Order Code RL33435

CRS Report for Congress

The South Korea-U.S. Free Trade Agreement (KORUS FTA) Negotiations

Updated March 19, 2007

William H. Cooper
Specialist in International Trade and Finance
Foreign Affairs, Defense, and Trade Division

Mark E. Manyin
Specialist in Asian Affairs
Foreign Affairs, Defense, and Trade Division

Prepared for Members and
Committees of Congress

The Proposed South Korea-U.S. Free Trade Agreement (KORUS FTA)

Summary

On February 2, 2006, United States Trade Representative (USTR) Robert Portman and South Korean Trade Minister Kim Hyun-chong, announced their two countries' intention to negotiate a Korea-U.S. free trade agreement (KORUS FTA). The announcement came after many years of official and unofficial discussions of the feasibility of concluding an FTA. The reaction in the United States to the negotiations has ranged from bipartisan support to some skepticism and opposition.

The negotiations on a KORUS FTA will likely be of considerable interest to 110th Congress, because the Congress would have to approve an FTA before it could enter into force, and the negotiations touch on many sensitive trade issues. The KORUS FTA negotiations being conducted under the trade promotion authority (TPA) that the Congress granted to the President under the Bipartisan Trade Promotion Act of 2002 (P.L. 107-210). The authority allows the President to negotiate trade agreements that would receive expedited congressional consideration (no amendments and limited debate). However, the TPA is due to expire July 1, 2007, placing tight time restrictions on the negotiations.

The KORUS FTA negotiations are taking place with a high degree of political risk for both South Korea and the United States. The U.S.-South Korean alliance, while remaining very strong, has showed signs of fraying. Some observers assert that the FTA would help to shore up the alliance. On the other hand, failure of the negotiators to reach an agreement could damage the relationship for some time. The fact that the two sides have agreed to negotiate despite the risks indicates a degree of mutual trust and expectation of success.

Each country enters the negotiations with some key objectives. The United States seeks, among other goals, the reduction or elimination of South Korean restrictions on agriculture imports, the resolution of issues affecting auto and pharmaceutical trade, and the reduction in barriers to foreign investment. In addition, the United States has been encouraging stronger South Korean government enforcement of intellectual property rights and discussion of and changes to competition policies that discourage foreign business activity in South Korea. South Korea has been seeking preferential treatment for goods produced by South Korean firms in the Kaesong industrial zone in North Korea, the inclusion of South Korean residents in the U.S. visa waiver program, discussion of U.S. antidumping policies and practices, and the reduction of U.S. restrictions on maritime services trade. A number of these issues have proved contentious during the negotiations.

South Korea is the seventh largest U.S. trading partner, and the United States is South Korea's third largest trading partner. The KORUS FTA would be the second largest FTA in which the United States is a participant and the largest in which South Korea is a participant, representing a major step for both countries in the pursuit of their respective trade strategies. These negotiations could have repercussions beyond the bilateral relationship as well. This report will be updated as events warrant.

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On February 2, 2006, United States Trade Representative (USTR) Robert Portman and South Korean Trade Minister Kim Hyun-chong announced their two countries' intention to negotiate a free trade agreement (FTA). The announcement came after many years of official and unofficial discussions of the feasibility of concluding an FTA. The climate for launching the negotiations improved following South Korean willingness to address four areas of concern to the United States: beef, automobiles, pharmaceuticals, and "screen quotas." (Screen quotas limit the amount of screen time that foreign films could be shown.)[1]

The negotiations on a KORUS FTA will likely be of considerable interest to the 110th Congress, because the Congress would have to approve an FTA before it could enter into force. The U.S.-South Korea FTA (KORUS FTA) negotiations are being conducted under the trade promotion authority (TPA) that the Congress granted to the President under the Bipartisan Trade Promotion Act of 2002 (P.L. 107-210). The authority allows the President to negotiate trade agreements that would receive expedited congressional consideration (no amendments and limited debate). However, the executive branch must fulfill a number of criteria in order to exercise the authority, including specified negotiating objectives in the final agreement and consultation with the Congress prior to and during the negotiations.

The negotiations take place with a high degree of political risk for both South Korea and the United States. The U.S.-South Korean alliance remains very strong. The United States and South Korea have been allies since the United States intervened on the Korean Peninsula in 1950 and fought to repel a North Korean takeover of South Korea. Over 33,000 U.S. troops were killed and over 100,000 were wounded during the three-year conflict.[2]

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[1] United States Trade Representative (USTR) Robert Portman reportedly told his South Korean counterparts that an FTA could not be launched unless Seoul demonstrated its ability to deliver compromises in major outstanding bilateral issues, and throughout 2005 U.S. officials had included these sectors on the list of major trade disputes. South Korean government officials say that whatever changes were made in beef, automotive, and pharmaceuticals were unrelated to the negotiations over launching an FTA. Inside US Trade, "Portman Says U.S. Not Ready to Launch FTA Talks with Korea," June 10, 2005; Edward Alden, et. al., "South Korean Film Concession Paves Way for Free Trade Talks with the US," *Financial Times*, January 27, 2006; conversations with U.S. officials in June 2005, September 2005, and December 2005.

[2] For more on the U.S.-South Korean alliance, see CRS Report RL33567, *Korea-U.S. Relations: Issues for Congress*, by Larry A. Niksch.

Although the alliance remains strong, it has shown signs of fraying. Some observers argue that the FTA would help to strengthen the alliance.

U.S.-South Korean trade frictions have diminished over the last decade and a half as political leaders have been forced to give higher priority to foreign policy and national security concerns, and the United States and South Korea have increasingly used the multilateral dispute settlement mechanism of the World Trade Organization (WTO) and other fora to address bilateral trade problems. In addition, South Korea has introduced a number of reforms to open its economy to foreign competition and investment that have addressed some of the U.S. complaints. Yet, even though tensions have diminished, a number of long-standing, deep-seated differences in trade and investment relations remain below the surface. The decision to launch FTA negotiations has exposed many of these fissures. If South Korean and U.S. negotiators can successfully address them, the relationship would strengthen. If not, and the negotiations fail, the bilateral relationship could be seriously harmed for some time as failure may be a sign of the lack of trust.

The timing of the negotiations also presents a challenge. The President's TPA is scheduled to expire on July 1, 2007; that is, an agreement must be signed before July 1, 2007, if it is to receive expedited congressional consideration under that authority. In addition, the TPA requires a 90-day presidential notification to Congress of *intent* to sign the agreement; therefore, the KORUS FTA would have to be completed before April 2, 2007.[3] Some U.S. FTA agreements have been completed within a year, others have taken more than a year. While reauthorization of TPA in 2007 is a possibility, it is widely considered remote at this time given the highly charged partisan environment in Congress on trade. In addition, the United States and South Korea are negotiating an FTA as multilateral talks in the Doha Development Agenda (DDA) have floundered, leading many analysts to doubt the feasibility of a successful outcome before TPA expires.

The KORUS FTA talks appear to have entered their endgame. On March 12, 2007, South Korea and the United States completed the eighth and final round of formal negotiations they have held in the 10 months since the talks officially opened. According to the lead U.S. negotiator, Assistant U.S. Trade Representative Wendy Cutler, talks have been completed in three areas: customs, government procurement, and competition, and U.S. and South Korean negotiators say they are "very close" on completing negotiations in seven other areas.[4] Cutler also has stated that the two sides have a mutual "outline" of a possible agreement on automotive trade.

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[3] Because the agreement would have to be translated and legally "scrubbed" before given April 2, 2007, the negotiations would probably have to be completed as much as a month before then. However, as the negotiations entered their final phase in March 2007, a U.S. trade official stated that a legal "scrub" would not begin until April 2007.

[4] Cutler identified these areas as services, financial services, market access, transparency, telecommunications, e-commerce, and technical barriers to trade. Remarks presented at Global Business Dialogue/Korea Economic Institute Colloquium, "KORUS: From Demands to Agreement," March 16, 2007.

From March 19-22, Cutler and her Korean counterpart, Kim Jong-hoon, will meet in Washington to try to reach compromises in outstanding areas, particularly those in contentious sectors such as autos, trade remedies, textiles, and the Kaesong Industrial Complex. Simultaneously, in Seoul, U.S. and Korean agricultural negotiators will continue their meeting, held over from the previous week, to try to resolve outstanding agricultural issues in the FTA as well as South Korea's continued quarantine on imports of U.S. beef. The two sides reportedly plan to pass any remaining differences to higher-level officials, with a possible meeting of U.S. Trade Representative Susan Schwab and Korean Trade Minister Kim Hyun-chong taking place on March 26 in Seoul to attempt to wrap up any outstanding disagreements.[5]

A number of Members of the 110th Congress from both political parties have expressed strong support for undertaking an FTA with South Korea. Others have expressed skepticism that an FTA could bridge the differences between the two countries on trade. Still others oppose the effort outright. As the negotiations have progressed, Members of the 110th Congress have begun to monitor the negotiations closely, thus exercising Congress's responsibilities of oversight over the executive branch as well as participating in the consultation process mandated by the TPA. For instance, in a March 1, 2007, letter to President Bush, a bipartisan group of Members of the House Ways and Means and Senate Finance Committees demanded that the USTR link reductions in U.S. automotive tariffs to prior increases in sales of U.S. autos in Korea.[6]

This report is designed to assist Members of Congress as they perform these responsibilities. It examines the FTA negotiations in the context of the overall U.S.-South Korean economic relationship, U.S. objectives, South Korean objectives, and potential outcomes. The report will be updated as events warrant.

An Overview of the U.S.-South Korean Economic Relationship

South Korea is a major economic partner for the United States. In 2005, two-way trade between the two countries was over $70 billion, making South Korea the United States's seventh-largest trading partner, ahead of France and Italy, and approached $80 billion in 2006 . (See **Table 1.**) This trend is occurring despite the continued South Korean ban on U.S. beef imports. South Korea is among the United States's largest markets for agricultural products. Major U.S. exports to South Korea include semiconductors, machinery (particularly semiconductor production machinery), aircraft, and agricultural products.

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[5] Yoo Soh-jung, "Korea, U.S. Tackle FTA in High-level Discussion," *The Korea Herald* 20 March 2007

[6] "Korea, U.S. Congress Hold Firm On Conflicting Auto Positions," *Inside US Trade*, March 9, 2007.

Table 1. Annual U.S.-South Korea Merchandise Trade, Selected Years

(Billions of U.S. Dollars)

Year	U.S. Exports	U.S. Imports	Trade balance	Total trade
1990	14.4	18.5	-4.1	32.9
1995	25.4	24.2	1.2	49.6
2000	26.3	39.8	-13.5	66.1
2003	22.5	36.9	-14.4	59.5
2004	25.0	45.1	-20.1	70.1
2005	26.2	43.2	-17.0	69.4
2006	30.8	44.7	-13.9	75.5
Major U.S. Export Items	Semiconductor chips and manufacturing equipment; aircraft; corn and wheat; plastics. (See Appendix A for more details)			
Major U.S. Import Items	Cellular phones; cars, semiconductor circuits; televisions and flat panel screens; construction vehicles (See Appendix A for more details)			

Sources: 1990 and 1995 data from Global Trade Information Services. 2000-2006 data from U.S. International Trade Commission.

South Korea is far more dependent economically on the United States than the United States is on South Korea. In 2006, the United States was Korea's third-largest trading partner, second-largest export market, third-largest source of imports, and its largest supplier of foreign direct investment (FDI). In 2003, China for the first time displaced the United States from its perennial place as South Korea's number one trading partner. Preliminary data from the Bank of Korea for 2005 indicate that Japan overtook the United States to become South Korea's second-largest trade partner.

Table 2. Asymmetrical Economic Interdependence (2005)

	Total Trade	Export Market	Source of Imports	Source of FDI
For the U.S., South Korea ranks	#7	#7	#7	#28 (2004)
For South Korea, the U.S. ranks	#3	#2	#3	#1

Sources: U.S. Department of Commerce, U.S. Census Bureau and Bureau of Economic Analysis; Bank of Korea.

Increased economic interaction between the United States and South Korea has been accompanied by numerous disagreements over trade policies. In general, U.S. exporters and trade negotiators identify the lack of transparency of South Korea's trading and regulatory systems as the most significant barriers to trade with South

Korea in almost every major product sector. Many U.S. government officials also complain that Seoul continues to use government regulations and standard-setting powers to discriminate against foreign firms in politically sensitive industries, such as automobiles and telecommunications. Another major cross-sectoral complaint is that rigidities in the South Korean labor market, such as mandatory severance pay, raise the cost of investing and doing business. Finally, the United States and other countries have pressed South Korea to open further its agricultural market, which is considered one of the most closed among members of the Organization of Economic Cooperation and Development (OECD).[7]

The intensity of these disputes has diminished considerably since the late 1980s and early 1990s, in part because South Korea has enacted a set of sweeping market-oriented reforms as a *quid pro quo* for receiving a $58 billion package from the International Monetary Fund (IMF) following the near collapse of the South Korean economy in 1997. In particular, as a result of the reforms, South Korea has opened its doors to foreign investors, ushering in billions of dollars of foreign portfolio and foreign direct investment (FDI). The result is that foreign companies, including U.S. firms, now are significant shareholders in many prominent industrial conglomerates (*chaebol*), own an estimated 40% of the value of the shares traded on South Korea's stock exchange, and at one point owned about one-third of the South Korean banking industry. Since the 1997 crisis, FDI commitments by U.S. companies have totaled approximately $20 billion.

Additionally, the United States and South Korea appear to have become more adept at managing their trade disputes. This may be partly due to the quarterly, working-level "trade action agenda" trade meetings that were initiated in early 2001. Both sides credit the meetings, which appear to be unique to the U.S.-South Korean trade relationship, with creating a more constructive dialogue that helped pave the way for the two sides to feel sufficiently confident to launch FTA negotiations.

The Possible Structure of the FTA

A limited definition of an FTA is a pact between or among two or more countries under which tariffs and non-tariff border restrictions (for example quotas) are eliminated in trade in goods among the parties to the agreement. However, FTAs in which the United States participates have been more complex, reflecting the increasing complexity of bilateral and regional economic relationships in which tariffs and quotas are among the least critical issues. These FTAs cover regulations, policies, and practices that affect a broad range of economic activities.

While the final shape and content of the KORUS FTA, if achieved, will be the product of the bilateral negotiations scheduled to begin on June 5, 2006, previous U.S. FTAs have some generic elements that will probably be part of an agreement with South Korea. Specifically, the FTA would likely include provisions on market access for manufactured and agricultural goods, including schedules for phase-out of tariffs and nontariff barriers and special provisions for longer phase-in periods for

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[7] OECD, *Economic Survey - Korea 2004*.

sensitive products, such as rice, beef, autos, and textiles and apparel. The length of the phase-out periods will probably be a major focus of the negotiations.

The agreement will likely also contain provisions on trade in services. The United States has insisted FTAs in which it participates use *the negative list* approach in scheduling treatment of services. In other words, the agreement covers barriers to trade in all services sectors and subsectors unless specifically listed as to be excluded in the agreements' schedule of commitments. In contrast, the WTO employs the more cumbersome *positive list* approach that requires that a service sector or subsector must be identified in a schedule of commitments in order to covered under the General Agreement on Trade in Services (GATS).

In addition to provisions on trade in manufactured goods, agricultural goods, and services, an FTA would probably include provisions on intellectual property rights (IPR) protection, foreign investment, trade-related labor and environment issues, government procurement policies and practices, and competition policy. An important element of any FTA is rules of origin: How will the agreement partners define which products are to be considered eligible for duty-free or other preferential treatment provided under the agreement, if they include parts from third countries. Another important provision would indicate how disputes on issues covered by the agreement will be handled. The agreement would also include a provision providing the date on which the FTA would enter into force.

U.S. Interests and FTA Negotiating Objectives

An FTA with South Korea would have immediate economic and foreign policy implications for U.S. relations with South Korea specifically, but could also have broader implications for U.S. economic and foreign policy interests in East Asia and beyond. The United States enters the negotiations with a number of issues and objectives.

Why an FTA?

As indicated earlier, South Korea is the seventh largest U.S. trading partner overall. It is also the third largest U.S. trading partner in East Asia (behind China and Japan). Many supporters view an FTA as a logical extension of the bilateral economic relationship that would provide a means by which the two trading partners could address and resolve fundamental issues and, thereby, raise the relationship to a higher level. The FTA could also stand as a symbolic indication of the firmer relationship.

An FTA may also be viewed by some as a means to reassert the importance of a critical foreign policy and national security alliance by rising above differences that have caused the U.S.-South Korean alliance to fray recently. For example, the Bush Administration and South Korean leaders have differed over how to manage relations with North Korea. Specifically, South Korea's "sunshine policy" of emphasizing bilateral reconciliation with North Korea generally has meant that Seoul has not supported U.S. diplomatic and rhetorical efforts to pressure North Korea, especially

on North Korea's nuclear weapons programs. The re-positioning of U.S. troops in South Korea has also generated some friction between the two allies.[8]

Some experts have suggested that a KORUS FTA could curb the rising tide of China's economic and political influence in East Asia. China has surpassed the United States as the most important export market for South Korea and the second most important source of imports into Korea (behind Japan). China is also forging ties with the 10-member Association of Southeast Asian Nations (ASEAN) in an ASEAN+3 arrangement (China, Japan and South Korea), arrangements from which the United States is excluded. An FTA could ensure that the United States has an institutional presence in East Asia. In addition, trade expert Claude Barfield of the American Enterprise Institute suggests that a KORUS FTA could generate a "domino effect" that leads to other countries, such as Japan, entering into similar arrangements with the United States.[9] All of this would come as the discussions within the Asian-Pacific Economic Cooperation (APEC) forum have stalemated.

In terms of broader U.S. trade policy, an FTA with Korea would build on the policy first introduced by then-USTR Robert Zoellick, "competitive liberalization," that uses free trade agreements and multilateral trade agreements to encourage trading partners to remove trade and investment barriers and be a model for others. In that sense, the KORUS FTA would be a major step forward in the policy. It would be the largest U.S. FTA in terms of mutual trade and investment, since the North American Free Trade Agreement (NAFTA) went into effect in 1994. It would also respond to some critics of Bush Administration trade policy that the FTAs that the United States has entered into since NAFTA account for very little trade and yield relatively little in commercial benefits.

South Korea has entered into FTAs with Chile, Singapore, the European Free Trade Association (EFTA), the Association of Southeast Asian Nations (ASEAN), and is negotiating with other countries, including Japan.[10] A U.S. FTA could help prevent U.S. exporters from being placed at a competitive disadvantage with these other countries in the South Korean market.

U.S. Issues and Negotiating Objectives

The U.S.-South Korea negotiations have received by and large bipartisan support in the Congress and broad approval in the U.S. business community, the members of which see the agreement as an opportunity to obtain the removal of long-standing South Korean tariff and non-tariff barriers to trade and investment.[11] Some

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[8] CRS Report RL33567, *Korea: U.S.-Korea Relations — Issues for Congress*, by Larry Nikisch.

[9] Remarks given at AEI Conference, *The Future of U.S. Trade Policy*. April 3, 2006.

[10] EFTA is comprised of Iceland, Norway, Switzerland, and Liechtenstein. ASEAN consists of Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam.

[11] Primosch, William. *Testimony of Senior Director, International Business Policy,* (continued...)

groups oppose the negotiations because they doubt that an FTA can address their problems of doing business in South Korea. For example, organized labor raised concerns about workers' rights issues in South Korea and about the possibility of products that North Korean workers produce in the Kaesong industrial zone could be transshipped duty free to the United States through South Korea.[12] The U.S.-based auto manufacturers may also oppose the FTA, if South Korea does not show signs of improving market access to their exports.

The issues that the United States has been raising during the negotiations cuts across many sectors and other areas of interest.

Agriculture. Agriculture is high on the U.S. agenda and is an area expected to be among the most contentious in the negotiations. Agriculture is an important sector in U.S. trade as a whole and in trade with South Korea. It is also an area that has generated a great deal of bilateral trade friction because of Korea's highly protectionist agricultural policies.

Negotiations pertaining to access to Korea's domestic **rice market** have been among the most contentious, pitting a diminishing but, nevertheless, highly vocal community of South Korean rice farmers against an equally influential community of U.S. rice growers who are also major exporters. Although agriculture accounts for around 7% of South Korean employment, strong cultural ties to rural areas still makes the agriculture sector a formidable political force that is manifested in very strict controls on imports of agricultural products, including rice.

As the South Korean economy has become more dependent on exports of manufactured goods, South Korea's trading partners, including the United States, have demanded that South Korea reduce restrictions on agricultural imports in exchange for greater access for South Korea's exports of manufactured goods. As part of the WTO Uruguay Round Agreements that went into effect on January 1, 1995, South Korea opened its rice markets to imports but was given "special treatment" by being allowed to do so under an import quota system that gradually increased the volume of rice imports. The program was due to expire at the end of 2004, but South Korea reached an agreement with major rice-exporting countries to continue importing rice under a growing, but restrictive, quota that is in effect through 2014.

U.S. rice producers have expressed support for the U.S.-South Korean FTA negotiations. However, they want the FTA to include completely free trade in rice, requiring Korea to remove the quotas completely. Furthermore, they want the quotas and tariffs to be phased out faster than the United States agreed to in the DR-CAFTA,

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[11] (...continued)
National Association of Manufacturers on the Proposed United States-Korea Free Trade Agreement for the Trade Policy Staff Committee, Office of the U.S. Trade Representative. March 14, 2006.

[12] Lee, Thea M. *Testimony on the Proposed U.S.-South Korea Free Trade Agreement*. Submitted by the American Federation of Labor and Congress of Industrial Organizations. March 14, 2006.

and in FTAs with Peru and Colombia. U.S. rice producers also oppose emergency safeguards measures for Korean rice imports beyond the phase-out period.[13]

In addition to restrictions on rice, the USTR and agriculture trade groups have indicated the following among U.S. priorities in the negotiations:[14]

- eliminate "unnecessary" and unscientific South Korean sanitary and phyto-sanitary (SPS) regulations, with Korea reaffirming its commitment to the WTO SPS agreement that requires SPS regulations to be "science-based;"
- ensure that the phase-out periods for agricultural tariffs and quotas would not be unnecessarily long and eliminate non-tariff barriers, including permit and licensing requirements;
- eliminate unnecessary restrictions on perishable imports and cyclical agricultural products;
- provide special rules of origin for U.S. beef shipments to South Korea that would include a "born, raised, and slaughtered rule" giving preferential treatment to U.S. beef producers;[15] and
- eliminate export subsidies on all South Korean agricultural products.

During the negotiations, the United States has also objected to South Korea's demand that more than 200 agricultural products be treated as"special products" and exempted from tariff and quota elimination under an FTA. U.S. observers/negotiators argue that is an unusually high number of exemptions**.**

An issue not directly on the KORUS FTA agenda, but which nevertheless could impede the successful completion of the negotiations, has been South Korea's practices regarding imports of U.S. beef. On September 11, 2006, the South Korean government announced that it would resume imports of U.S. beef after having banned them since December 2003 because of the discovery of one case of mad cow disease in Washington State. However, in December 2006, South Korean meat inspectors prohibited the entry of the first three shipments of U.S. beef after they found bone fragments. The agreement on lifting the ban would allow only boneless beef from cattle 30 months or younger. A senior official from the Korean

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[13] USA Rice Federation. *Submission to the Trade Policy Subcommittee in Response to the Federal Register Notice of February 9, 2006 — U.S.-Korea Free Trade Agreement.* March 14, 2006.

[14] Office of the United States Trade Representative. Notification to Congress of intent to begin free trade agreement negotiations with the Republic of Korea. *Congressional Record.* February 2, 2006. p. S503-S505.

[15] R-CALF USA. United Stockgrowers of America. Press Release. Korea FTA Could Provide Substantial Benefits to U.S. Cattle Producers. March 16, 2006.

Agricultural Ministry stated that U.S. and Korean negotiators were unable to come up with a mutually acceptable definition of "boneless beef," among other issues, and therefore had failed to resolve the dispute as of February 12.[16] U.S. officials and beef producers have argued that the fragments are so small as not to be a potential cause of mad cow. A number of Members of Congress have called for the suspension of the negotiations until the matter is resolved or have indicated they would not approve an FTA with Korea as long as it continued to stop U.S. beef imports.

Autos and Autoparts. Negotiations on trade in some manufactured goods have also been intense, particularly on trade in cars and auto parts. After a rough start in the 1980s and 1990s, South Korean manufactured passenger cars have been achieving competitive success in the U.S. market, especially as soaring gasoline prices have increased demand for smaller, gas-efficient vehicles. However, U.S.-based car manufacturers have been much less successful in gaining shares of the Korean domestic car market. South Korean imports of foreign automobiles totaled around 37,000 in 2006 — including about 6,500 U.S. vehicles — just over 4% of total car sales in the South Korean market. In contrast, South Korean auto manufacturers exported nearly 750,000 cars to the United States in 2006, capturing over 4% of the U.S. market.

U.S.-based auto producers have blamed various Korean regulations for the limiting U.S. market share. In 1998, the United States and South Korea signed a Memorandum of Understanding (MOU) in which the Korean government agreed to take steps to address the U.S. issues. While the Office of the USTR reports that South Korea has fulfilled many of the commitments, it asserts that other steps should be taken to prevent discrimination toward U.S. auto exporters. Among them would be to reduce or eliminate the 8% tariff on car imports and to revise the domestic taxes that are applied to the full price (including tariffs) of imported cars, and car taxes that are based on engine displacement that allegedly disadvantage U.S.-made cars, which tend to be larger than domestically-produced Korean cars.[17] An indication of the importance of the issue in the negotiations is that a special working group on the auto issue is part of the structure of the negotiations.

Charles Ulthus, vice-president of the Automotive Trade Policy Council, complaining about past South Korean anti-import policies on autos, laid out the U.S. auto industry position stating:

> Given Korea's status as a major global player, its closed market to imports, and [the] long history of unsuccessful U.S. efforts to dismantle Korea's nontariff barriers, we are advocating for a comprehensive dismantling of Korea's nontariff barriers and we are asking that Korea demonstrate up front that its market is open before we unilaterally provide it with preferential access to the U.S. market... [W]e are looking for something more than just promises that the

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[16] *Washington Trade Daily*. February 12, 2007.

[17] Office of the United States Trade Representative. *National Trade Estimates — Foreign Trade Barriers Report, 2006.* April 2006. p. 413-414.

> market will open, more than just commitments to address one tariff barrier, which very well could be circumvented at a later date."[18]

The aforementioned March 1, 2007, letter from several House Ways and Means Committee and Senate Finance Committee members to President Bush proposes the following: the immediate elimination of Korea's 8% auto tariff; the longest possible phase out for the 2.5% U.S. auto tariff, with the United States progressively reducing its tariff only after certain numbers of U.S. cars were sold in Korea; the creation of a safeguard mechanism for the U.S. auto industry that would go into effect when the U.S. auto tariff is phased out; and the exclusion of the 25% U.S. tariff on pickup trucks from the FTA negotiations. The letter was supported by major U.S. auto industry groups.[19]

Other Manufactured Goods. In addition, U.S. exporters of manufactured goods have indicated that they would like to see the following objectives, among others, included a final U.S.-South Korea FTA:

- eliminate tariffs and other barriers to reciprocal access to the South Korean market for U.S. textile and apparel products with reasonable phase-in periods;
- eliminate immediately tariffs on 99% of imports of manufactured goods (as is the case in the U.S.-Australia FTA);
- remove non-tariff barriers and prevent new ones from emerging, for example, health and safety requirements that differ widely from accepted practices in other countries; unnecessarily burdensome technical standards; duplicative testing requirements for foreign products; and requirements to submit proprietary manufacturing information;
- provide access to U.S. exporters in the development of South Korean domestic regulations; and
- address the use of adjustable border taxes, adjustment taxes, domestic taxes, and indirect government support for local industries that adversely affect U.S. exports.[20]

An issue that has arisen since the negotiations were launched pertains to the change in the South Korean government's policy on reimbursements for costs for **pharmaceuticals**. The government announced on May 3 that it was changing its

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[18] Quoted in *International Trade Reporter*. May 18, 2006. p. 760.

[19] "Korea, U.S. Congress Hold Firm On Conflicting Auto Positions," Inside US Trade, March 9, 2007.

[20] Primosch, William. *Testimony of Senior Director, International Business Policy, National Association of Manufacturers on the Proposed United States-Korea Free Trade Agreement for the Trade Policy Staff Committee, Office of the U.S. Trade Representative.* March 14, 2006.

approach from a negative list to a positive list. In other words, only those products specifically listed as eligible for reimbursement would be covered, making non-coverage the default. U.S. pharmaceutical representatives and U.S. negotiators have been pressing the South Korean government to reverse its decision.[21] South Korea announced at the beginning of the second round of negotiations on July 10 that it intended to go ahead with the change. As a result, lead U.S. negotiator, Assistant USTR Wendy Cutler, suspended the work of the pharmaceuticals working group, stating that South Korea's decision to implement the decision was "inconsistent with both the mandate of the pharmaceuticals group and the market opening spirit of the KORUS FTA." [22]

Intellectual Property Rights (IPR) Protection. U.S. negotiators will strive to secure South Korean agreement to strengthen enforcement of intellectual property rights, including controls over unauthorized online transmission and distribution of copyrighted works, the seizure of pirated goods and equipment to make and transmit pirated goods, and proper compensation to victims of IPR violations.[23] The U.S. business community has targeted specific Korean policies and practices in intellectual property issues. For example, the Korean Food and Drug Administration (KFDA) requires that proprietary data on pharmaceutical manufacturing processes be submitted for new drugs; in addition, the South Korean government has, in some cases, approved marketing of some pharmaceuticals before it has determined that the applicant is the rightful owner of the patent and trademark.[24] The USTR has continued to place South Korea on the special 301 "Watch List." The USTR indicated that the South Korean government has strengthened its enforcement of copyright laws but still needs to go further.[25]

Services. The United States likely will press South Korea to reduce barriers to sales of U.S.-origin media in South Korea. South Korea took a major step in this direction, leading up to the launch of the negotiations, by reducing by half the to 46 days per year the number of days that South Korean cinemas had to show South Korean films. U.S. movie producers and distributors will likely push for a further reduction. U.S. providers in telecommunications, financial services, professional services, and other services sectors want to see greater market access in South Korea, and the United States will be pushing for improved transparency and predictability of South Korean government regulatory procedures in all services sectors.

Foreign Investment. In the area of South Korean foreign investment policies and regulations, U.S. negotiators will generally push South Korea to: remove trade distorting barriers (export and local content requirements) to U.S. investment; provide timely resolution of disputes between U.S. investors and South Korean

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[21] USTR, Industry Push Korea on New Reimbursement Program. *Inside U.S. Trade*. May 26, 2006.

[22] Office of the U.S. Trade Representative. *Transcript of Assistant USTR Wendy Cutler Press Roundtable on KORUS FTA.* July 14, 2006.

[23] Office of the U.S. Trade Representative.

[24] Primosch, William.

[25] Office of the USTR. *Special 301 Report.* April 2006.

authorities; and extend national treatment for U.S. investors in Korea, so that U.S. investors would be treated no less favorably than domestic South Korean investors. U.S. negotiators will aim to obtain other rights for U.S. investors comparable to their rights in the United States but make sure that South Korean investors in the United States are not accorded rights that are more favorable than U.S. domestic investors.[26]

Competition Policy. The United States wants to encourage discussion, in the areas of competition policy, anti-competitive business conduct, designated monopolies, state enterprises, and other competition-related issues as appropriate. It also wants to prevent the application of South Korean competition laws and regulations in a discriminatory manner and apply anti-trust laws effectively against South Korean firms. U.S. businesses have complained that the *chaebols*, the family-owned business conglomerates that dominate the South Korean economy, have made it difficult for foreign companies to compete in the Korean market.[27] U.S. and other foreign businesses also have complained that the opacity of the *chaebols'* ownership structure makes it difficult, if not impossible, for foreigners to acquire majority stakes in major South Korean companies. Additionally, the relationship between major *chaebol* and the South Korean government occasionally has led to trade disputes between the two governments. In 2003, for instance, the United States and the European Union assessed punitive countervailing duties tariffs against Hynix Semiconductor, then the world's third-largest producer of dynamic random access memory (DRAM) semiconductor chips, for allegedly receiving subsidies from the South Korean government. South Korea challenged the rulings in the WTO, which eventually upheld the U.S. duties. Hynix formerly was part of the Hyundai *chaebol*.

Other U.S. Objectives. In addition to the above, the USTR has indicated that the following will be among U.S. goals in the negotiations:[28]

- ensure that South Korea does not discriminate in **e-commerce trade**.
- get South Korea to reaffirm its commitments under the WTO Agreement on **Technical Barriers to Trade**.
- press South Korea to expand its commitments under the WTO Agreement on **Government Procurement** to cover more government agencies and at lower contract-value thresholds.
- provide **safeguards** measures in the form of temporary revocation of tariff preferences during a transition period to protect against import surges.

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[26] Office of the United States Trade Representative. Notification to Congress of intent to begin free trade agreement negotiations with the Republic of Korea. *Congressional Record.* February 2, 2006. p. S503-S505.

[27] *Inside U.S. Trade.* April 21, 2006.

[28] Ibid unless otherwise indicated.

- encourage South Korea to pursue policies that limit **currency intervention** and allow the won/dollar exchange rate to be set by the market.[29]

- promote trade and **environment** policies that are mutually supportive and ensure South Korean commitment to enforcing **labor** rights.

South Korean Interests and FTA Negotiating Objectives

Why an FTA?

Entering an FTA with the United States meshes with a number of South Korean President Roh Moo-hyun's long term economic and strategic goals. Roh apparently has made the signing of an FTA, along with reducing income inequality, the top economic priority for the remainder of his tenure, which expires in February 2008.[30] Soon after his election in 2002, Roh committed himself to raising South Korea's per capita gross domestic product (GDP) to $20,000 by the end of the decade and to transforming South Korea into a major "economic hub" in Northeast Asia by expanding the economic reforms begun by his predecessor following the 1997 Asian financial crisis. Ongoing competitive pressure from Japanese firms, increased competition from Chinese enterprises, and the rapid ageing of the South Korean workforce has heightened the sense of urgency about boosting national competitiveness. Continuing along this line of argument, Han Duk-soo, South Korea's Deputy Prime Minister and Minister of Finance, has said that a failure to adopt significant economic changes will mean that "Korea's long term growth potential is likely to deteriorate."[31]

During a televised debate over the proposed FTA in March 2006, he went further, arguing that the KORUS FTA is essential for South Korea's survival.[32] To accelerate Korea's reform efforts — and also to avoid being left out from other FTAs being created globally and in Asia — President Roh has pursued an aggressive effort to negotiate FTAs, the first of which South Korea signed with Chile in 2004. Convincing the United States to launch an FTA became a part of this larger effort.[33]

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[29] Primosch, William.

[30] "ROK Editorial: Roh's 'Special Lecture'," *The Korea Times*, posted on the Open Source Center, KPP20060329042002, March 29, 2006.

[31] Ministry of Finance and Economy Weekly Briefing, "Korea-US FTA Projected to Boost the Korean Economy," March 9, 2006.

[32] Korea Broadcast System, March 31, 2006 Broadcast in Korean, summarized by the Open Source Center, "ROK TV Carries Economic Minister's Comments on ROK-US FTA," April 10, 2006, FEA20060410021900.

[33] During an on-line chat with South Koreans, President Roh reportedly said that the (continued...)

South Korea's FTA Drive

Completed FTAs:
- Chile (entered into force April 2004)
- Singapore (entered into force March 2006)
- EFTA (signed December 2005)
- ASEAN (final agreement on goods reached May 2006; excludes Thailand due in part to South Korea's exemption of rice from the agreement)

FTAs being negotiated:
- United States (launched February 2006)
- Mexico (launched September 2005)
- Canada (launched July 2005)
- Japan (launched December 2003; negotiations currently stalled)

FTAs under consideration:
- India (joint study concluded January 2006)
- China (joint study expected in 2007)
- European Union (negotiations expected to begin in 2007)
- Australia (plans for joint study announced in December 2006)

South Korean officials and other South Korean proponents of the KORUS FTA have tended not to focus on the increased access to the U.S. market that South Korean firms presumably would receive, despite the predictions that South Korean manufacturing exports would increase significantly. Rather, they emphasize the medium and long-term gains that would stem from increased allocative efficiency of the South Korean economy, particularly in the services industries. This would presumably be brought about by an influx of U.S. investment and technology into South Korea and by the spur of increased competition with U.S. firms.[34] The President and other senior officials in particular have emphasized the need to boost the competitiveness of South Korean service industries. An FTA with the United States, they argue, will help address South Korea's increased economic polarization by spurring job creation in fields such as medical, legal, education, and accounting

[33] (...continued)
initiative to launch the FTA had come from South Korea. The President was responding to criticism that the United States had pressured South Korea to begin negotiations. "ROK Daily: Roh Discusses Administration's Policies in Online Chat," *JoongAng Ilbo*, posted on the Open Source Center, KPP20060324971166, March 23, 2006.

[34] See, for instance, Junkyu Lee and Hongshik Lee, *Feasibility and Economic Effects of a Korea-U.S. FTA* (Seoul: Korea Institute for International Economic Policy, 2005), p. 116-117; Inbom Choi and Jeffrey Schott, *Free Trade between Korea and the United States?* (Washington, DC: Institute for International Economics, 2001), p. 79-82.

services in a free trade agreement.[35] Some, however, say an FTA will worsen South Korea's income gap.[36]

Strategically, some in South Korea and the United States also see the FTA as a means for boosting the U.S.-South Korean alliance. In announcing the launch of the FTA, for instance, Trade Minister Kim stated that the FTA launch was "the most important event" in the history of the alliance, one that would take the U.S.-South Korean relationship "to the next tier, the next level."[37] Some in Korea and the United States feel a need to boost the relationship because of bilateral strains over major alliance issues, primarily brought about by different views about how to handle North Korea and China. Since the late 1990s, even as Americans have come to feel that the danger from North Korea has increased, South Koreans' perception of a threat from North Korea has declined markedly. This has led some to question the purpose of the U.S.-South Korea alliance, which is predicated upon deterring an attack by North Korea. Additionally, South Korea's policy of emphasizing bilateral reconciliation with North Korea generally has meant that South Korea has not supported U.S. efforts to pressure North Korea. Another major difference between Seoul and Washington is that many South Korean officials, including President Roh, oppose the deployment of U.S. forces based in South Korea to other areas in Asia without South Korean consent; South Korean leaders generally do not wish to antagonize China over the Taiwan issue. In the face of these growing questions about the utility of the alliance to Seoul, many argue that an FTA will provide a counterweight to help balance areas of difference and help provide a "new basis" for the alliance with something to "stand for" rather than "stand against."[38]

There is an expectation among some Koreans that a U.S.-South Korea FTA will have even broader strategic effects. Some analysts in Seoul believe that an FTA will improve South Korea's standing in Northeast Asia by boosting its status as a middle power. President Roh has spoken vaguely of South Korea asserting a future role as a "balancer" among the major powers in the region. An FTA conceivably might help South Korea play this role not only by boosting South Korea's economic performance, but also by ensuring that the United States remains a strategic and economic counterbalance to China and Japan.[39] Some South Koreans have turned this argument on its head, positing that China might consider a U.S.-South Korean FTA a threat to its interests.[40] Additionally, some South Korean proponents of an FTA believe that successfully negotiating an agreement could lessen disagreements

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[35] "Roh's 'Special Lecture'," *The Korea Times*, March 26, 2006.

[36] Korea Broadcast System, March 31, 2006 Broadcast.

[37] USTR Press Release, "Remarks by U.S. Trade Representative Rob Portman and Republic of Korea Trade Minister Hyun-chong Kim, Launch of U.S.-Korea Free Trade Agreement," US Capitol, February 2, 2006.

[38] For more on U.S.-Korean strategic relations, see CRS Report RL33567, *Korea: U.S.-Korean Relations*, and CRS Report RL33590, *North Korea's Nuclear Weapons Development and Diplomacy*, both by Larry Niksch.

[39] ROK President Roh Moo-hyun's speech at the 53rd Air Force Academy Graduation and Commissioning Ceremony, March 8, 2005, translated by FBIS, KPP20050308000923.

[40] "Former Presidential Aide Slams FTA Talks With U.S.," *Yonhap*, April 4, 2006.

between Washington and Seoul over North Korea policy, by compelling "politicians and officials in each nation toward a deeper understanding of the broad forces at play in the other."[41] An FTA shows that President Bush and President Roh have some level of trust. Given the importance of North Korea in the foreign policies of both countries, however, it is unlikely that an FTA will have much impact.

Criticism of the FTA within South Korea

The launch of FTA negotiations with the United States has generated much debate in South Korea. Numerous news articles have analyzed the benefits and costs of an agreement, and a number of televised debates about the FTA have been held. Criticism of the decision to launch an FTA with the United States intensified in the early spring of 2006, fanned in part by public opposition by some former senior members of Roh's ruling camp. Opposition to the FTA occasionally has been intense. In February, farmers' groups blocked the South Korean government's initial public hearing in Seoul regarding the FTA. At least one major umbrella group, the Pan-national Movement Headquarters to Frustrate the South Korea-U.S. FTA, comprising over a dozen organizations, has been formed to rally opposition to the agreement. In mid-April 2006, one Korean information technology union announced it had mobilized thousands of its members to try to shut down the White House's website by flooding it with e-mails.[42] In early 2007, a number of prominent left-of-center politicians, including two former chairmen of Roh's Uri Party who are running for president, publicly stated their opposition to the KORUS FTA.[43] Many observers of the Korean political scene have criticized the Roh government for not waging an earlier and more assertive campaign to promote the its decision to launch the KORUS FTA.

One reason for the intensity of the opposition to a proposed FTA with the United States is that the negotiations have merged a number of forces in the Korean polity, including anti-American forces on the far left of Korea's political spectrum and traditional trade liberalization opponents, such as farmers and trade unions. The latter groups also have opposed other trade deals. South Korean farmers engaged in occasionally violent protests during the December 2005 multilateral Doha Development Agenda (DDA) ministerial meetings in Hong Kong, and one Korean farmer committed suicide outside the meetings in the 2003 Cancun DDA Ministerial Meeting. After the Roh government signed Korea's first FTA, with Chile, in 2003, it took South Korea's National Assembly nearly a year to ratify the agreement because of the strength of the opposition, particularly from farm groups and rural legislators.[44] Some Koreans argue that an FTA with the United States will primarily

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[41] *Feasibility and Economic Effects of a Korea-U.S. FTA*, p. 139.

[42] "ROK Civic Groups Launch Joint Anti-ROK-US FTA," *Hankyoreh* (Internet version, in Korean), March 29, 2006, from OpenSource.gov, KPP20060329051001; "Unionists Attack White House Web Site," *The Korea Times* (in English) April 6, 2006, from OpenSource.gov, KPP20060412971421.

[43] "Progressive Lawmakers in United Front Against FTA," *Chosun Ilbo*, March 18, 2007.

[44] "Assembly Passes Chile FTA at Last," *The Korea Herald*, February 17, 2004.

benefit Korean *chaebol* (conglomerates), thereby widening economic disparities inside South Korea.[45]

Barring a dramatic reversal in Roh's political fortune, the South Korean President is in a weak political position to try to sell an FTA to the National Assembly for ratification if South Korea and the United States successfully reach an agreement. According to many observers, the full force of the "lame duck" phenomenon has hit Roh; South Korea will hold its presidential election in December of 2007 and by law Roh cannot run for a second term. Roh is widely regarded as an unpopular president; various polls put his popularity at the 20% level. His Uri party lost control of the National Assembly in 2005, when it was routed in successive bi-elections by the main opposition group, the conservative Grand National Party (GNP). In early 2007, several lawmakers defected from his party, dropping Uri to the second-largest group in the National Assembly. Complicating the political difficulties for President Roh is that, as a left-of-center politician, he has drawn significant political support from many of the groups that oppose the KORUS FTA. Indeed, many of these groups have turned lukewarm toward Roh since his election in 2002, as a result of his support for continued market-opening measures and his periodic efforts to cooperate with the United States, particularly his dispatch of over 3,000 Korean troops to Iraq after the U.S. invasion.

It is unclear how Korean politics will affect the KORUS FTA, if an agreement is reached. Despite vocal opposition to the agreement, many Korea watchers believe that an agreement would pass the National Assembly due to strong support from the GNP and supporters within Roh's Uri party. Presidential politics, however, may influence the vote. If trends in early 2007 continue, most observers believe the presidency is the GNP's to lose; the GNP's leading candidates, former Seoul mayor Lee Myung-bak and former party chairwoman, Park Geun-hye, are far ahead in the polls, and the leading Uri party candidates are polling in the single digits. This could open the door for a candidate to burst onto the scene by waging a populist campaign in which opposition to the KORUS FTA plays a prominent role.

South Korean Issues and Negotiating Objectives

With some important exceptions, in the FTA talks, South Korea is likely to be the *demandeur* on fewer issues compared to the United States. Not only is South Korea far more economically dependent on the United States, but the United States also has lower and fewer tariff and non-tariff barriers than Korea. Also, as discussed above, top South Korean officials believe the FTA's primary economic benefits will derive not from the short-term reductions in U.S. trade barriers, but rather from the medium-to-long term effects of improving the dynamism and efficiency of the South Korean economy. Thus, as in the overall bilateral economic relationship, South Korea's basic stance in the FTA talks by definition is likely to be defensive and reactive in nature. In general, South Korea is expected to adopt a traditional "customized" negotiating strategy of seeking higher protections and longer phase-in periods for particularly sensitive products and sectors such as medical services.

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[45] "Korea-U.S. FTA Remains Contentious," *The Korea Herald,* April 25, 2006.

Korean officials reportedly will push for a general safeguard system to guard against a surge in imports, including the most sensitive sector, agriculture.[46]

Agriculture. A net importer of food, South Korea is among the United States's largest export markets for agricultural products.[47] South Korea's farmers, while shrinking in terms of population and contribution to GDP, remain a politically powerful force in South Korea. This political power is reflected in the protection South Korea's farm sector has been able to gain from Seoul; South Korean agricultural tariffs are particularly high compared to the United States and most OECD members. According to United States Trade Representative (USTR), South Korea's average applied agricultural tariff is 52%, more than four times the U.S. average.[48] South Korean exports of agricultural products to the United States in 2005 were just over $200 million, representing approximately 0.5% of total South Korean bilateral exports.[49]

When asked about opening Korea's farm market at the February 2, 2006 launch of the FTA, Trade Minister Kim said that while South Korea is ready to make "tough decisions," he added that "I don't know a single free trade agreement whereby there are no exceptions, or a staged implementation period...."[50] South Korea's chief negotiator in the KORUS FTA has said that Seoul will try to obtain a phase-in period of more than ten years for certain sensitive products, particularly rice.[51] An outline of the South Korean government's goals presented to the National Assembly in May 2006 by the South Korean Ministry of Foreign Affairs and Trade (MOFAT) mentions excluding some highly sensitive agricultural goods. For other items, the draft envisioned long-term tariff reductions, tariff rate quotas, and special safeguards.[52] In May 2006, South Korea and the ASEAN announced an FTA that excluded a number of agricultural items, including rice. Thailand, a major rice exporter, did not join in the agreement.

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[46] "FTA Chief Lays Out Goals for Korea-U.S. Agreement," *JoongAng Ilbo*, April 27, 2006.

[47] In 2005, U.S. agricultural exports to South Korea surpassed $2 billion, making South Korea the United States' sixth largest market for agricultural goods despite Korea's ban on imports of U.S. beef. U.S. beef exports totaled nearly $800 million in 2003 before the beef ban went into place late that year. USTR, "FTA: United States and Republic of Korea. Opportunities for Agriculture," *Trade Facts*, February 2006; USTR, "FTA: United States & Republic of Korea. Economic and Strategic Benefits," February 2, 2006.

[48] USTR, *FTA: United States & Republic of Korea Economic & Strategic Benefits*, February 2, 2006.

[49] South Korean trade data compiled by Global Trade Information Service, Inc.

[50] USTR, "Remarks by U.S. Trade Representative Rob Portman And Republic of Korea Trade Minister Hyun-chong Kim, Launch of U.S.-Korea Free Trade Agreement," February 2, 2006.

[51] "FTA Chief Lays Out Goals for Korea-U.S. Agreement," *JoongAng Ilbo*, April 27, 2006.

[52] South Korean government report to the National Assembly, "Negotiating Objectives of Korea-U.S. FTA," translation provided by the U.S. Embassy; BNA International Trade Reporter, "South Korea's MOFAT Outlines Goals of Draft Free Trade Agreement with U.S.," May 18, 2006.

Seoul plans to spend over $100 million in adjustment assistance to South Korean farmers and rural areas over the coming decade. The package was first unveiled during the debate over the South Korea-Chile FTA.

The Kaesong Industrial Complex. A potentially contentious issue in the FTA talks is the status of the Kaesong Industrial Complex (KIC). Located near the North Korean city of Kaesong (also spelled "Gaesong"), 40 miles north of Seoul, the KIC is designed for South Korean companies to employ North Korean workers. A pilot site at Kaesong, housing the factories of over fifteen South Korean firms, opened in 2004, and as of late 2006 employed over 10,000 North Korean workers. In 2005, firms in the complex produced nearly $15 million in manufactured goods, mostly light industrial products such as textiles and electronic goods.[53] There are plans to expand the zone dramatically — to 300 tenant South Korean companies employing about 70,000 North Koreans — by the end of 2007, though South Korean officials say the pace and scope of the expansion is contingent upon the status of negotiations over North Korea's nuclear programs.[54] In the summer of 2006, following North Korea's missile tests in July, the South Korean government suspended taking new applications from South Korean firms to invest in the second phase of the KIC. In January 2007, the South Korean Unification Minister announced that an additional 40 firms, which had been selected prior to the suspension, would open operations in Kaesong in 2007. The United States officially supports the KIC. In 2004 and 2005, the United States approved several export controls clearances that were required by U.S. law for South Korean firms to bring items — such as computer and telecommunications equipment — to Kaesong.[55]

Since the KIC opened, it has been South Korean policy to request that its FTA partners allow exports from Kaesong to be considered as "Made in Korea" (meaning South Korea), thereby enabling these products to receive the preferential status conferred by the FTA. The Korea-Singapore, Korea-EFTA, and Korea-ASEAN FTAs contain such a provision.[56] In May, the South Korean government reported to the National Assembly that it would seek treatment comparable to that provided in the South Korea's FTA with EFTA.[57] That agreement lists a specific set of products that will receive FTA treatment if the KIC's contribution to the final product is no more than 40%, if final production takes place in South Korea, and if the final

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[53] Ministry of Unification, "The Statistics on the Gaesong Industrial Complex (As of Jan. 31, 2006)."

[54] April 2006 conversations with South Korean officials.

[55] U.S. Embassy in Korea, "Questions and Answers from Economic Press Roundtable with Embassy Official," February 8, 2006; January and February 2006 conversations with officials familiar with the Kaesong export control discussions.

[56] For instance, the South Korea-ASEAN FTA reportedly includes a list of 100 items that will be recognized as "Made in Korea," as long as more than 60 percent of the materials from which they are made are of South Korean origin or if the added value of South Korean materials put in the product is more than 40 percent. *Dong-A Ilbo*, "One Hundred Gaesong Product Items Recognized as 'Made in Korea'," May 17, 2006.

[57] South Korean government report to the National Assembly, "Negotiating Objectives of Korea-U.S. FTA," translation provided by the U.S. Embassy, Seoul.

product is exported from South Korea. When questioned about this policy during the February 2, 2006 launch of the FTA, USTR Portman stated that the FTA would cover only products made in South Korea. The United States has maintained this position during the negotiations. During the fourth round of negotiations, U.S. lead negotiator Wendy Cutler stated that the nuclear weapon's test conducted by North Korea on October 9, 2006, confirms the U.S. position that the FTA should apply only to products made in South Korea.[58] Senator Max Baucus, ranking Member of the Senate Finance Committee, stated that including Kaesong-origin products in an FTA could "sink" the negotiations.[59]

Two important issues for the United States in considering South Korea's demand are the conditions for North Korean workers and the income the KIC provides for the North Korean government. Some U.S. labor and human rights advocates have argued that North Korean workers in Kaesong are being exploited. South Korean officials, as well as other analysts, counter by saying that conditions — including wage conditions — at Kaesong are far better than those in the rest of North Korea.

The North Korean government derives hard currency from several sources in the KIC project, including leasing fees and surcharges levied on North Korean workers' wages, which are paid to an arm of the North Korean government agency before being passed on to employees (in the form of North Korean *won*).[60] To date, according to information provided by the South Korean government, these streams likely total less than $20 million in hard currency. However, if the South Korean government realizes its most ambitious goals for the Kaesong project, by the middle of the next decade the North Korean government would likely derive hundreds of millions of dollars annually from tax revenues and its slice of North Korean workers' wages, assuming the KIC's current tax and wage structures remain in place.[61] Some South Koreans caution that the uncertainties over the future course of the KIC project make such projections highly speculative.

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[58] U.S., Korea Battle Over Textile, Farm Tariffs in Latest Round. *Inside U.S. Trade.* November 3, 2006.

[59] *Washington Trade Daily*. June 16, 2006.

[60] North Korean workers in Kaesong receive a base monthly salary of $50 for a 48-hour work week. In 2005, the average workweek (including overtime) at Kaesong was 55 hours, bringing the average gross monthly salary to $67 per month. South Korean officials say they are unsure of precisely how much is taken by the North Korean government, but from conversations with workers and other sources, they estimate the government takes an estimated 30% "social services fee" from the wages to pay for housing and other services that are to be provided the North Korean state. If these figures are correct, the average Kaesong worker's take-home monthly pay in 2005 was just under $37, paid in North Korean *won*. Presumably, payments are made at the official rate of exchange, which is much lower than black market rates. The North Korean government also levies a 15% social insurance surcharge, which is paid by the South Korean employer, to pay for unemployment and occupational hazards.

[61] Moon Ihlwan, "Bridging the Korean Economic Divide," *Business Week*, Mar 8, 2006.

The KIC arguably has become the centerpiece for South Korea's "sunshine policy" of engaging North Korea. The South Korean government envisions the complex, which has broad support inside South Korea, as a way to ensure stability on the Korean Peninsula and ease the presumed costs of an eventual North-South reunification by introducing global economic standards to North Korea and linking North Korea to the global economy. The complex is also designed to encourage legitimate North Korean economic activity. Additionally, the worsened economic situation for many South Korean small and medium sized enterprises has led many in South Korea to see cheaper North Korean labor as a way to compete against lower-cost Chinese firms.

Many South Korean officials appear to view the U.S. position on including Kaesong in the KORUS FTA as a litmus test for the U.S. approach toward Seoul's entire sunshine policy. To some in the United States, however, the South Korean push to include Kaesong in the FTA may appear to be an attempt to move U.S. policy from not opposing the KIC to promoting it.

The U.S. Visa Waiver Program. Although South Korea's status in the U.S. Visa Waiver Program (VWP) is not formally part of the FTA negotiations, it is a priority the South Korean government is pursuing with the United States.[62] Any changes made by the United States in this area are likely to play a political role in selling the agreement in Seoul. For years, South Korean officials, Korean businesses, the American Chamber of Commerce in South Korea, Korean-Americans, and others have questioned why South Korea is not a participant in the VWP, under which foreigners traveling from certain countries are permitted to travel to the United States for up to 90 days without obtaining a visa. Since the United States put in place new visa procedures after the September 11, 2001 terrorist attacks, almost all South Koreans who want to visit the United States must interview for a visa at the U.S. Embassy in Seoul. Reportedly, the U.S. consular section in Seoul has become among the busiest and largest U.S. nonimmigrant visa processing posts in the world, processing an average of almost 2,000 visas per day. During his November 2005 summit with President Roh in South Korea, President Bush announced that the United States would work with Seoul to develop a "roadmap to assist South Korea in meeting the requirements for membership" in the Visa Waiver Program.[63] H.R. 4304, introduced in November 2005 by Representative James Moran, would designate South Korea as a program country under the VWP.

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[62] For more on the U.S. Visa Waiver Program, see CRS Report RL32221, *Visa Waiver Program*, by Alison Siskin. Speech by ROK Ambassador to the United States Lee Tae-sik, "The Korea-US Alliance - A Partnership for the Future," February 7, 2006 Korea Economic Institute forum, The St. Regis Hotel, Washington, DC; Balbina Hwang, "A Bumpy Road for the U.S. — ROK Free Trade Agreement," *Heritage Foundation Executive Memorandum* No. 995, March 2, 2006. U.S. trade officials say they do not plan to include the VWP in the FTA negotiations. Spring 2006 conversations with U.S. officials. If the VWP, or any other immigration issue, is included in the FTA, those provisions could fall under the jurisdiction of the House and Senate Judiciary Committees.

[63] White House Press Office of the Press Secretary, "Joint Declaration on the ROK-U.S. Alliance and Peace on the Korean Peninsula," November 17, 2005.

Among the statutory requirements for countries to participate in the VWP is that the country must have a nonimmigrant visa refusal rate of below 3%.[64] According to State Department officials, South Korea's visa refusal rates have consistently been over this threshold. The FY2004 rate was 3.6% and according to one report, in early 2005 the rate again was below 4%.[65] Meeting the refusal rate is not the only requirement. A country's participation in the VWP must also be deemed to be in the economic, law enforcement, and security interests of the United States. Since the late 1990s, no country has been added to the VWP, an indication of the difficulty in meeting the participation requirements. For South Korea to become a participant would likely require significant attention from the White House.

U.S. Antidumping Practices. For over a decade, South Korea has chafed at the U.S. use of antidumping (AD) and countervailing duty (CVD) laws that raise tariffs on South Korean exports. According to one study, in July 2000 the five CVD and 18 AD orders against South Korean exports covered approximately $2.5 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 South Korean industries — semiconductors, steel, televisions, and telecommunications equipment — that have considerable political influence in Seoul. MOFAT's May 2006 draft FTA contains provisions that would constrain U.S. use of AD measures.[66] South Korea is specifically concerned about the U.S. practice of zeroing in determining antidumping margins and cumulation in determining material injury in antidumping and countervailing duty determinations. It is also concerned about U.S. sunset reviews of countervailing duty and antidumping cases, which South Korea alleges results in antidumping and countervailing duty orders being extended unnecessarily. In the multilateral Doha Development Agenda talks, South Korea is one of several countries demanding revisions to global antidumping rules, changes the United States opposes.[67]

During the sixth round of negotiations January 15-19, 2007, in Seoul, a South Korean government document was reportedly leaked that indicated that South Korean negotiators were going to step back from their demands on U.S. antidumping laws. The document reportedly indicated that the South Korean negotiators would strive

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[64] Specifically, to qualify for the VWP, countries must have had a nonimmigrant refusal rate of less than 3% for the previous year, or an average of no more than 2% over the past two fiscal years with neither year going above 2.5%. 8 U.S.C. §1187(c)(2)(A).

[65] Balbina Hwang, "Including South Korea in the U.S. Visa Waiver Program," *Heritage Foundation Backgrounder* No. 1872, July 25, 2005.

[66] South Korean government report to the National Assembly, "Negotiating Objectives of Korea-U.S. FTA," translation provided by the U.S. Embassy, Seoul; BNA, "South Korea's MOFAT Outlines Goals of Draft Free Trade Agreement."

[67] In his address at the December 2005 Doha Development Round ministerial in Hong Kong, South Korean Trade Minister Kim said that a "tangible outcome" in anti-dumping was "indispensable" for South Korea. Statement by Mr. Hyun Chong Kim Minister for Trade, World Trade Organization Ministerial Conference Sixth Session Hong Kong, WT/MIN(05)/ST/19 14 December 2005 (05-5992).

to obtain concessions from the United States on other issues of importance to South Korea.[68]

In the meantime, the Office of the USTR sent Congress a report on the negotiations, specifically indicating the possibility that any provisions of a proposed KORUS FTA would require changes in U.S. trade remedy laws. The report is required under section 2104(d)(3)(A) of the Trade Act of 2002, the statute that established the TPA. It requires the Administration to notify Congress no later than 180 calendars prior to entering into an agreement negotiated under TPA if that agreement might require changes in U.S. trade remedy laws.

The USTR report states that so far in the negotiations, both the United States and South Korea were considering the inclusion of a bilateral escape clause mechanism that would require no changes in U.S. trade remedy laws. However, South Korea has proposed a broad safeguard clause that would require each country to exclude imports from the other country from any global safeguard (section 201) measures it imposes, if those imports are not a substantial cause, or threat, of serious injury to the domestic industry. The United States ruled out the inclusion of such a proposal. The report also indicates that South Korea has made proposals regarding antidumping and countervailing duty measures that would require changes in U.S. trade remedy laws. (The specific proposals are not detailed in the unclassified version of the USTR report.) U.S. negotiators have ruled these out as well. South Korean negotiators expressed disappointment in the contents of the report.

Other Issues for South Korea. Kim Jong-hoon, the lead South Korean negotiator in the KORUS FTA, reportedly has said that his delegation will take the "offensive" in areas such as autos and textiles/clothing items to promote South Korean exports to the United States.[69] South Korea also may ask the United States to eliminate its 25% tariff on light trucks. In services trade, South Korea plans to encourage the United States to open its domestic market to services delivered by so-called mode-4 delivery, that is by the temporary movement of South Korean service providers to the United States, and to maritime services.[70] South Korea has promoted these issues in the Doha Development Agenda round of WTO negotiations currently underway. However, they are issues that would likely meet with strong U.S. resistence.[71] Another set of issues South Korea plans to present deal with U.S. customs procedures, which many South Korean exporters believe are inefficient.[72]

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[68] *Washington Trade Daily*. January 19, 2007.

[69] "S. Korea Seeks To Exclude Sensitive Goods From U.S. FTA: Official," *Yonhap*, April 27, 2006.

[70] South Korean government report to the National Assembly, "Negotiating Objectives of Korea-U.S. FTA," translation provided by the U.S. Embassy.

[71] For more information on the antidumping issue in the Doha Development Agenda round, see CRS Report RL32810, *WTO: Antidumping Issues in the Doha Development Agenda*, by Vivian C. Jones.

[72] South Korean government report to the National Assembly, "Negotiating Objectives of Korea-U.S. FTA," translation provided by the U.S. Embassy.

The Potential Economic Effects of a U.S.-South Korean FTA

A KORUS FTA would likely have important direct and indirect effects on the bilateral economic relationship as well as on U.S. economic relations throughout East Asia. South Korean tariffs are much higher than U.S. tariffs, so U.S. exporters, especially of agricultural goods, could realize gains in trade. South Korea's average applied tariff is 11.2%, and the average U.S. applied tariff is 3.7%. South Korea's average applied tariff on agricultural goods is 52%, while the U.S. average applied tariff is 12%.[73]

At this point a more general assessment of the impact can only be circumscribed since the contours of an agreement, especially in such sensitive areas as agriculture and autos, would take shape only after negotiators have reached agreement. Nevertheless, informed, albeit speculative, analyses provide some insights that could be helpful to the Congress as it oversees the negotiations.

Economists usually base their analysis of the impact of FTAs on the concepts of *trade creation* and *trade diversion*. These concepts were first developed by economist Jacob Viner in 1950.[74] Viner focused his work on the economic effects of customs unions, but his conclusions have been largely applied to FTAs and other preferential trade arrangements. His analysis was also confined to static (one-time) effects of these arrangements.

Trade creation occurs when a member of an FTA replaces domestic production of a good with imports of the good from another member of the FTA, because the formation of the FTA has made it cheaper to import rather than produce domestically. The creation of the trade is said to improve economic welfare within the group because resources are being shifted to more efficient uses. Trade diversion occurs when a member of an FTA switches its import of a good from an efficient nonmember to a less efficient FTA member because the removal of tariffs within the group and the continuation of tariffs on imports from nonmembers, make it cheaper to do so. Trade diversion is said to reduce economic welfare because resources are being diverted from an efficient producer to a less efficient producer.

In most cases, it appears that FTAs lead to both trade diversion and creation with the net effects determined by the structure of the FTA. Therefore, even if two or more countries are moving toward freer trade among themselves in an FTA, the

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[73] Office of the United States Trade Representative. Fact Sheet. *FTA: United States and Republic of Korea Economic and Strategic Benefits.* February 2006.

[74] Viner, Jacob. *The Customs Union Issue.* Carnegie Endowment for International Peace. 1950. New York. These concepts are discussed in CRS Report RL31356, *Free Trade Agreements: Impact on U.S. Trade and Implications for U.S. Trade Policy*, by William H. Cooper.

FTA could make those countries and the world as a whole worse off if the FTA diverts more trade than it creates, according to economic theory.[75]

U.S.-based analysts have conducted some comprehensive estimates of the direct economic impact of an FTA on the U.S. and South Korean economies. The United States International Trade Commission (USITC) conducted a study published in 2001 that the Senate Finance Committee requested.[76] The non-partisan Institute for International Economics (IIE) produced a study in 2001 that it updated in 2004.[77] Both studies concentrated on the static economic effects, that is, the direct economic effects resulting from the elimination of tariffs and quotas on all bilateral trade, including agricultural trade. These analyses do not take into account the dynamic effects of trade liberalization, that is, the indirect longer-term economic effects on other parts of the economy. They also do not take into account the economic effects which result from changes in non-tariff and non-quotas barriers, such as sanitary and phyto-sanitary regulations, intellectual property rights protection, trade-related foreign investment regulations, a services-related barriers, all of which are difficult to quantify. Therefore, the eventual impact of an FTA would likely be greater than the static estimates that the two studies present.

The two studies draw very similar conclusions. A U.S.-South Korean FTA's economic impact on South Korea would be relatively much greater than the impact on the U.S. economy. This is a logical conclusion, since the South Korean economy is much smaller, is more protected, and is much more dependent on foreign trade than is the U.S. economy. The IIE study predicts that the FTA would increase South Korean GDP between 0.38% and 2.41%, and the USITC study estimates the growth at about 0.7% . The two studies predict very small effects on the U.S. GDP: the IIE study estimates an increase of 0.02% to 0.13% while the USITC study estimates the growth at 0.2%.

Regarding the impact on bilateral trade flows, the IIE and USITC studies draw similar conclusions. According to both studies, U.S. exports to South Korea would rise more than U.S. imports from South Korea. U.S. exports to South Korea would rise by 54% and U.S. imports from South Korea would rise by 21%, according to the USITC. The IIE estimates that U.S. exports to South Korea would increase 46% to 49%, while imports from Korea would increase 26% to 30%. As might be expected,

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[75] This conclusion is called the General Theory of the Second Best and was developed by economists Richard Lipsey and Kelvin Lancaster. Lipsey, Richard and Kelvin Lancaster. The General Theory of the Second Best. *Review of Economic Studies.* vol 24. p. 11-32. Cited and discussed in Lawrence, Robert Z. *International National Economies: Regionalism, Multilateralism, and Deeper Integration.* Brookings Institution. Washington. 1996. p. 22.

[76] A new, classified USITC study, that is required under the Bipartisan Trade Promotion Act of 2002, is scheduled to be submitted to the USTR by July 14, 2006.

[77] United States International Trade Commission. *U.S.- Korea FTA: The Economic Impact of Establishing a Free Trade Agreement (FTA) Between the United States and the Republic of Korea.* Investigation No. 332-425. September 2001 Also, Choi, Inbom and Jeffrey J. Schott. *Free Trade Between Korea and the United States?* Institute for International Economics. Washington. April 2001.

the largest trade-flow impact of an FTA would occur in the most sensitive, and therefore the most-protected, sectors. These are the areas that are expected to present the greatest negotiating challenges. Thus, the largest gains for U.S. exports would be in agricultural exports. USITC has estimated that U.S. exports to South Korea of beef and cheese could increase as much as 60% and exports of beer by as much as 100%. The largest gains in South Korean exports to the United States would be in manufactured goods, especially in textiles and apparel, leather goods, chemicals and allied products, electronic products, and cars, according to the USITC. The USITC also concludes that at least some of the increase in U.S.-South Korean bilateral trade would be as the result of the diversion of trade from other U.S. and South Korean trade partners. For example, increased U.S. exports to South Korea would be at the expense of German and Japanese exports to South Korea. Increased South Korean exports to the United States would be partially at the expense of exports from Taiwan, Japan, and Mexico to the United States.

In December 2005, the Korea Institute for International Economic Policy (KIEP) published a study measuring the potential economic impact of an FTA on South Korea alone. The study estimated some of the dynamic economic effects in addition to the static effects of the FTA on South Korea. The KIEP study estimated that the FTA would eventually lead to a 0.42% to 0.59% increase in South Korea's GDP according to a static analysis, and 1.99 to 2.27% according to a dynamic analysis.[78]

Not captured by these studies would be the non-trade economic effects as a comprehensive FTA would be expected to promote a more efficient allocation of economic resources, especially in South Korea, the smaller and more regulated of the two economies. South Korea would likely realize welfare gains in the long term by reducing protection for agriculture and opening up its services sectors to foreign competition. On the other hand, the South Korean government would probably have to provide some type of transitional income programs to help those adversely affected by the increased competition and to obtain political support for the FTA.

Recent Developments and Potential Implications

As of February 12, South Korea and the United States had completed six rounds of negotiations and were in the midst of the seventh round which began on February 11, 2007, in Washington and was scheduled to end on February 14. The two sides have reported progress in some areas such as industrial tariffs, including customs administration, anti-corruption measures, and foreign investment. They had reportedly made progress on textiles trade; however, the South Korean negotiators would like to see a U.S. offer to loosen restrictions on textile imports from South Korea rapidly.

During the fifth and sixth rounds of the negotiations, the South Korean side forced the suspension of meetings by the trade remedies, autos, and pharmaceuticals working groups because it considered the U.S. position on the trade remedies to be

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[78] Lee, Junyu and Hongshik Lee. *Feasibility and Economic Effects of a Korea-U.S. FTA.* Korean Institute for International Economic Policy. December 2005. p. 86.

insufficient. In the interim between the sixth an seventh rounds, USTR Schwab and South Korean Minister of Trade Kim met for bilateral talks during the last week in January, in Davos, Switzerland, where both officials were attending the World Economic Forum. They reportedly discussed trade remedies, pharmaceuticals, and autos. As a sign of progress, all working groups, including those that had been suspended, were scheduled to meet during the seventh round. In addition, Kim Jong-hoon, the chief South Korean negotiator, indicated, in a report to the South Korean National Assembly, that South Korea would be prepared to partially accommodate U.S. demands on autos and pharmaceuticals, if the United States does the same on South Korean concerns on anti-dumping. The United States is pressing South Korea to open its markets on rice, a position that the South Korean negotiators have strongly resisted.[79]

At the end of the seventh round, Assistant USTR Wendy Cutler, the chief U.S. negotiator, reported that a number of sensitive issues still remain, including rice. She indicated that the two sides had discussed auto issues, including the South Korean engine displacement tax, and they had reached agreement in substance on auto standards. Among the other outstanding issues are U.S. tariffs on textiles and trade remedies. South Korea still insists on the inclusion under the FTA of products made in the Kaesong Industrial Complex, which the United States refuses to do.[80]

Negotiators have scheduled an eighth round to take place March 8-12, 2007, in Seoul. Both sides are still striving to complete the negotiation before the expiration of TPA. To consider the prospects for the negotiations, one might examine those factors that promote success and those that could prove problematic.

Factors Promoting Success

Among the factors promoting success is the **political commitment** of the U.S. and South Korean leaders as demonstrated by their decision to undertake the negotiations in the first place. The February 2, 2006 announcement to negotiate occurred after many years of discussions and studies on the feasibility of such an endeavor and presumably a clear understanding of its potential pitfalls. The joint political commitment implies a sense of mutual trust that could carry negotiators through the rough periods of negotiations.

Another factor dictating success is that the KORUS FTA negotiations will take place on the foundation of an already **strong bilateral economic relationship**. Each country is an important trade and investment partner of the other and views an FTA as preserving, if not strengthening, the relationship. Furthermore, a KORUS FTA conforms to each country's current trade policy of pursuing regional and bilateral agreements with critical partners.

The **emergence of China** as an economic power in East Asia provides another incentive for success. The rise of China is an ambiguous phenomenon for both South

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[79] *Washington Trade Daily*. February 12, 2007.

[80] *Inside U.S. Trade.* February 16, 2007.

Korea and the United States. Each sees China as both an increasingly important economic partner and a challenger. Each country sees the KORUS FTA as a hedge against the threat of China as a challenger. The FTA could be seen as of symbolic importance. When all factors are taken into account, the impression is that these negotiations are too important to fail.

Factors that Could Inhibit the Negotiations

If the factors that are pulling the United States and South Korea toward reaching an FTA are substantial, so are those that could inhibit the negotiations. One factor is the **tight deadline** under which the FTA must be negotiated. The United States faces the expiration of trade promotion authority on July 1, 2007, and South Korea faces the conclusion of President Roh's term in 2007.

The **complexity of the issues** to be negotiated, especially those that go to policies and practices behind national borders (not just at borders) present another challenge. For example, competition policy will likely be on the agenda as the United States will want South Korea to go further in reducing the influence of the *chaebols* and make government regulatory procedures more transparent. In addition, the United States will raise its concern about *domestic* taxation of autos in South Korea.

Some **issues will be politically sensitive**. South Korean rice farmers are demanding that they be protected from trade liberalization and South Korean negotiators have already indicated they will seek special treatment for rice under the FTA. South Korea has also indicated that it will seek the inclusion of products from the Kaesong industrial zone inside North Korea under the FTA — an objective that will likely meet with strong resistence from U.S. labor and other sources. South Korea has indicated that antidumping and countervailing duty rules should be part of the negotiations, an idea that would likely meet with strong resistence from the U.S. Congress.

Furthermore, the **imbalance in U.S.-South Korean economic relationship** will probably be reflected in the manner the countries conduct the negotiations and could create some tension. The U.S. economy is much larger, less dependent, and more open than the South Korean economy; therefore, U.S. negotiators will be the primary *demandeur* in the negotiations, placing South Korean negotiators on the defensive. This could make it more difficult for South Korean President Roh's administration to sell a deal to the South Korean National Assembly even though reductions in trade barriers would benefit the domestic economy as a whole.

Additionally, **developments with North Korea** are likely to affect the fate of the KORUS FTA because events on the Peninsula will influence Americans' and South Koreans' views of the value of the U.S.-ROK alliance. This is especially the case in light of North Korea's October 9, 2006 test of a nuclear weapon. Much is likely to hinge on the status of the Six-Party Talks on North Korea's nuclear program. If the talks produce a breakthrough or appear to be developing some forward momentum, then U.S. and South Korean differences over North Korea policy are less likely to spill into the trade realm. However, if the talks collapse completely or appear to stagnate, more Americans and Koreans may begin to

question the benefit of the alliance, particularly if it leads the Bush Administration to increase economic and other pressures on North Korea. In such a scenario, more U.S. policymakers are likely to view South Korea's "peace and prosperity policy" of emphasizing bilateral reconciliation with North Korea as undermining U.S. policy. Likewise, more South Koreans would be likely to view the United States as blocking their paramount foreign policy goal of pursuing North-South reconciliation. Such an atmosphere could make it difficult for leaders in both capitals to make the concessions necessary to produce a final free trade agreement.

Potential Implications

The outcome of the negotiations could have broad implications for the U.S.-South Korean bilateral relationship. If the two sides successfully resolve the fundamental issues that have caused friction, the bilateral relationship could be stronger in the long term. If they fail, the relationship could be damaged for some time. Also, the KORUS FTA would be the second largest FTA in which the United States is a participant and the largest in which South Korea is a participant, representing a major step for both countries in their pursuit of their respective trade strategies.

The U.S. and South Korean FTA negotiations could have repercussions beyond the bilateral relationship. For example, some of the issues that the two sides will address, such as agriculture and competition policy, are similar to issues confronting the U.S.-Japan economic relationship. If U.S. and South Korean negotiators can successfully address these issues, the outcome could serve as a model for the U.S.-Japan relationship. Indeed, the KORUS FTA negotiations have already stimulated discussion of a U.S.-Japan FTA.

Other Relevant CRS Products

CRS Report RL31356, *Free Trade Agreements: Impact on U.S. Trade and Implications for U.S. Trade Policy*, by William H. Cooper.

CRS Report RL33567, *Korea: U.S.-Korean Relations — Issues for Congress*, by Larry A. Niksch.

CRS Report RL30566, *South Korea-U.S. Economic Relations: Cooperation, Friction, and Prospects for a Free Trade Agreement (FTA)*, by Mark E. Manyin.

CRS Report RS22339: *Trade Liberalization Challenges Post-CAFTA*, by Raymond J. Ahearn.

CRS Report RL32221, *Visa Waiver Program*, by Alison Siskin.

CRS Products on North Korea

CRS Report RL32167, *Drug Trafficking and North Korea: Issues for U.S. Policy*, by Raphael F. Perl.

CRS Report RL32743, *North Korea: A Chronology of Events October 2002-December 2004*, by Mark E. Manyin, Emma Chanlett-Avery, and Helene Machart.

CRS Report RL33389, *North Korea: A Chronology of Events in 2005*, by Emma Chanlett-Avery, Mark E. Manyin, and Hannah Fischer.

CRS Report RL31696, *North Korea: Economic Sanctions*, by Dianne E. Rennack.

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CRS Report RL32493, *The North Korean Economy: Background and Policy Analysis*, by Dick K. Nanto and Emma Chanlett-Avery.

CRS Report RL33590, *North Korea's Nuclear Weapons Program*, by Larry A. Niksch.

CRS Report RS21391, *North Korea's Nuclear Weapons: How Soon an Arsenal?*, by Sharon A. Squassoni.

CRS Report RS21834, *U.S. Assistance to North Korea: Fact Sheet*, by Mark E. Manyin.

CRS Report RL31785, *Foreign Assistance to North Korea*, by Mark E. Manyin.

Appendix A. Top 10 U.S. Exports to and Imports from South Korea, 2005

(Billions of U.S. Dollars)

U.S. Exports		U.S. Imports	
Total	**27.7**	**Total**	**43.8**
Electrical Machinery	6.9	Electrical Machinery	13.6
Non-electrical Machinery	4.6	Vehicles	10.2
Optical Equipment	2.2	Non-electrical Machinery	6.7
Organic Chemicals	2.0	Mineral Fuels	1.8
Aircraft	1.9	Iron and steel products	1.1
Plastic	0.9	Plastic	1.0
Vehicles	0.7	Rubber	0.9
Mineral Fuels	0.6	Iron and steel	0.9
Cereals	0.4	Knit Apparel	0.7
Misc. Chemical Products	0.4	Special category	0.7

Source: Two-digit HS categories. U.S. Department of Commerce data compiled by Global Trade Information Systems, Inc.

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