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South Korea-U.S. Economic Relations: Cooperation, Friction, and Future Prospects

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South Korea-U.S. Economic Relations: Cooperation, Friction, and Future Prospects

Summary

Over the past decade, South Korea has emerged as a major economic partner for the United States. Korea is the U.S.'s seventh-largest trading partner – ahead of Western European countries such as France and Italy – and its sixth-largest export market. Korea has also become a significant investment site for American companies, which have poured nearly $10 billion into the country over the past three years. The U.S. is Korea's largest export market, second-largest source of imports, and largest supplier of foreign direct investment.

Increased economic interaction has been accompanied by disagreements over trade policies. The level of bilateral friction is principally affected by four factors: the size of the U.S. trade deficit with South Korea; the state of the U.S. economy; the progress of Korea's economic reforms; and whether or not bilateral political or security issues override bilateral trade considerations.

During Korea's financial crisis in 1997 and 1998, the Clinton Administration tended to mute its criticism of Seoul's alleged barriers to foreign exports and investors. Since the spring of 2000, however, the United States has intensified its pressure on bilateral trade issues, protesting that Seoul has been unresponsive to a host of longstanding U.S. complaints. In its annual report on foreign trade barriers, issued in April 2002, the Office of the United States Trade Representative (USTR) devoted 28 pages to South Korea, more than it did to any other economic entity except Japan, the European Union, and China. The shift in U.S. policy was due in part to the swings in the U.S.-Korean trade balance; after enjoying three years of trade surpluses with South Korea, the U.S. has run increasingly large bilateral trade deficits since 1998. As the U.S. economy has slowed and Korea's economic reforms have stalled, Congress became more vocal on bilateral trade issues, particularly on semiconductors and automobiles. Additionally, the Bush Administration's harsher U.S. policy toward North Korea, combined with the overall stalemate in North-South Korean relations, dulled the acuteness of security issues in the U.S.-South Korean relationship; unlike the situation during the Clinton years, Washington does not have to be as concerned that its trade policy will jeopardize its own or Seoul's negotiations with Pyongyang.

An interesting development over the past year has been that Washington and Seoul appear to have become more adept at managing their trade disputes, so that they tend to be less acrimonious than in the past. In large measure, this is due to the quarterly, working-level bilateral trade meetings that were first held in early 2001.

This report summarizes the main issues in U.S.-South Korean economic relations. It will be updated periodically.

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South Korea-U.S. Economic Relations: Cooperation, Friction, and Future Prospects

U.S.-South Korea Bilateral Trade Flows

Over the past decade, South Korea has emerged as a major economic partner for the United States. Between 1990 and 2000, U.S.-Korean trade more than doubled (see Table 1). In 2001, two-way trade (exports plus imports) was over $55 billion, down 17% from the all-time high reached in 2000. For several years, South Korea has been the U.S.' seventh-largest trading partner and its sixth-largest export market (after Canada, Mexico, Japan, Germany and the United Kingdom). Major U.S. exports to South Korea include semiconductors, machinery (particularly semiconductor production machinery), aircraft, agricultural products, and beef. South Korea is the U.S.' 4^{th} largest market for agricultural products and 3^{rd} largest market for beef.

For decades, the United States has been Korea's largest export market. Exports to the U.S. accounted for approximately 20% of Korea's total exports in 1999 and 2000. In recent years, exports to the United States accounted for around 5% of Korea's gross domestic product (GDP). Moreover, since Korea's financial crisis in 1997, the United States has overtaken Japan as Korea's largest supplier of imports. Major U.S. imports from South Korea include electrical machinery (with semiconductors typically accounting for nearly 20% of total South Korean shipments to the U.S.), cellular phones, general machinery, automobiles, textile products, and steel.

Mid-1990s: U.S. Bilateral Trade Surplus. As shown in Table 1, from 1994-1997 the U.S. ran a trade surplus with South Korea, after several years of trade deficits. The surplus peaked at nearly $4 billion in 1996, the same year South Korea became the U.S.'s fifth largest export market. The primary reason for the surplus was a sharp rise in U.S. exports – which peaked at $26.6 billion in 1996 – propelled by the boom in South Korea's economy in the mid-1990s, which increased demand for foreign products. The 60% rise in U.S. shipments from 1990 to 1997 more than offset the 25% increase in U.S. imports from South Korea over the same time period.

1998-2002: U.S. Bilateral Trade Deficit. In the fall of 1997, South Korea plunged into a serious economic crisis. In December of that year, Seoul and the International Monetary Fund (IMF) agreed to the terms of a $58 billion financial support package. As a *quid pro quo* for receiving IMF emergency loans, Seoul agreed to tighten its fiscal and monetary policies and engage in far-reaching, market-oriented reforms of its financial and corporate sectors, and of its labor market policies. South Korea also agreed to open its economy further to foreign goods and investors.

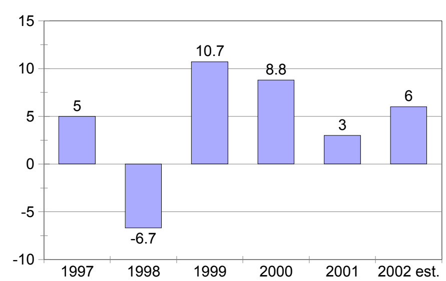
Table 1. Annual U.S.-South Korea Merchandise Trade
(Billions of U.S. Dollars)

Year	U.S. Exports	U.S. Imports	Trade Balance	Total Trade (Exports + Imports)
1990	$14.40	$18.49	-$4.09	$32.89
1991	$15.51	$17.02	-$1.51	$32.53
1992	$14.64	$16.68	-$2.04	$31.32
1993	$14.78	$17.12	-$2.34	$31.90
1994	$18.03	$19.63	-$1.60	$37.66
1995	$25.38	$24.18	$1.20	$49.56
1996	$26.62	$22.66	$3.97	$49.28
1997	$25.05	$23.17	$1.87	$48.22
1998	$16.49	$23.94	-$7.46	$40.43
1999	$22.04	$31.15	-$9.11	$53.19
2000	$26.30	$39.83	-$13.53	$66.13
2001	$20.89	$34.92	-$14.03	$55.81
Jan - May, 2001	$ 9.16	$14.94	-$5.78	$24.10
Jan - May, 2002	$ 8.46	$14.19	-$5.73	$22.65

Sources: 1990-1998 data from Global Trade Information Services. 1999-2001 data from U.S. International Trade Commission.

Since Korea's economic crisis, the U.S. has run an increasingly large bilateral trade deficit with that country. Korea's 1998 recession, during which time its gross domestic product (GDP) shrank by 6.7% (see **Figure 1**), led to a sharp decline in most countries' exports to South Korea, including those from the United States.[1] American imports from South Korea, however, rose slightly in 1998 and significantly in 1999 and 2000. These increases were propelled by the strong U.S. economy, which increased U.S. demand for foreign goods and services, and by the devaluation of the won (see **Figure 2**), which made Korean products cheaper for Americans to buy. In 2001, the slowing U.S. economy led to a drop in Korean imports.

Figure 1. Korea's GDP Growth
Sources: Bank of Korea, DRI-WEFA



In 1999, when Korea's economy grew by 10.9%, U.S. exports to South Korea recovered somewhat. With Korea's economy growing by over 9% in 2000, U.S. shipments to Korea rose by more than 20% compared with 1999. Growth in imports from Korea (up by nearly 30% in 2000), however, continued to outstrip U.S. export

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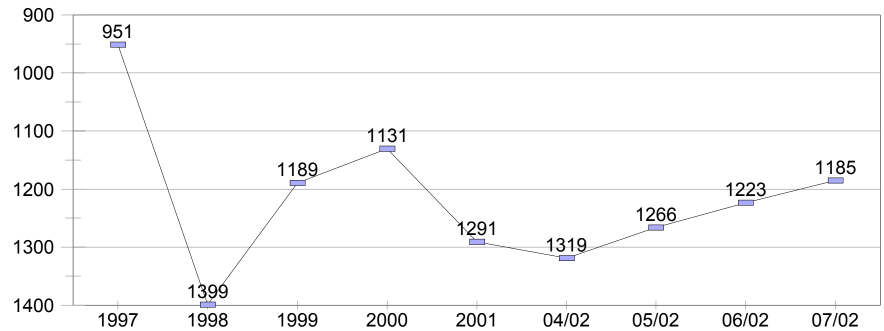
[1] See Raymond Ahearn, *South Korea's Economic Prospects*, CRS Report RS20041, February 1, 1999.

growth, causing the trade deficit to widen. The deficit further expanded in 2001. U.S. exports decreased in large measure because of Korea's sharp economic slowdown and the effects of the Korean *won*'s devaluation (see **Figure 2**). The sharp devaluation of the dollar against the won (and other major currencies) in the late spring and summer of 2002 may reduce the deficit.

Figure 2. Won:Dollar Exchange Rate (Average), 1997-2002
Source: Bank of Korea



Foreign Direct Investment Flows

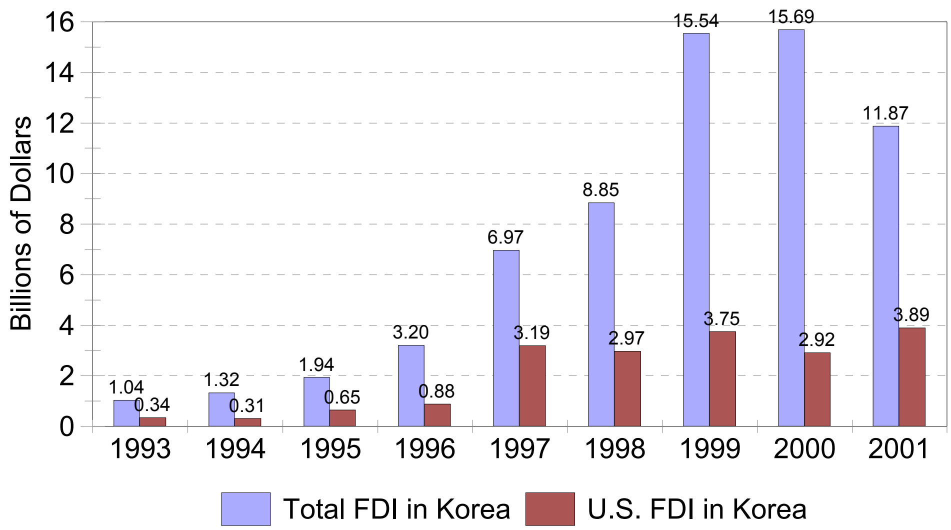
As part of its commitment to the IMF in December 1997, Seoul pledged to eliminate most restrictions on foreign direct investment (FDI). The government of President Kim Dae Jung, who was elected during the nadir of Korea's financial crisis, has moved aggressively to liberalize Korea's foreign investment regime. Partly as a response to Kim's reforms, and partly in response to the lower prices of Korean assets following the 1997 crisis, FDI flows have increased markedly, soaring from $3.2 billion in 1996 to $15.7 billion in 2000, before falling to $11.9 billion in 2001. American companies have invested nearly $10 billion in South Korea over the past three years. U.S. FDI in 2001 alone was greater than total U.S. FDI in Korea from 1993 to 1996. In 2001, U.S. firms resumed their historical position as the leading source of FDI into Korea. From 1998-2000, European firms had supplanted their American counterparts at the number one position.

Despite the increased openness to foreign ownership, a number of high-profile acquisitions by foreign companies have been either delayed or cancelled, due to nationalistic objections to the sale, disagreements over the sales price, and/or the discovery of previously undisclosed debts owed by the Korean suitor.

For the first half of the 1990s, annual South Korean FDI in the U.S. ranged from $350 million to $535 million. After soaring to $1.57 billion in 1996, Korean FDI fell to $729 million in 1997 and $874 million in 1998.[2]

[2] Organization for Economic Cooperation and Development, *International Direct Investment Statistical Yearbook 1999*.

Figure 3. Foreign Direct Investment in Korea, 1993-2001
Source: Ministry of Commerce & Industry



Bilateral Investment Treaty Negotiations. For several years, the U.S. and South Korea have been discussing a bilateral investment treaty (BIT). BITs are designed to improve the climate for foreign investors – typically by committing the signatories to prohibit discrimination against foreign investors – by establishing dispute settlement procedures and by protecting foreign investors from performance requirements, restrictions on transferring funds, and arbitrary expropriation. The U.S. has signed over 30 BITs, primarily with countries undergoing significant economic reforms. The U.S. and South Korea last held formal negotiations in 1999. The major stumbling block is Korea's so-called "screen quotas," which are limits on the dates and screen time given to foreign films. Foreign ownership in the Korean telecommunications industry and Korea's copyright rules also remain outstanding issues.

A Possible Korea-U.S. Free Trade Area (FTA). In recent years, there have been some calls for the U.S. and Korea to negotiate a free trade area, which would lower trade barriers between the two countries. The idea enjoys the support of the American business community in Korea, and many Korean businesses operating in the U.S. In the Senate, Max Baucus introduced legislation in May 2001 (S. 944) authorizing FTA negotiations with Seoul, the second time he has presented this initiative. No legislative action was taken on his first attempt, S. 1869, introduced in the 106th Congress. To date, no formal government-to-government discussions have been held over an FTA. Speaking in December 2001, U.S. Ambassador to Korea Thomas Hubbard said that a Korea-U.S. FTA is not on the Bush Administration's short-term policy agenda.

In 2001, at the request of the Senate Finance Committee, the International Trade Commission conducted a fact-finding investigation on the likely economic impact of a South Korea-U.S. FTA. The ITC's final report estimated that within four years after implementation of an FTA, U.S. exports to Korea would increase by 54% while U.S. imports would rise by 21%. In the short run, the biggest beneficiaries would likely be those industries in both countries that face high initial trade barriers. On the U.S. side, the ITC found that bilateral agricultural exports would increase by more than 200%. For Korea, the ITC projected that textiles and apparel exporters would see their shipments to the U.S. rise by 125%.[3] Thus, the report implied that the FTA's potential benefits would be greatly diluted if these politically sensitive sectors were excluded.[4]

Overall, the ITC estimated that within four years after implementation of an FTA, U.S. GDP would increase by approximately 0.2%, while Korean GDP would rise by 0.7% as a result of the FTA.[5] An earlier study by the Institute for International Economics (IIE), found similar effects for the U.S. economy, but had a wider band for the increase on Korean GDP, which was projected in the 0.4%-2.0% range. As in the ITC study, the IIE report found that most of the benefits to U.S. firms would derive from increased access to Korea's market. In contrast, the IIE projected that most of Korea's gains from an FTA would stem not from preferential access to the U.S. market but from improvements in the allocative efficiency of the Korean economy brought about the trade reforms required by an FTA.[6] President Kim also has discussed publicly his desire to negotiate FTAs with Japan and Chile, presumably to give further impetus to the economic reforms he initiated.

Major U.S. Trade Disputes with South Korea

Given the disparities in size and economic dependence, it is not surprising that the United States typically sets the agenda of U.S.-ROK trade talks. A recent exception is the case of steel, where Korea increasingly has taken on the role of *demandeur* in challenging U.S. measures to protect its domestic steel industry.

During the Asian financial crisis in 1997 and 1998, the U.S. tended to mute its criticism of South Korea's alleged barriers to foreign companies. Since the spring of 2000, however, the U.S. has intensified its pressure on trade issues, protesting that Seoul has been unresponsive to a host of longstanding U.S. complaints. In its annual report on foreign trade barriers, issued in April 2002, the Office of the United States Trade Representative (USTR) devoted 28 pages to South Korea – a country of slightly less than 50 million people – more than it did to any other country except Japan, the European Union, and China. A year earlier, the USTR cited Korea as a "priority watch country" under "Special 301" (Section 182 of the Trade Act of 1974) because it deems Seoul's enforcement of intellectual property rights to be unsatisfactory. Korea remains on this list. In the spring of 2001, U.S. negotiators – frustrated by the lack of progress in bilateral talks – proposed that the two countries hold quarterly, working level, interagency "trade action agenda" meetings to discuss

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[3] United States International Trade Commission (ITC), *U.S.-Korea FTA: The Economic Impact of Establishing a Free Trade Agreement (FTA) Between the United States and the Republic of Korea*, (Washington, DC, 2001), p. 5-1 - 5-2.

[4] For a similar argument, see Choi and Schott, *Free Trade*, p.80.

[5] ITC, *U.S.-Korea FTA*, p. x-xi.

[6] See Choi and Schott, *Free Trade*, p. 79-82.

progress on and strategies for settling major bilateral trade disputes. Korea's Ministry of Foreign Affairs and Trade accepted, and negotiators on both sides credit the meetings with creating a more constructive dialogue by serving as "action-forcing" events.

Congressional interest in U.S.-Korean trade relations also has increased in recent months. After introducing no major Korea-related economic legislation in 2000, in 2001 and 2002 Members of Congress have introduced a number of measures complaining about alleged Korean trade barriers and allegedly unfair subsidy policies.

Below are brief descriptions of several major sector-specific disputes between the U.S. and South Korea. In general, U.S. exporters and trade negotiators identify the lack of transparency of Korea's trading and regulatory systems as the most significant barrier to trade with Korea, in almost every major product sector.

Automobiles. South Korea, the world's fourth-biggest producer of automobiles, has long maintained a variety of barriers to the import of automobiles, including a ban on Japanese automobiles and the auditing of the income taxes of individuals who purchased foreign luxury cars. The ban on Japanese automobiles was eliminated in 1999. In its October 1997 Super 301 report to Congress, the Clinton Administration designated Korea as a "Priority Foreign Country" for its barriers to foreign motor vehicles.[7] USTR subsequently initiated an investigation under Section 301 of the U.S. Trade Act of 1974, as amended, and issued a call for bilateral consultations to provide fair market access for foreign autos in Korea.[8] In 1998, the U.S. and South Korea signed a Memorandum of Understanding (MOU) on foreign access to Korea's auto market, which led the USTR to terminate the Section 301 investigation. Under the MOU, Seoul agreed to reduce its tariffs on motor vehicles from 80% to 8%,[9] proactively address instances of anti-import activity in Korea, lower or eliminate many automobile taxes, create a new financing system to make it easier to purchase automobiles, and streamline its standards and certification procedures. Many of these steps – including lowering tariffs – have been implemented.

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[7] Super 301 (Section 310 of the 1974 Trade Act) requires the USTR to report to congress on "priority foreign countries" that practice unfair trade and "priority practices" that have the greatest effect on restricting U.S. exports. If agreement is not reached on the priority practices, the USTR is required to initiate a Section 301 case (see the following footnote). For more information, see Wayne Morrison, *Section 301 of the Trade Act of 1974*, CRS Report 98-454. See also Gwenell Bass, *U.S.-South Korea Auto Talks*, CRS Report 97-1030, December 4, 1997.

[8] Section 301 (sections 301-309 of the Trade Act of 1974) authorize the USTR to initiate investigations of foreign trade practices that allegedly discriminate against U.S. commerce. If a settlement with the foreign country is not reached following the initiation of the investigation, the USTR decides whether or not to retaliate, usually in the form of 100% tariffs on selected imports from the offending country. See CRS Report 98-454, *Section 301 of the Trade Act of 1974*, by Wayne Morrison.

[9] By way of comparison, the U.S. tariff on passenger vehicles is 2.5%. The Japanese tariff rate is 0%.

Table 2. U.S.-ROK Auto Trade
(number of vehicles)

	1999	2000	2001
Korean Auto Companies' Exports to the U.S.	410,000	573,000	618,000
U.S. Auto Companies' Exports to Korea	739	1,214	1,500

Source: American Chamber of Commerce in Korea

In the spring of 2000, the USTR criticized South Korea's compliance with some areas of the MOU, and called on Seoul to take additional steps – outside the MOU – to open the auto market. Foreign market share for autos remains extremely low at approximately 0.37%, compared with 5% in Japan, 25% in the European Union, and 30% in the United States.[10] Meanwhile, led by Hyundai Motors, Korean auto manufacturers exported over 600,000 vehicles to the United States in 2001.[11] U.S. officials and businesspeople attribute the poor sales in Korea to a "buy Korea" mentality among most Koreans, protectionist statements made by high level Korean government officials, high tariffs and auto taxes, onerous standards and certification rules, and a perception among Koreans that their income taxes will be audited if they purchase a foreign automobile. The U.S. government and auto executives have called on the Korean government to take more visible steps to encourage purchases of foreign cars and to rewrite Korean regulations to reduce the barriers to foreign autos. Most recently, U.S. initiatives have focused on pressuring Seoul to lower its 8% tariff on autos to 2.5%.

Korean officials contend that few foreign vehicles are sold because of the decreased purchasing power of Korean consumers since the crisis (foreign autos cost considerably more than Korean models), the lack of advertising by foreign auto manufacturers, and Korean consumers' preference for smaller vehicles. The finalization in April 2002 of GM's long-anticipated takeover of Daewoo Motors may help to increase the sales of U.S. autos in Korea.

U.S.-Korean consultations on the MOU have been held regularly in recent months, but without any new progress reported. One obstacle appears to be paralysis in the Korean government; with President Kim Dae Jung's popularity at an all-time low, governmental authorities appear unwilling to take the high-profile, politically unpopular, steps to encourage more automobile imports. It is unclear whether the completion of General Motors' takeover of Daewoo Motors – a deal that is in the

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[10] According to the American Chamber of Commerce in Korea, of the more than 1 million automobiles sold in Korea in 2000, 4,414 were foreign-made. See American Chamber of Commerce in Korea, *Improving Korea's Business Climate. Recommendations from American Business 2001*, p.50-52.

[11] In April 2002, Hyundai Motors announced it would build a $1 billion production plant in Alabama.

final stages of negotiation – will alter Korea's auto imports. During his summit with President Kim in February 2002, President Bush raised the automobile trade issue.

H.Con.Res. 144 and S.Con.Res. 43, introduced in May 2001, call on South Korea to end the practices that impede foreign market access, and request various U.S. executive agencies to monitor Korea's progress on this issue.

Pharmaceuticals. Korea is ranked in the world's top 15 pharmaceutical markets, with sales approaching $4 billion annually. Imports comprise approximately 30% of the total market, compared with an average of 50%-70% for countries that do not have a significant research-based domestic industry. Korea's expenditures on pharmaceutical products is about $115 per person, less than half the $240 average for OECD countries.[12] The country has a nationalized health insurance system, which has had a negative cash flow since 1995.

For years, the U.S. government has raised complaints about a number of Korea's pharmaceutical policies, which it describes as "onerous," non-science based, and designed to protect the domestic Korean industry.[13] Criticisms have mounted since 2001, when the Korean government began to implement a series of emergency measures to fill the national health insurance fund's mounting deficit, estimated at over 4 trillion won ($3.3 billion). Recent complaints include: the lack of transparency of the Korean Ministry of Health and Welfare, particularly the Ministry's allegedly poor record on consulting with and notifying companies about regulatory changes; poor protection of intellectual property rights for medical patents; the vagueness of a July 2000 Korean law requiring that "cosmeceuticals" – cosmetic products that have a functional or therapeutic effect – be reviewed for safety and efficacy; and the discriminatory nature of Seoul's requirements that foreign drugs must be retested on Koreans living in Korea, rather than on other ethnic Asians, as the U.S. has insisted. In a sign of pharmaceuticals' growing importance on the bilateral trade agenda, in January 2002, the two sides established a bilateral health care reform working group.

U.S.-Korea friction over pharmaceutical issues flared up into a political controversy in Korea in July 2002, when some Seoul politicians and officials blamed the dismissal of the Health and Welfare Minister on pressure from U.S. government and foreign multinationals. The minister was replaced as part of a July 11, 2002 Cabinet reshuffle. The dispute first arose in May 2001, when the Ministry announced a new "reference pricing" system for reimbursing patients' prescription drug expenditures as part of efforts to stabilize the health insurance fund. Foreign multinationals and the U.S. government criticized the plan as favoring domestic producers of generic drugs and of violating a 1999 U.S.-ROK agreement on prescription drug pricing policies. The plan was scheduled to enter into force in August 2001, but following strong opposition from the foreign pharmaceutical industry and the U.S. government, it was delayed. The dismissed Health and Welfare Minister had called for the reference pricing plan to be implemented. To

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[12] American Chamber of Commerce in Korea, *Improving Korea's Business Climate 2002*, p. 148.

[13] United States Trade Representative, *2001 National Trade Estimate Report on Foreign Trade Barriers*, p. 288, 294-96.

date, the plan's status is unclear. Some reports indicate the new system may be unveiled later this year.

Agricultural Issues. U.S. agricultural exporters have long complained about high tariff and non-tariff barriers maintained by Korea, which is the United States' fourth largest market for agricultural products, to protect domestic Korean producers. Approximately 44% of Korea's farm imports in 2000 came from the United States.[14] Agricultural policy is highly political in South Korea due to the clout of the country's shrinking but vocal farm sector. Korean Ministers of Agriculture often have lost their jobs due to concessions made in bilateral and multilateral trade talks.

In September 2001, Washington and Seoul settled their most contentious agricultural dispute in recent years, when the U.S. accepted Korea's abolition of its requirement that imported beef be distributed and sold through different channels than domestic beef. In 2000, a dispute settlement panel requested by the U.S. and Australia had ruled that Korea's beef import system discriminated against foreign suppliers. South Korea is the United States' third largest market for beef.

Although the beef dispute has been temporarily settled, several other disagreements linger. The U.S. has criticized the clarity of Korea's new labeling and rule of origin requirements for genetically modified foods, and President Bush raised the issue in his February 2002 summit with South Korean President Kim. Bilateral consultations appear to have partially resolved the dispute. Significant market access barriers allegedly remain on foreign citrus products and rice. In the fall of 2001, Korea for the first time tendered a contract for imported rice to a U.S. company. The U.S. has also charged that Korea's quarantine policies and mandated shelf-life requirements are barriers to imports. U.S. agricultural groups contend that Korea's import certification requirements and testing standards are unduly onerous.[15]

Steel. For years, South Korean steel exports to the United States have been one of the most politically charged items on the bilateral economic agenda, particularly since the 1997 Asian financial crisis. From 1997 to 1998, Korean shipments of steel to the U.S. surged by 109%, vaulting South Korea into the top five U.S. sources of steel imports. Although Korea's steel exports to the U.S. have declined since 1998 (see Figure 4), they have not returned to pre-crisis levels. For the first six months of 2001, Korean exported just under 1.3 metric tons of steel to the United States, a 22.4% year-on-year decline, in line with a general decline in U.S. steel imports.

In response to the 1998 surge from Korea and other steel-producing countries, Congress joined major U.S. steel manufacturers in pressuring the Clinton Administration to take action. President Clinton granted safeguard relief (under Section 201 of the Trade Act of 1974) for U.S. producers of steel welded line pipe and wire rod, a move that raised tariffs on imports of those products.[16] In September

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[14] ITC, *U.S.-Korea FTA*, p.3-10.

[15] Caroline Cooper, "KEI Trade Brief. U.S.-Korea Bilateral Trade Relations," July 2002.

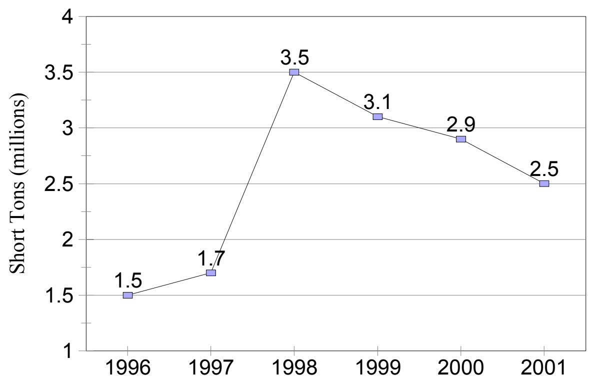
[16] Section 201 relief, often referred to as "safeguard" or "escape clause" relief, is defined in (continued...)

2000, Korea challenged the Section 201 action in the World Trade Organization (WTO). In October 2001, the WTO panel ruled that the Korean claims were partly valid. The U.S. lost an appeal to the WTO Appellate Body. Following the appeal, in July 2002, the two sides reached a bilateral agreement significantly increasing Korean line pipe exporters' access to the U.S. market for the remaining six months that the Section 201 safeguard action is in effect.[17]

The Clinton Administration also imposed anti-dumping duties on Korean exports of stainless steel plate in coils and stainless steel sheet and strip. Seoul protested these duties in the WTO, and a dispute settlement panel was formed in November 1999. In its final report of December 2000, the WTO panel ruled against the United States' methodology used to calculate the margin of dumping in the case, and the U.S. subsequently agreed to abide by the ruling.

Figure 4. Steel Imports from Korea

Source: International Trade Commission



President Bush's Section 201 Steel Investigation. Steel became an even more prominent trade issue in June 2001, when President Bush initiated a Section 201 investigation of the effects of imports of over 600 steel products on the U.S. steel industry. In December 2001, the U.S. International Trade Commission (ITC) recommended that the President grant the U.S. industry relief through a variety of trade remedies – including increased tariffs – for imported steel products representing a majority of U.S. imports. Three months later, President Bush announced trade remedies (higher tariffs and in some cases quotas) for almost all of the products for which the ITC had found substantial injury. All remedies will be of three years' duration, and will decline over that period. Tariffs for some products

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[16] (...continued)
sections 201-204 of the Trade Act of 1974, as amended (19 U.S.C. 2251-2254). Safeguard relief provides for temporary duties, quotas, or other restrictions on imports that may be traded fairly, but that enter in such quantities as to cause or threaten to cause serious injury to a domestic industry. The relief is intended to give the domestic industry an opportunity to adjust to the new competition and remain competitive. Within six months after a Section 201 petition has been filed with the International Trade Commission, the ITC must conduct an investigation, determine if relief is warranted, and recommend appropriate remedial action from a specified range of options. The President then decides whether to implement the recommended measure, apply an alternative measure, or take no action at all.

[17] The agreement entitles Korean companies to 17,500 tons of line pipe per quarter at the most favored nation tariff rate, more than a seven-fold increase from the Section 201 tariff-rate quota of 9,000 tons per year. "U.S. Increases Korean Steel Access, Resolving WTO Line Pipe Dispute," *Inside US Trade*, August 2, 2002.

will rise to 30% in the first year.[18] The President will make final decisions on specific product exemptions over the next 120 days.

Higher duties are expected to have a substantial, but not devastating, impact on Korea's steel industry in part because many of Korea's major export items to the United States were excluded from the Section 201 investigation. Additionally, in a major concession, Pohang Iron & Steel Co (POSCO), the world's second-largest steel producer, received an exemption from President Bush for up to 750,000 metric tons (827,000 short tons) of crude steel exports to its California joint venture with U.S. Steel, equivalent to about one-third of Korea's total steel exports to the United States in 2000 and 2001.[19] The Korea Iron and Steel Association (KOSA) estimates that the higher duties will reduce Korea's exports to the U.S. market by 20% in 2002, costing the industry between $200 million - $300 million. Seoul has joined the European Union and Japan in challenging the Section 201 decision in the WTO.

Korean Government Ownership of the Steel Industry. From time to time, Congress has called on the Korean government to end its ownership of some steel firms and subsidization of others. The October 1998 omnibus spending bill (P.L. 105-277), for example, directed (section 621) USTR to monitor and report upon the Korean government's support for Korean producer Hanbo Steel, the insolvency of which in 1997 helped precipitate the country's financial crisis later that year.[20] In 2000, a consortium of U.S. investors abandoned its attempt to purchase Hanbo for $480 million, reportedly because a number of its demands had not been met by the government-controlled entity that is managing Hanbo. Japan's Yamato Steel has announced a take-over of Hanbo.

For years, the U.S. has demanded that the South Korean government reduce its ownership of the Korean steel industry. Most prominently, the U.S. has called on Seoul to *fully* privatize POSCO, which has been accused of using government subsidies to dump steel in the U.S.[21] In October 2000, the Korean government partially met U.S. demands by selling off the remaining 6.84% stake held by state-run Korea Development Bank (KDB), formerly the majority shareholder in POSCO. Shortly before the sale, the government also scrapped its rules limiting individual owners to a 3% stake in POSCO. Seoul now contends that the privatization of the steel-maker is complete. Korea, however, has not yet met the United States' demand that the Korea Industrial Bank – which is 98% owned by the Korean government – divest its 3% stake in POSCO. Foreign interests now own a majority of POSCO's

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[18] For more on the Section 201 case, see CRS Report RS21152, *Steel: Key Issues for Congress*, by Stephen Cooney.

[19] The exemption is contained in section b:xxiv of the annex to President Bush's proclamation. The proclamation and the annex can be found at [http://www.usitc.gov/steel]. The European Union received a 420,000 ton exemption. Japan received 250,000 tons. See *American Metal Market*, August 12, 2002.

[20] See CRS Report RL30073, *The Steel Import Surge: Causes and Proposed Remedies*, by Gwenell Bass.

[21] See Chapter 3 of the U.S. Department of Commerce's report, *Global Steel Trade*, available as of October 4, 2000 at [http://www.ita.doc.gov/media/steelreport726.htm].

shares. POSCO dominates the Korean steel industry, accounting for over 60% of the nation's crude steel output in 1999.[22]

Intellectual Property Rights Issues. Bilateral tensions often have arisen over U.S. allegations that Korea does not sufficiently protect intellectual property rights (IPRs). In 1999, the U.S. praised Korea for making significant efforts to strengthen its IPR laws, a result of Seoul becoming a signatory to the World Trade Organization Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) in 1994. The USTR downgraded Seoul from Special 301 "priority watch list" in 1997 to "watch list" in 1998.[23] In May 2000, however, Korea was elevated back to the "priority watch list," due to concerns about inadequate protection of rights in the pharmaceutical industry, continued piracy of computer software, and new (December 1999) revisions to Korea's copyright laws. In 2000 and early 2001, the Korean government took many steps to improve the enforcement of its intellectual property rights regulations, particularly those pertaining to the computer software industry. Citing these moves, in 2002, USTR again downgraded Korea to "watch list" status.[24] However, bilateral IPR talks in August 2002 broke down over the lack of progress in copyright and other issues.

Assistance to Hynix Semiconductor.[25] In 2001, a major trade dispute nearly erupted between the United States and South Korea over allegations that the Seoul government was propping up Hynix Semiconductor, presently the world's third-largest producer of dynamic random access memory (DRAM) semiconductor chips. Last year, Hynix's leading creditors – most of which are owned by the Korean government – orchestrated a series of rescue packages that have kept Hynix in business by enabling it to restructure its 8.6 trillion *won* (over $6.5 billion) in debt. In the U.S., Micron Technology, the Idaho-based second largest producer of DRAMs, led a campaign against the support packages, arguing that they amounted to government-sponsored bailouts that allow Hynix to export at low prices and that they were a prime cause of the drastic plunge in global chip prices in 2001. Micron, the last U.S.-based DRAM producer, threatened to file countervailing duty and anti-dumping petitions. Prodded by Micron and some Members of Congress,[26] the Bush

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[22] ITC, *U.S.-Korea FTA*, p.3-23.

[23] "Special 301" refers to Section 182 of the Trade Act of 1974. Since the start of the Special 301 provision in 1989, the USTR has issued annually a three-tier list of countries judged to have inadequate regimes for IPR protection, or to deny access: 1) *priority foreign countries* are deemed to be the worst violators, and are subject to Section 301 investigations and possible trade sanctions; 2) *priority watch list countries* are considered to have major deficiencies in their IPR regime, but do not currently warrant a Section 301 investigation; and 3) *watch list countries*, which maintain IPR practices that are of particular concern, but do not yet warrant higher level designations. See Morrison, *Section 301 of the Trade Act of 1974*, CRS Report 98-454.

[24] United States Trade Representative, *2002 Special 301 Report*, [http://www.ustr.gov/reports/2002/special301.htm].

[25] For more on the Hynix Semiconductor dispute, see Mark Manyin and Steven Cooney, *The Semiconductor Industry and South Korea's Hynix Corporation*, CRS Report RL31238.

[26] For instance, in September, an amendment sponsored by Senator Larry Craig protesting (continued...)

Administration raised the matter in bilateral and multilateral meetings with South Korea and considered requesting that the World Trade Organization establish a dispute settlement panel to investigate. The Korean government has presented evidence that the decisions on whether to aid Hynix have been in the hands of the company's creditors.

The economic stakes are high. U.S. and South Korea trade in DRAMs totaled almost $3 billion in 2000, nearly twice the value of the two countries' trade in iron and steel products. Semiconductors as a whole are the number one U.S. import from and export to Korea. Furthermore, the Hynix packages call into question the Korean government's commitment to economic reforms, which are designed to make Korean conglomerates more responsive to market pressures and end the past practice of rescuing troubled conglomerates considered "too big to fail." Hynix accounts for an estimated 4% of South Korea's exports. Over 150,000 Koreans are employed by Hynix and its network of suppliers.

In early December 2001, the impetus for the dispute was suddenly removed – at least temporarily – by the announcement that Micron and Hynix had begun negotiating a possible strategic alliance. In April 2002, the two sides announced that Micron would acquire Hynix's DRAM business for $200 million and over 100 million shares of Micron stock. Hynix's board, however, vetoed the deal, arguing that the sale price was too low and that the recent rise in global chip prices meant that Hynix's DRAM business could survive independently. Subsequently, the Korean government pledged that it would not bail out the company and Hynix's creditors – most of whom backed the deal with Micron – exercised their right to take management control of Hynix.

The new management team initially appeared to favor selling off the company's assets, a move that is likely to generate considerable political controversy in South Korea, which is in the middle of a presidential election campaign. Recently, however, there are reports that the creditors are backing away from a sale in favor of internal restructuring. Micron has stated that it no longer has any interest in acquiring Hynix or any of its constituent parts, and has taken steps that some believe are designed to preserve its ability to file an anti-dumping or countervailing duty case against Hynix in the future.

Korean's Complaints Against U.S. Anti-Dumping and CVD Practices. For over a decade, South Korea has chafed at the United States' use of anti-dumping and counter-vailing duty (CVD) laws to raise tariffs on Korean exports. According to Choi and Schott's study, in July 2000 the five CVD and 18 anti-dumping orders against South Korean exports covered approximately $2.5

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[26] (...continued)
the "Republic of Korea's improper bailout of Hynix" was incorporated into the Senate's version of H.R. 2500, the appropriations bill for Commerce, Justice, and State. The legislation notes that in 1998, Congress inserted a provision into the Omnibus Fiscal 1999 Appropriations Act (H.R. 4328, P.L. 105-277) requiring that the 1997 IMF $58 billion assistance package to Seoul not be used to support South Korean companies that compete unfairly with U.S. companies. The Craig amendment was stripped from the bill in conference.

billion, or over 7%, of U.S. imports from South Korea in 1999. Moreover, these tariff hikes have tended to be concentrated in a handful of Korean industries – semiconductors, steel, televisions, and telecommunications equipment – that have considerable political influence in Seoul.

During the Uruguay Round (1986-1993) of the General Agreement on Tariffs and Trade (GATT, the WTO's predecessor organization), Korea was one of several countries demanding revisions to global anti-dumping rules, changes the United States opposed because of fears they would constrain U.S. anti-dumping investigators. South Korea, joined most prominently by Japan, has taken up this issue again in the WTO's current round of negotiations, against U.S. opposition.[27]

In recent years, Seoul has become more assertive in using the WTO to challenge United States' trade practices. In 1999 and 2000, Seoul took the U.S. to the WTO over allegedly discriminatory U.S. anti-dumping duties placed on Korean exports of steel and semiconductors. Korea won both of the steel cases it initiated. In the semiconductor case, in September 2000 Korea and the U.S. reached an agreement whereby the U.S. dropped anti-dumping duties imposed against Korean dynamic random access memory (D-RAM) chips. In exchange the Korean semiconductor industry pledged to collect D-RAM price and cost data, and provide this information to the U.S. if a new anti-dumping case is filed against Korean semiconductor imports. The agreement preempted a WTO panel decision that was widely expected to rule against the U.S., a ruling that could have required changes to U.S. anti-dumping regulations. As part of the agreement, Korea asked that the WTO suspend its panel covering the case.

Conclusion

The level of U.S.-South Korean trade friction is principally affected by four factors: the size of the U.S. trade deficit with South Korea; the state of the U.S. economy; the progress of Korea's economic reforms; and whether or not political or security issues override bilateral trade considerations. Since the spring of 2000 – a period of rising bilateral deficits and a slowing U.S. economy – trade tensions between Washington and Seoul have been rising, after a lull of about three years in which trade disputes were deemphasized to focus on Korea's recovery from its 1997 financial crisis. The change was more a result of shifting priorities on the U.S. side, rather than an increase in the number of disputes, as virtually all current areas of disagreement have been sources of tension for years.

For most of 1999 and 2000, with the notable exception of steel, the United States' focus on areas of trade friction was confined primarily to the executive branch. The 107th Congress, however, has intensified its interest in U.S.-Korean economic relations, principally on the issues of semiconductors and automobiles. In late 2001, tensions over assistance to the Hynix Semiconductor – which some

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[27] Notwithstanding Korea's position on anti-dumping, U.S. trade officials have praised their Korean counterparts for their willingness to compromise and serve as a bridge to developing countries during the November 2001 WTO Ministerial talks in Doha, Qatar.

Members of Congress closely tracked – very nearly caused a major trade dispute between the United States and South Korea to erupt. Additionally, the months-long stalemates in North-South Korean and North Korean-U.S. relations mean that Washington does not have to be as concerned that its trade policy will jeopardize Seoul's negotiations with Pyongyang. However, in the near future, the growing attention that the Bush Administration is placing on North Korea's weapons of mass destruction may mean that security issues will crowd out many economic issues that otherwise would occupy a higher place on the bilateral negotiating agenda. This phenomenon was seen during the February 2002 Bush-Kim summit in Seoul; the two leaders' debate over how to deal with North Korea left little time to discuss trade matters. President Bush raised the issues of trade in automobiles and genetically-modified organisms. President Kim expressed concern over the Bush Administration's Section 201 investigation of imported steel.[28]

An interesting development over the past year and a half has been that Washington and Seoul appear to have become more adept at managing their trade disputes, so that they tend to be less acrimonious than in the past. In large measure, this is due to the quarterly, working-level bilateral trade meetings that were first initiated by Deputy Assistant USTR Barbara Weisel and her counterpart in the Korean embassy, Cho Tae-yul, in early 2001. Dubbed the Trade Action Agenda Meetings, the forum in some ways is a more robust successor to the U.S.-ROK annual trade subgroup meetings that were initiated in the early 1980s, but had lapsed in the 1990s. Both sides credit the meetings, which appear to be unique to the U.S.-South Korean trade relationship, with creating a more constructive dialogue by serving as "action-forcing" events.

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[28] *Inside U.S. Trade*, March 1, 2002.