korea within the scope of an existing antidumping or countervailing duty order on steel from China, it is not clear how the lax rules of origin in the Korea trade agreement may affect the Department's treatment of such goods in an anti-circumvention proceeding. In addition, if Chinese producers take advantage of the trade agreement's weak rules of origin to ship steel to the U.S. through Korea (with minor processing), it could make it more difficult for the U.S. steel industry and its workers to meet legal thresholds regarding injury or import surges directly attributable to China when bringing future trade remedy cases against imports from China. This is particularly important given this Committee's recognition that many U.S. manufacturers lack confidence in the Bureau of Customs and Border

[5] We note with disappointment that EU's FTA with South Korea has a 5 percent cap on the duty-drawback, a significant protection lacking from the KORUS FTA.

Protection's present ability to enforce anti-dumping and countervailing duty orders in this environment of budget cuts and extremely high import volumes.[6]

With regard to autos, the KORUS FTA includes three different methodologies that manufacturers can use to calculate the content of the vehicles they produce (build-up, build-down, and net cost), and manufacturers have sole discretion as to which methodology to use. The regional value content (the percentage of the good that must be created domestically to qualify for preferential treatment under the FTA) varies with the methodology: 35% for build-up, 55% for build-down, and 35% for net cost. We remain concerned that 35% RVC would provide preferential tariff rates to autos that are 65% Chinese (our concerns with unfair trade from China are well known and need not be restated here).

Moreover, while we understand that both U.S. and Korean auto manufacturers currently use the build-up and build-down accounting methods, the net cost method appears to open the door for manufacturers to further minimize regional value content—endangering jobs in both the U.S. and South Korea. While U.S. and Korean auto manufacturers apparently do not currently use the net cost method, there is no reason why they could not use it in the future, if it is economically advantageous to do so.

The trade agreement could also increase the incentive for other nations to send their unfairly traded products into South Korea to become eligible for benefits. The low 35% threshold for South Korean content—dramatically lower than the 55% content provision (under a different methodology) obtained by the EU during its negotiations with South Korea—would allow for the vast majority of components in a final product to be produced outside of Korea and obtain the preferential trade benefits of the KORUS FTA—even if they were subject to an existing dumping or countervailing duty order if shipped directly to the U.S. The trade agreement, therefore, provides a substantial loophole to the effective enforcement of U.S. trade law.

IV. Kaesong Industrial Complex

The AFL-CIO opposes the inclusion of any goods or inputs whatsoever produced in the Kaesong Industrial Complex (KIC) because of grave concerns over the lack of basic labor rights in the KIC and the potential impact on jobs and wages of the exports of these goods—produced at wages even lower than in China, quite possibly among the lowest industrial wages in the world.

Core labor rights, especially freedom of association and the right to organize and bargain collectively, are completely repressed in North Korea, including in the KIC. KIC workers reportedly work excessive hours and also lack the right to change employers—which keeps wages from rising as workers gain skills. KIC workers have no right to form a union or to bargain collectively. KIC employers do not pay wages directly to the workers, but rather to the government of North Korea, which then makes an unknown number of deductions, including at least 30% for "costs" associated with housing, transportation, and health care. Some analysts

[6] Hearing: "Enforcing America's Trade Laws in the Face of Customs Fraud and Duty Evasion." Senate Finance Committee, Subcommittee on International Trade, Customs, and Global Competitiveness. May 5, 2011.

have estimated that the workers eventually receive only a few dollars a month; pay often comes in the form of "chits" that can be exchanged for foodstuffs—rather than cash.

The effect of the President's Executive Order (EO) 13570 on protecting American workers from unfair competition from KIC-originating goods is unclear. Some analysts believe that it effects a complete ban on the importation, direct or indirect, of any goods, services, or technology from North Korea, while others convincingly argue that it merely restates current law, under which approval to import North Korean goods is "routinely" granted.[7] In either case, the Congressional Research Service has indicated that, despite current law, there **already exists** the possibility that imported goods from South Korea contain North Korean content, and that, at the margins, this possibility could increase with the passage of the KORUS FTA.[8]

We remain extremely concerned about the potential for transshipment of North Korean made goods to South Korea and subsequently to the United States. It does not appear that this issue was adequately addressed in the text or through EO 13570. Effective enforcement of rules of origin, including adequate funding for enhanced Customs enforcement, must be undertaken in order to prevent such illegal transshipment.

Finally, we have serious concerns that Annex 22-B leaves the door open to permanently increasing imports from the KIC. Under this Annex, the parties will establish a committee to "review whether conditions on the Korean Peninsula are appropriate for further economic development through the establishment and development of outward processing zones [OPZs]." The Committee will meet periodically to identify geographic areas that may be designated as an OPZ, the goods of which may therefore be considered "originating goods" for the purposes of the KORUS FTA. Given the prevailing labor conditions in the KIC and the fact that the KIC is a significant source of foreign hard currency for North Korea—a non-Party to this agreement—the AFL-CIO opposes Annex 22-B, as well as any attempt to classify KIC goods as originating goods under this agreement.

V. Investment

Trade agreements and their investment provisions should not incentivize off-shoring of U.S. jobs; establish substantive rights for foreign investors that extend beyond those granted to domestic investors; unduly limit countries' ability to impose capital controls where indicated; or invite challenges in international tribunals to non-discriminatory laws that legitimately seek to protect workers, the environment, or the health and safety of American citizens. The KORUS FTA's investment provisions do not meet this standard.

As with the investment chapters of previous trade agreements, we remain deeply concerned by this agreement's rules on expropriation, extremely broad definition of investment, and vague standard for fair and equitable treatment. In addition, the agreement's deeply flawed investor-to-state dispute resolution mechanism contains none of the controls, such as exhaustion

[7] *See, e.g.*, Stephan Haggard and Marcus Noland. "Executive Order 13570: What Does It Really Mean?" Peterson Institute for International Economics Blog. April 28, 2011.
[8] Mark E. Manyin and Dick K. Nanto. "The Kaesong North-South Korean Industrial Complex." Congressional Research Service. April 18, 2011.

requirements, that could limit abuse of this private right of action. As negotiated, the investment provisions in the Korea agreement do give foreign investors greater rights than domestic investors, workers, or advocates to challenge democratically enacted American public interest laws and regulations. Further, the KORUS FTA gives us new causes for concern due to new and unprecedented language and expansion of the scope of property rights.

Of particular concern to the AFL-CIO is the agreement's overly inclusive concept of expropriation. The KORUS FTA adds several provisions that do not appear in prior FTAs that will likely expand the scope of actions considered "indirect expropriations." For example, the KORUS FTA provides that relevant considerations in determining whether a government action is an expropriation could include "whether the government action imposes a special sacrifice on the particular investor or investment that exceeds what the investor or investment should be expected to endure for the public interest." The "special sacrifice" standard has no corollary in U.S. or international law. The KORUS FTA also provides that indirect expropriation will have occurred if a government action is "extremely severe" or "disproportionate in light of its purpose or effect," adding vague new criteria to the determination. Arbitrators, interpreting these vague new terms, could strike down any number of laws intended to protect public health, safety, or the environment.

Taken together, these broad and vague provisions will afford foreign investors greater rights than U.S. investors—and likely greater rights than even foreign investors covered by existing FTAs. While some will argue that the U.S. has never lost an investor-state challenge, there is no guarantee that this will always be the case. Certainly, resources used to defend such cases could be better used elsewhere in this austere fiscal environment. Moreover, it is impossible to measure the chilling effect that the investment provisions have on the policy debate. In the past, investors have challenged a state's right to ban the toxic gasoline additive MTBE—that challenge may have weighed into policy decisions regarding regulation of bisphenol A (BPA) and other potentially endocrine disrupting chemicals. Finally, we raise once again the absence of non-discriminatory labor regulations from the list of what does not constitute an indirect expropriation, taking due note that the list is not exhaustive.

VI. Services

The AFL-CIO believes that important public services should be performed by the government and that quality control and accessibility should be assured by close government oversight. Maintaining public control over these services is essential to maintaining accountability to the local consumers of those services. As in previous agreements, the KORUS FTA does not contain a broad, explicit carve-out for essential public services. Rather, public services provided on a commercial basis or in competition with private providers are generally subject to the rules on trade in services, unless specifically exempted. There are few public services within the United States, however, that would qualify for the exception as it is written.

The specific exemptions for services in the KORUS FTA fall short of what is needed to protect these important sectors. There are, for example, no U.S. exceptions for energy services (except atomic), water services, sanitation services, public transportation, education, or health care. Even for those services that the U.S. did make exceptions for, the exemption only applies to

some of the core rules of the FTA, not all. Any trade agreement should preserve the ability of federal, state, and local governments to regulate services for the public benefit, allowing distinctions between domestic and foreign service-providers and setting appropriate qualifications or limitations on the provision of those services.

VII. Conclusion

In addition to the concerns discussed above, we remain concerned about the effects of the Government Procurement Chapter (17) on the ability to direct spending to create desperately needed local jobs; the obstacles that the Financial Services Chapter (13) poses to addressing the financial crisis that began in 2008; and the special status the agreement grants to foreign investors, who are the only entities able, under the agreement, to skip the Dispute Settlement provisions of Chapter 22 and challenge the United States government directly at the International Centre for Settlement of Investment Disputes.

In sum, this agreement does not adequately address the economic futures of workers either in the United States or South Korea. American workers are willing to support increased trade if the rules that govern it stimulate growth, create good jobs, and protect fundamental rights. However, this agreement fails to meet these goals.