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The Proposed U.S.-South Korea Free Trade Agreement (KORUS FTA): Provisions and Implications

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The Proposed U.S. South Korea Free Trade Agreement (KORUS FTA): Provisions and Implications

Summary

On June 30, 2007, United States Trade Representative Susan Schwab and South Korean Foreign Trade Minister Kim Hyung-chong signed the proposed U.S.-South Korean Free Trade Agreement (KORUS FTA) for their respective countries. If approved, the KORUS FTA would be the largest FTA that South Korea has signed to date and would be the second largest (next to North American Free Trade Agreement NAFTA) in which the United States participates. South Korea is the seventh-largest trading partner of the United States and the United States is South Korea's third largest trading partner. Various studies conclude that the agreement would increase bilateral trade and investment flows.

The final text of the proposed KORUS FTA covers a wide range of trade and investment issues and, therefore, could have wide economic implications for both the United States and South Korea. The KORUS FTA includes issues on which the two countries achieved early agreement, such as the elimination on tariffs on trade in most manufactured goods and the partial liberalization in services trade. The agreement also includes provisions on a number of very sensitive issues, such as autos, agriculture, and trade remedies, on which agreement was reached only during the final hours of negotiations.

If the agreement is to enter into force, Congress will have to approve implementation legislation. The negotiations were conducted under the trade promotion authority (TPA), also called fast-track trade authority, that the Congress granted the President under the Bipartisan Trade Promotion Act of 2002 (P.L. 107-210). The authority allows the President to enter into trade agreements that receive expedited congressional consideration (no amendments and limited debate). The White House has not indicated when it will send the draft implementing legislation to Congress. (The TPA sets no deadline for the President to do this.)

While a broad swath of the U.S. business community supports the agreement, the KORUS FTA faces opposition from some groups, including some auto and steel manufacturers and labor unions. In addition, the agricultural community and some Members of Congress have withheld support for the agreement until South Korea lifts its restrictions on imports of U.S. beef. Some U.S. supporters view passage of the KORUS FTA as important to secure new opportunities in the South Korean market, while opponents claim that the KORUS FTA does not go far enough. Other observers have suggested the outcome of the KORUS FTA could have implications for the U.S.-South Korean alliance as a whole. Differences between the White House and the Democratic leadership in the Congress over the implications of the KORUS FTA have made the timing and even the likelihood of the President's submission and Congress's subsequent consideration of implementing legislation uncertain. Agricultural groups and some Members of Congress welcomed South Korea's recent decision to accept imports of U.S. beef — a move that Korea hopes will make it easier for the White House to submit the agreement to Congress. This report will be updated as events warrant.

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On June 30, 2007, United States Trade Representative Susan Schwab and South Korean Foreign Trade Minister Kim Hyung-chong signed the proposed U.S.-South Korean Free Trade Agreement (KORUS FTA) for their respective countries.[1] If approved, the KORUS FTA would be the largest FTA South Korea has signed to date and would be the second largest (next to the North American Free Trade Agreement) in which the United States currently participates. South Korea is the United States's seventh-largest trading partner and the KORUS FTA, if enacted, is expected to expand bilateral trade and investment flows according to some studies.

The final text of the proposed free trade agreement (FTA) covers a wide range of trade and investment issues and, therefore, could have wide economic implications for both the United States and South Korea. The subjects include ones on which the two countries achieved early agreement, such as the elimination on tariffs on trade in most manufactured goods and the liberalization in services trade. But the text also includes a number of very sensitive issues on which agreement was reached only during the final hours of negotiations — autos, agriculture, and trade remedies, among others.

Congress will have to approve implementation legislation for the KORUS FTA before it can enter into force. The negotiations were conducted under the trade promotion authority (TPA), also called fast-track trade authority, that the Congress granted the President under the Bipartisan Trade Promotion Act of 2002 (the act) (P.L. 107-210). The authority allows the President to enter into trade agreements that receive expedited congressional consideration (no amendments and limited debate). The White House has not indicated when it will send the draft implementing legislation to Congress. (The TPA sets no deadline for the President to do this.) South Korea's President, Lee Myung-bak, has said he hopes to have the South Korean National Assembly and pass the agreement before its current legislative session ends in May 2008. However, an uproar in South Korea over the April 2008 beef agreement appears to have made achieving this goal unlikely.

The United States and South Korea entered into the KORUS FTA as a means to further solidify an already strong economic relationship by reducing barriers to

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[1] For more specific information, you may contact the following CRS analysts: William Cooper, x7-7749 (general questions on the KORUS FTA); Stephen Cooney, x7-4887 (autos and other industrial goods); Vivian Jones, x7-7823 (trade remedies); Remy Jurenas, x7-7281 (agricultural trade); and Mark Manyin, x7-7653 (the U.S.-South Korean bilateral relationship and security issues).

trade and investment between them and to resolve long festering economic issues. The United States specifically has sought increased access to South Korean markets for agricultural products, services, and foreign investment. Of importance to South Korea was change in U.S. trade remedy procedures which it considers to be discriminatory and U.S. recognition of products made in an industrial park in North Korea as eligible for preferential treatment under the KORUS FTA.

Supporters of the FTA argue that failure to approve the KORUS FTA would allow those opportunities to slip away. Some opponents of the KORUS FTA have argued that the agreement failed to go far enough in addressing South Korean trade barriers and would be a lost opportunity if approved in its current form. A congressionally mandated study by the United States International Trade Commission (USITC) concluded that investment and trade between the United States and South Korea would increase modestly as a result of the KORUS FTA.[2] This result is in line with other similar studies.

Many observers have argued that in addition to economic implications, the KORUS FTA would have diplomatic and security implications. For example, they have suggested that it would help to deepen the U.S.-South Korean alliance. 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.[3] South Korea subsequently has assisted U.S. deployments in other conflicts, most recently by deploying over 3,000 troops to play a non-combat role in Iraq. Some have also suggested that a KORUS FTA would help to solidify the U.S. presence in East Asia to counterbalance the increasing influence of China while failure to pass it could harm the alliance.

This report is designed to assist Members of the 110th Congress as they consider the costs and benefits of the KORUS FTA. It examines the provisions KORUS FTA in the context of the overall U.S.-South Korean economic relationship, U.S. objectives, and South Korean objectives. The report will be updated as events warrant.

The KORUS FTA in a Nutshell

The KORUS FTA was the product of much compromise. As negotiators from both countries stated, each country was able to accomplish some of its objectives, but neither side got everything it wanted. For example, South Korea made concessions in agriculture and services while the United States made concessions on rice and textiles. Yet, U.S. car manufacturers felt that South Korea did not go far enough in

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[2] United States International Trade Commission (USITC). *U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects.* Investigation No. TA-2104-24. USITC Publication 3949. September 2007.

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

addressing barriers to auto imports and South Korea would have liked to have more U.S. concessions on trade remedies.

Some highlights of the results of the agreement are provided below. Background information on a more detailed examination of the agreement's provisions is provided in the main sections of this report.

Agriculture

Under the KORUS FTA's agricultural provisions, South Korea immediately would grant duty-free status to almost two-thirds of current U.S. agricultural exports. Tariffs and import quotas on most other agricultural goods would be phased out within 10 years, with the remaining commodities and products subject to provisions that phase out such protection by year 23. Exports of seven U.S. products (skim and whole milk powders, evaporated milk, in-season oranges, potatoes for table use, honey, and identity-preserved soybeans for food use) would be subject to import quotas that slowly expand in perpetuity.

Much effort went into negotiating provisions covering three agricultural commodities of export interest to the United States. Under the KORUS FTA, South Korea agreed to eliminate its 40% tariff on beef muscle meats imported from the United States over a 15 year period. Also, South Korea would have the right to impose safeguard tariffs on a temporary basis in response to any potential surge in imports of U.S. beef meats above specified levels. However, negotiators did not reach a breakthrough by the end of the talks on the separate but parallel issue of how to resolve differences on the terms of access for all U.S. beef in a way that would address Korea's human health concerns arising from the 2003 discovery of mad cow disease in the U.S. cattle herd. Sales of U.S. boneless beef from cattle aged less than 30 months, though, did resume in April 2007 under the terms of a separate agreement reached in early 2006. However, Korean inspectors' discovery of prohibited cattle parts in some boxes of shipped beef that did not meet those terms in October 2007 temporarily placed on hold retail sales of U.S. boneless beef. The new South Korean president, seeking to remove this impediment to congressional consideration of the KORUS FTA, instructed his negotiators to resolve this longstanding bilateral dispute. On April 18, 2008, both countries reached an agreement that will allow sales in the Korean market of boneless and in-bone (rib) U.S. beef from all cattle irrespective of age that meet specified criteria.

The KORUS FTA does not give U.S. rice and rice products any preferential access to South Korea's market. The agreement only requires South Korea to continue to abide by its multilateral trade commitments to increase rice imports. Access for U.S. citrus products was not settled until just before the talks concluded. With South Korea protecting its orange sector by a 50% tariff, negotiators compromised on a multi-part solution. A small duty free quota was created for "in-season" U.S. navel oranges that would grow slowly in perpetuity. Sales during this September to February period in excess of this quota would continue to face the high 50% tariff. For "out-of-season" oranges that pose less competition to South Korea's orange producing sector, the tariff would be phased out by year 7.

Automobiles

Trade in autos and autoparts proved to be among the most difficult issues tackled by U.S. and South Korean negotiators, pitting an increasingly competitive South Korean industry seeking to increase its market share in the United States and a U.S. industry that wants South Korea to eliminate policies and practices that seemingly discriminate against U.S. auto imports. The KORUS FTA would:

- *eliminate most South Korean tariffs on U.S.-made motor vehicles.* South Korea would immediately eliminate its 8% tariff on U.S.-built passenger cars and its 10% tariff on pickup trucks.

- *reduce discriminatory effects of engine displacement taxes.* South Korea would simplify its three-tier "Special Consumption Tax" and would also simplify its five-tier "Annual Vehicle Tax" both of which are based on engine displacement by making it a three-tier system.

- *harmonize standards and create an "Automotive Working Group."* The agreement provides for self-certification on safety and emissions standards for a limited number of U.S.-exported vehicles, and a commitment that South Korea will evaluate emissions using the methodology applied by the State of California. South Korea also agreed "not to adopt technical regulations that create unnecessary barriers to trade and to cooperate to harmonize standards."

- *eliminate of U.S. tariffs and provide for "snapback" clause.* The United States would immediately eliminate its 2.5% duty on gasoline-fueled passenger vehicles with engine displacement up to 3000 cc, would phase out over three years the 2.5% duty on South Korean imports with larger engine capacity or that are diesel-powered , and would phase out over ten years the 25% duty on South Korean pickup trucks.

Other Key Provisions

The KORUS FTA would cover a broad range of other areas. According to the Office of the United States Trade Representative (USTR), most U.S.-South Korean trade in **consumer and industrial products** would become duty-free within three years after the agreement enters into force, and virtually all remaining tariffs would be lifted within 10 years. The two countries agreed to liberalize trade in **services** by opening up their markets beyond what they have committed to do in the World Trade Organization (WTO). About 60% of U.S.-South Korea trade in **textiles and apparel** would become duty-free immediately, and the KORUS FTA would provide a special safeguard mechanism to reduce the impact textile and apparel import surges.

Trade remedies were a critical issue for South Korea and a sensitive issue for the United States. The FTA provides the United States could exempt imports from South Korea from a "global" escape clause (section 201) measure if they are not a major cause of serious injury or a threat of serious injury to the U.S. domestic

industry. The FTA would also provide for a binational consultative committee to review trade remedy decisions involving one another.[4]

In addition, South Korea and the United States agreed to establish an independent body to review recommendations and determinations regarding South Korean pricing and government reimbursement for **pharmaceuticals and medical devices** and to improve transparency in the process for making those determinations. Furthermore, one year after the KORUS FTA enters into force, a binational committee would be formed to study the possibility of eventually including products from "Outward Processing Zones," such as the **Kaesong Industrial Complex,** that use North Korean labor.

Estimates of the Overall Economic Effects of a KORUS FTA

Economists have released several studies estimating the potential effects of the KORUS FTA. As required by the TPA statute, the USITC conducted a study of the KORUS FTA at the request of the President.[5] The USITC study concludes that U.S. GDP would increase by $10.1 billion to $11.9 billion (approximately 0.1%) when the KORUS FTA is fully implemented, a negligible amount given the size of the U.S. economy. The USITC based this estimate primarily on the removal of tariffs and tariff-rate-quotas, that is, barriers that can be relatively easily quantified. The study concludes that U.S. exports of goods would likely increase by $9.7 billion to $10.9 billion primarily in agricultural products, machinery, electronics, transportation equipment, including passenger vehicles and parts. U.S. imports would increase $6.4 billion to $6.9 billion, primarily in textiles, apparel, leather products, footwear, machinery, electronics, and passenger vehicles and parts.[6]

The range does not take into account the impact of the reduction of barriers to trade in services and to foreign investment flows and the impact of changes in regulations as a result of the KORUS FTA. The study notes that U.S. exports in services would increase as a result of South Korean commitments under the KORUS FTA and that changes in the regulatory environment in both countries would also help to increase bilateral trade and investment flows.

The study estimates that changes in aggregate U.S. employment would be negligible given the much larger size of the U.S. economy compared to the South Korean economy. However, while some sectors, such as live stock producers, would experience increases in employment, others such as textile, wearing apparel, and

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[4] Trade Remedy Piece of Korea FTA Ignores Korean ADF Demands. *Inside U.S. Trade.* April 13, 2007.

[5] Section 2104(f) Trade of 2002. P. L. 107-210. United States International Trade Commission (USITC). *U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects.* Investigation No. TA-2104-24. USITC Publication 3949. September 2007.

[6] USITC. p. xvii-xviii.

electronic equipment manufacturers would be expected to experience declines in employment.[7]

Other studies draw the same basic conclusions, although the magnitudes differ because they employ different models from the USITC study. For example, a University of Michigan analysis commissioned by the Korea Economic Institute estimates that U.S. GDP would increase by $25.12 billion (0.14% of U.S. GDP). This is larger than the USITC estimate, but in part this is because its authors quantified the effects of liberalization in services trade.[8] The authors also analyzed the impact of a KORUS FTA before the final text had been released and assumed, among other things, that rice trade would be liberalized, which, in the end, was not the case.

In December 2005, the Korea Institute for International Economic Policy (KIEP) published a study measuring the potential economic impact of a U.S.-South Korean FTA on South Korea alone. The study estimated some of the dynamic, or long-run, economic effects in addition to the static, or one-time, 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.[9]

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

South Korea is a major economic partner for the United States. In 2006, two-way trade between the two countries exceeded $75 billion, making South Korea the United States's seventh-largest trading partner. (See **Table 1**.) 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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[7] USITC. p. xix.

[8] Kiyota, Kozo and Robert M. Stern. *Economic Effects of a Korea-U.S. Free Trade Agreement.* Korea Economic Institute, Special Studies 4. 2007.

[9] 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.

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
2007	33.0	45.4	-12.4	78.4
Major U.S. Export Items	Semiconductor chips and manufacturing equipment; aircraft; corn and wheat; plastics. (See Appendix C for more details.)			
Major U.S. Import Items	Semiconductor circuits; televisions and flat panel screens; cars; steel. (See Appendix C 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 South Korea's third-largest trading partner, second-largest export market, and the third-largest source of imports. It was also South Korea's second 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. In 2005 Japan overtook the United States to become South Korea's second-largest trade partner.

Table 2. Asymmetrical Economic Interdependence (2007)

	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	#2

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 for Economic Co-operation and Development (OECD).[10] Many of these issues arose during the KORUS FTA negotiations.

The intensity of these disputes has diminished considerably since the late 1980s and early 1990s, in part because South Korea enacted a set of sweeping market-oriented reforms as a *quid pro quo* for receiving a U.S.-led $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 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*); at one point earlier in the decade, foreign firms owned about one-third of the South Korean banking industry and an estimated 40% of the value of the shares traded on South Korea's stock exchange. Since the 1997 crisis, FDI commitments by U.S. companies have totaled over $25 billion.[11]

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.

U.S. and South Korean Objectives in An FTA

U.S. and South Korean policymakers shared certain goals in launching and completing the negotiations on the KORUS FTA. Both governments saw in the FTA a logical extension of an already important 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. For the United States these issues have included the high tariffs and other restrictions on agricultural imports. For South Korea, these difficult issues have included perceived U.S. discrimination toward South Korean imports in the application of trade remedies and treatment of products made at the Kaesong Industrial Complex in North Korea.

While sharing some broad objectives, U.S. and South Korean leaders also approached the KORUS FTA from different perspectives that were reflected in the conduct and outcome of the negotiations. A primary objective of the United States

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[10] OECD, *Economic Surveys - Korea*, 2007.

[11] Korea Economic Institute, "Current Economic Info, South Korean Economic Data," accessed at [http://www.keia.org], on January 2, 2008.

was to gain access to South Korean markets in agricultural products, pharmaceuticals and medical equipment, some other high-technology manufactured goods, and services, particularly financial and professional services — areas in which U.S. producers are internationally competitive but for which South Korean barriers seemed to be high.

For South Korea gaining a large increase in market access was not as critical a priority since South Korean exporters already have a significant presence in areas in which they have proved to be competitive — consumer electronics and autos, for example, and in which they already face only low or zero U.S. tariffs. However, South Korea arguably did seek to preserve its share of the U.S. market the face of growing competition from emerging East Asian producers from Thailand, Malaysia, Vietnam, and possibly China. South Korea likely also aimed to improve its competitive position in the U.S. market vis-a-vis Japan where the elimination of even low tariffs might give South Korean exporters some price advantage.

Launching the FTA negotiations was largely at the initiative of South Korea. Its main objective in securing an FTA with the United States was much broader than gaining reciprocal access to the U.S. market. Entering an FTA with the United States meshed with a number of South Korean President Roh Moo-hyun's long term economic and strategic goals. Roh made an FTA the top economic priority for the remainder of his tenure, which expires in February 2008.[12] 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, South Korean Prime Minister Han Duk-soo has said that a failure to adopt significant economic changes will mean that "Korea's long term growth potential is likely to deteriorate."[13] Lee Myung-bek, who was elected President in December 2007, made the economy the centerpiece of his campaign and has supported the KORUS FTA as part of a larger program to promote South Korean economic growth.

During the negotiations, South Korean officials and other South Korean proponents of the KORUS FTA tended not to focus on the increased access to the U.S. market. Rather, they emphasized 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

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

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

competition with U.S. firms.[14] The President and other senior officials in particular emphasized the need to boost the competitiveness of South Korean service industries. An FTA with the United States, they argued, will help address South Korea's increased economic polarization by spurring job creation in fields such as medical, legal, education, and accounting services in a free trade agreement.[15] Some, however, say an FTA will worsen South Korea's income gap.[16]Also, during the talks, there were continuous and often large scale anti-FTA protests particularly by South Korean farmers and trade unionists.

The absence of mirror-image or reciprocal U.S. and South Korean objectives in the negotiations is reflected in the structure of the KORUS FTA. Except for some provisions dealing with issues specific to U.S.-South Korea economic relations, for example, South Korea taxation of autos and the Kaesong industrial complex, the structure of the KORUS FTA largely resembles the structure of other FTAs, such as Dominican Republic-Central American FTA (DR-CAFTA), that the United States has entered into. This conclusion does not suggest that South Korea did not bring to the table its own specific demands, which it did (such as the exclusion of rice) and held to them firmly.

Sector-Specific Issues and the KORUS FTA

Under the KORUS FTA, U.S. and South Korean negotiators addressed a number of sector-specific issues. Some issues, such as elimination of tariffs on most manufactured goods, were not very controversial and were dealt with in early stages of the negotiations. Other issues, such as trade in agricultural products and in autos, were the most difficult and were not resolved until the final hours of the negotiations.

Agriculture and Sanitary and Phytosanitary Issues

Overview. Attaining comprehensive market access for U.S. agricultural products to South Korea's large market and finding a way to resolve Korea's continued restrictions on U.S. beef purchases (imposed to protect human health following the late 2003 discovery of mad cow disease in the U.S. cattle herd) were the two primary objectives pursued by U.S. agricultural negotiators. Though South Korea in 2006 was the 14th largest agricultural importer in the world, its farm sector is highly protected with high tariffs and quotas.[17] This reflects its farmers'

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[14] 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.

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

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

[17] South Korea's average applied agricultural tariff (2006) was 48%, compared to about 12% for the United States. WTO, Statistics Database, "Country Profile for Republic of Korea," as accessed at [http://stat.wto.org/CountryProfiles/KR_e.htm] on January 15, 2008; U.S. (continued...)

longstanding political influence (particularly rice producers) and its urban population's deep ties to its rural roots.

In concluding the KORUS FTA, the United States secured nearly complete access for all U.S. agricultural commodities and food products into Korea's market. However, a breakthrough on the beef issue (technically not part of the FTA talks but nevertheless the subject of high-level discussions) did not occur until April 2008. This appears to reflect the newly elected Korean President's view that an agreement spelling out the rules that apply to beef imports from the United States had to be in place before President Bush could consider sending this agreement to Capitol Hill. Several Members of Congress had for months stated that South Korea must agree to fully reopen its market to U.S. beef under scientifically based international rules in commercially significant quantities before Congress considers or approves the agreement. U.S. agricultural groups, well aware of this deal's potential benefits for producers, had also conditioned their support on the resumption of U.S. beef exports.

In 2007, South Korea was the 5th largest market for U.S. agriculture, as export sales totaled $3.5 billion. Under the KORUS FTA's agricultural provisions, South Korea immediately would grant duty-free status to almost two-thirds of current U.S. agricultural exports. Tariffs and tariff-rate quotas (TRQs)[18] on most other agricultural goods would be phased out within 10 years, with the remaining commodities and products subject to provisions that phase out such protection by year 23. Seven U.S. products (skim and whole milk powders, evaporated milk, in-season oranges, potatoes for table use, honey, and identity-preserved soybeans for food use) would be subject to Korean import quotas that slowly expand in perpetuity. However, the agreement does not give U.S. rice and rice products additional access to South Korea's market (see below).[19]

With the immediate elimination or phase out of most of South Korea's relatively high agricultural trade barriers under the KORUS FTA, the U.S. agricultural and food processing sectors would noticeably benefit from additional exports. The USITC estimates that the increase in U.S. exports of agricultural commodities and processed foods would account for up to one-third of the entire projected increase in total U.S.

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[17] (...continued)
Department of Agriculture, Economic Research Service, *Profiles of Tariffs in Global Agricultural Markets*, AER-796, January 2001, p. 26.

[18] A TRQ is a two-part tool used by countries to protect their more sensitive agricultural and food products. The quota component provides for duty-free access of a specified quantity of a commodity, which in an FTA usually expands over time. Imports above this quota are subject to a prohibitive tariff that in an FTA frequently declines over time. At the end of a product's transition period to free trade under an FTA, both the quota and tariff no longer apply (with a few exceptions), allowing for its unrestricted access to the partner's market.

[19] A summary of commodity-specific market access provisions (tariff reduction schedules, transition periods, TRQ amounts and growth rates, and safeguards) is found in the USDA fact sheet "U.S. - Korea Free Trade Agreement Benefits for Agriculture," July 2007, available at [http://www.fas.usda.gov/info/factsheets/korea.asp]. Detailed fact sheets on the agreement's commodity provisions and prospective impacts for agriculture in selected states are available at [http://www.fas.usda.gov/info/factsheets/Korea/us-koreaftafactsheets.asp].

exports to South Korea's market once the KORUS FTA's provisions are fully implemented. Sale of agricultural products would be from $1.9 billion to $3.8 billion (44% to 89%) higher in 2008 than exports under a no-agreement scenario. Almost half of this export increase would accrue to the U.S. beef sector, based on the USITC's assumption that U.S. beef exports recover to the level before South Korea imposed its restrictions import in late 2003. (For information on South Korea's restrictions on imports of U.S. beef and bilateral efforts that recently led to an agreement on new Korean rules that will govern U.S. beef imports, see **Appendix A**.) About 20% of the export increase would benefit U.S. producers and exporters of pork, poultry and other meat products.[20] In another analysis, the American Farm Bureau Federation (AFBF) projects that U.S. agricultural exports by the end of the transition period (2027) would be more than $1.5 billion (45%) higher under the KORUS FTA than would be the case otherwise. Sales of beef, poultry, and pork would account for $644 million (or 42%) of this increase.[21]

Because South Korean agricultural exports to the United States are small ($233 million in 2007) and largely complementary, there was no controversy in negotiating access to the U.S. market. The United States agreed to phase out tariffs and quotas on all agricultural imports from South Korea under seven phase-out periods ranging up to 15 years. One 10-year TRQ would apply to imports of fluid milk and cream, among other specified dairy products. The USITC projects that imports of agricultural products (primarily processed food products) from South Korea under the KORUS FTA would be from $52 million to $78 million (12% to 18%) higher than such imports under a no-agreement scenario.

Beef. Under the KORUS FTA, South Korea agreed to eliminate its 40% tariff on beef muscle meats imported from the United States over a 15 year period. Also, South Korea would have the right to impose safeguard tariffs on a temporary basis in response to any potential surge in imports of U.S. beef meats above specified levels. The trigger for this additional tariff would be 270,000 metric tons (MT) in year 1, which would increase 2% annually; in year 15, the trigger would be 354,000 MT.[22] In year 16, this protective mechanism would no longer apply. The 18% tariff on imports of beef offals (tongues, livers, tails and feet), and tariffs ranging from 22.5% to 72% on other beef products, would be similarly eliminated in 15 years.

Assuming that South Korea fully lifts its restrictions on U.S. beef and bilateral beef trade returns to normal, the USITC estimates that the phase out of South Korea's beef tariff and safeguard could increase U.S. beef exports from about $600 million

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[20] Derived from Table 2.2 in USITC, *U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects,* pp. 2-8 and 2-9.

[21] Derived from American Farm Bureau Federation's (AFBF) *Implications of a South Korea-U.S. Free Trade Agreement on U.S. Agriculture,* July 2007, p. 17. To be consistent with the agricultural and food product categories used to derive the USITC's estimate, AFBF's exports of fish products are not included in the estimated increase in agricultural exports and agriculture's share stated above.

[22] In 2003, U.S. exports of beef muscle meats to South Korea totaled 213,083 MT. The safeguard level in year 1 would allow for duty-free access for about 20% more U.S. beef than the average 2002-2003 level of U.S. beef exports to the South Korean market.

to almost $1.8 billion (58% to 165%) above what would be the case otherwise. Under the KORUS FTA, the AFBF projects that U.S. beef sales would be $265 million higher as the United States recaptures its historic share of the South Korean market. However, its analysis notes that the market share of U.S. beef likely will not increase over time. That is because South Korean tastes have developed a preference for grass-fed Australian beef, which will continue to be competitive in price against U.S. beef even with the current 40% tariff removed.

On April 18, 2008, U.S. and South Korean negotiators reached agreement on the requirements that will apply to Korean imports of U.S. beef and beef products. Imports of boneless and in-bone (rib) beef, and other beef products, from cattle *irrespective of age* will now be allowed entry, but are subject to various conditions that U.S. beef exporters and the U.S. government must meet. Against the backdrop of mounting public protests in Korea against this agreement, calls by opposition parties that it be renegotiated, and the Korean President's apology for how his government has mishandled this matter, the beef import protocol is now scheduled to take effect by the first week in June 2008 (see **Appendix A** for additional details).

Rice. South Korean negotiators succeeded in excluding the entry of U.S. rice on preferential terms — its prime objective in negotiating agriculture in the KORUS FTA. This reflects Korea's efforts to maintain its stated policy of self sufficiency in rice production, the national sentiment that preserving rice production is inseparable from the country's identity, and the political reality that rice farming preserves the basis for economic activity in the countryside. That rice was a make-or-break issue for Seoul is seen in the comment made by a top U.S. trade official, Deputy United States Trade Representative Karan Bhatia, the day after the talks concluded: "Ultimately, the question that confronted us was whether to accept a very, very good albeit less perfect agreement or to lose the entire agreement because South Korea refused to move on rice."[23] On rice, the KORUS FTA only requires South Korea to continue to abide by its multilateral trade commitments to increase rice imports.

At present, U.S. rice exporters have access to the South Korean market under (1) a 24% share (50,076 MT) of the rice import quota established under that country's multilateral World Trade Organization (WTO) commitments in 1995, and (2) a separate quota available to all countries.[24] Rice entering under both quotas faces a 5% tariff. Entries above each quota are prohibited — a unique concession that South Korea received in the last round of multilateral trade negotiations. U.S. rice

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[23] *Inside U.S. Trade*, "USTR Says Beef Market Access Must Precede Signing of Korea FTA," April 6, 2007, p. 5.

[24] Following the 2004 renegotiation of South Korea's WTO agricultural commitments, the United States and most other rice exporting countries beginning in 2005 have been able to take advantage of this other rice quota. Expanding by 20,347 MT each year through 2014, market access is on a first-come, first served basis. By 2014, both rice import quotas (under country allocations made to four countries including the United States, and the quota available to any country) will total 408,700 MT. For background on Korea's market access and domestic policies for rice, see USDA, Economic Research Service, South Korea Briefing page titled "Policy," available at [http://www.ers.usda.gov/Briefing/SouthKorea/policy.htm#ricemarket].

exports against both quotas have fluctuated, but since 2005 have risen to reach $43 million (73,283 MT) in 2007. Future U.S. sales are expected to grow slowly in line with the expansion of the most recently established rice quota.

Though the U.S. rice industry expressed disappointment with the rice exclusion, the United States will have other opportunities in the future to negotiate access for additional U.S. rice in Korea's market. This could occur in the process of concluding a multilateral agreement (possibly by 2009) to further liberalize agricultural trade in the WTO's Doha Development Round, which might require South Korea to further open its rice market. Also, the United States and other rice exporting countries could press for additional access when Korea's current multilateral rice access provisions expire in 2014.

Oranges. Differences on how quickly to liberalize trade in fresh oranges were not resolved until just before the negotiations concluded. The United States sought the complete elimination of Korea's border protection on all citrus products, while South Korea wanted to retain its quotas and tariffs, primarily because of the importance of the citrus industry to the economy of Cheju Island. At present, South Korea imposes a 50% tariff on all imports of oranges, irrespective of whether they enter within or outside an existing TRQ.

In reaching a compromise, negotiators agreed to a multi-part solution. First, a small duty-free quota would be created for "in-season" U.S. navel oranges (a variety that is not produced in Korea) that enter between September 1 and the end of February — a period that coincides with the Island's *unshu* (mandarin) orange harvest season. The initial 2,500 MT TRQ would increase at a compound 3% annual rate in perpetuity. Shipments in excess of this amount during this six-month period would continue to be subject to the 50% tariff. Second, in the first year, this high tariff would be reduced to 30% for "out-of-season" oranges that enter between March 1 and August 31, and then be completely phased out in stages by year 7. Third, South Korea's 144% tariff on mandarin oranges would be phased out over 15 years.

The cost of selling to what already is a leading U.S. export market for fresh oranges will be significantly reduced as Korea's high 50% tariff is phased out. In 2007, South Korea ranked second (after Canada), with U.S. sales totaling $85 million (88,335 MT). USDA estimates that the value of the in-season 2,500 MT quota and tariff reductions on all orange exports in the first year would be almost $20 million. Over seven years, USDA estimates the cumulative value of savings associated with these orange access provisions at $237 million.[25]

Sanitary and Phytosanitary Provisions. As found in most other U.S. FTAs, the KORUS FTA establishes a bilateral standing committee to address food safety and animal/plant life or health issues that frequently emerge in agricultural trade. However, there are no commodity-specific sanitary and phytosanitary (SPS) provisions to address outstanding issues, such as Korea's import requirements on U.S. beef imports by or Korean standards that have prevented sales of some U.S.

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[25] USDA, Foreign Agricultural Service, Fact Sheet "U.S.-Korea Free Trade Agreement — What's At Stake for Fresh Citrus and Orange Juice," July 2007.

horticultural products to that market. The Committee on SPS Matters would serve as a forum to implement the WTO's Agreement on the Application of SPS Measures, enhance mutual understanding of each country's SPS rules, resolve future bilateral SPS disputes that arise, coordinate technical assistance programs, and consult on issues and positions in the WTO and other international bodies where SPS issues are considered. The text of the SPS chapter specifically states that neither the United States nor South Korea has recourse to pursue dispute settlement to address any SPS issue that arises. Instead, any matter would be resolved using the formal process established under the WTO's SPS Agreement.

U.S. beef producers had argued until the April 2008 agreement was announced that Korea's stance on U.S. beef imports must be scientifically based upon internationally recognized guidelines issued by the World Organization for Animal Health, also known as OIE by its French acronym.[26] Other agricultural groups also have raised concerns about Korea's implementation of SPS measures on food additives and those that have restricted U.S. fruit and vegetable exports. This new standing committee potentially could be used as the venue to attempt to resolve future SPS disputes, taking into account latest available scientific findings and knowledge.

Autos

The export orientation of the South Korean motor industry, combined with the relatively low U.S. tariff of 2.5% on all imported motor vehicles except pickup trucks, has made the United States a good market of opportunity for South Korean exports. (For a discussion of the South Korean auto industry, see Appendix B.) Total Korean motor vehicle exports to the United States peaked at 860,000 units in 2004, according to U.S. Commerce Department data. It subsequently fell to 730,000 units in 2005, 695,000 units in 2006, and 675,000 units in 2007.[27] Hyundai has established a major U.S. assembly plant, thus substituting for some imports. Kia also plans to open a U.S. assembly plant by 2009.[28] Falling imports from Korea probably were affected by a general softening of the U.S. market. U.S. exporters, including South Korean and other foreign-owned manufacturers, shipped a total of 12,571 vehicles to South Korea in 2007.

The total value of South Korean automotive exports to the United States, including parts, was $12.1 billion in 2007, compared to U.S. exports of similar products to South Korea of $976 million. That meant a U.S. bilateral deficit in autos of $11.2 billion, growing over the long term from a deficit of $5.5 billion in 2000,

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[26] This stance is reflected in testimony by the National Cattlemen's Beef Association before the USITC on June 20, 2007.

[27] U.S. Dept. of Commerce. International Trade Administration. Office of Aerospace and Automotive Industries (Commerce Dept. OAAI). *U.S. International Trade Data for Road Motor Vehicles* series.

[28] Federal Reserve Bank of Atlanta. *EconSouth*, "West Point Restarts Its Engines" (1st Qtr. 2008), pp. 3,9.

and $1.5 billion in 1990.[29] Sang-yirl Nam, in an academic analysis of the effects of the proposed FTA, found in simulation models of projected market changes, Korea would always gain relative to the United States from bilateral liberalization, "because Korea has a comparative advantage over the United States in the automobile sector; in other words, Korea has been much more successful in accessing the U.S. market than the United States has been in accessing the Korean market."[30]

But Tom Walsh, writing in the *Detroit Free Press*, presents data to show that while the net U.S. bilateral automotive deficit will probably not decline substantially, the trends are favorable to the United States since 2004. Data attached to his article show that while the the total value of U.S. imports from Korea rose by less than 1% from 2004 to 2007, the total value of U.S. exports in the other direction nearly doubled (up 87%).[31]

South Korean policies that allegedly restrict imports of foreign-made motor vehicles have been a major target of U.S. trade policy. In 1995 and 1998, the USTR negotiated memoranda of understanding (MOUs) with South Korea, aimed at reducing formal and informal South Korean policies that were said to discriminate against imports of U.S.-made vehicles, and other foreign imports. U.S. policy primarily focused on motor vehicle taxation policies and South Korean motor vehicle standards, which supposedly did not conform to international standards, or those widely used in major markets.[32] The import share of the domestic market in South Korea has increased since the MOUs were signed — according to data calculated by CRS from standard industry sources cited above, total imports grew from a low of less than 1% of the market (5,000 units) in 2000 to a 3% market share by 2005.[33] But such a rate of progress has evidently been too slow for both the U.S. government and the domestically owned motor vehicle industry.

Automotive Trade Provisions in KORUS FTA. The Office of the USTR states that KORUS FTA, "Includes a broad and unprecedented range of focused provisions designed to open up Korea's auto market to U.S. cars and ensure that U.S. automakers have a fair opportunity to compete in Korea."[34] These provisions may be summarized as follows:

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[29] 2007 data from Commerce Dept. OAAI. Data for 1990 and 2000 quoted from CRS Report RL32883, Appendix 5.

[30] Sang-yirl Nam, "Implications of Liberalizing Korea-U.S. Trade in the Automobile Sector: Potential Impact of the Korea-U.S. Free Trade Agreement," Korea Economic Institute *Academic Paper Series*, III:1 (February 2008), p. 10.

[31] Tom Walsh, "Time for an Honest Chat About Trade," *Detroit Free Press* (April 24, 2008).

[32] CRS Report RL32883, p. 60.

[33] The USITC calculated a 2006 import market share of 4.2%, of which 60% was from Europe, 27% from Japan, and 7% from the United States. USITC. *U.S.-Korea Free Trade Agreement: Potential Economy-Wide and Selected Sectoral Effects*, Investigation no. TA-2104-24, USITC Publ. 3949 (September 2007), p. 3-74.

[34] Office of the USTR. "Free Trade with Korea: Summary of the KORUSFTA," *Trade Facts* (April 2007).

- *Elimination of most South Korean tariffs on U.S.-made motor vehicles.* "Korea would immediately eliminate its 8% tariff on U.S.-built passenger cars and its 10% tariff on pickup trucks,"[35] Tariffs would be immediately reduced to zero in each country for autoparts imported from the other.[36]

- *Reduction of alleged discriminatory effects of engine displacement taxes.* A major U.S. complaint has been that South Korea has a steeply ascending vehicle tax schedule, with very high rates on vehicles with larger engine capacities, such as might be exported by U.S. producers. Moreover, the tax system has a "cascade" effect, so that subsequent taxation rates incorporate, for example, the 8% duty paid on an imported vehicle. According to the U.S. International Trade Commission (USITC) report on the agreement, 76% of the South Korean market is in vehicles with engine displacement less than 2000 cc, with 54% in the range 1601-2000 cc.[37] Currently, the consumer pays a "Special Consumption Tax" on purchase of a vehicle: cars below 800 cc are exempt, cars in the next range up to 2000 cc pay 5%, anything larger is charged 10%. After an interim reduction period of three years, South Korea under the FTA would simplify this to a two-tier system: under 1000 cc tax-free, anything larger would be taxed at 5%. Besides this purchase tax, owners must pay an "Annual Vehicle Tax," also based on engine displacement. Currently, there are five different ranges in this system, and the owner of a vehicle with an engine larger than the 1600-2000 cc market "sweet spot" pays an extra 10% per cc ownership tax. South Korea has agreed to simplify the ranges to three: 80 won/cc below 1000 cc engine capacity, 140 won/cc up to 1600 cc, and 200 won/cc for anything larger.[38] Both of these changes would include the majority of domestically produced cars, as well as imports, in the highest tax bracket.

- *Standards harmonization and creation of an"Automotive Working Group."* U.S. manufacturers have complained that South Korea sets safety regulations and automotive product standards in a manner that is closed to outsiders and not transparent, and that consequently results in standards idiosyncratic to Korea. South Korean-based producers, who hold the lion's share of the domestic market, can afford to operate one line for domestic production, and another for export. Foreign companies have difficulty affording the high unit cost of customizing a small number of vehicles for the South Korean

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[35] USITC. *U.S.-Korea FTA*, p. 3-79 (Box 3.4).

[36] Office of USTR. *Report of Industry Trade Advisory Committee on Automotive and Capital Goods (ITAC 2)* (April 27, 2007), p. 2.

[37] Ibid., p. 3-76 (Table 3.16).

[38] Ibid., p. 3-78-8, incl. Box 3.4.

market.[39] This problem is addressed in the KORUS FTA (Chapter 9 — "Technical Barriers to Trade") and in an exchange of "confirmation letters" of June 30, 2007 between USTR Susan Schwab and South Korean Trade Minister Hyun Chung Kim. Essentially, the agreement provides for self-certification on safety and emissions standards for a limited number of U.S.-exported vehicles, and a commitment that South Korea will evaluate emissions using "the methodology applied by the State of California ..."[40] South Korea also agreed "not to adopt technical regulations that create unnecessary barriers to trade and to cooperate to harmonize standards."[41] Under terms of Annex 9-B, the two parties agree to create an "Automotive Working Group," which will meet at least annually, and will review and resolve "issues with respect to developing, implementing and enforcing relevant standards, technical regulations and conformity assessment procedures."[42]

- *Elimination of U.S. tariffs and "snapback" clause.* The major commitment on the U.S. side with respect to automotive trade issues is the elimination of all tariffs on South Korean-produced motor vehicles. The United States would immediately eliminate its 2.5% duty on gasoline-fueled passenger vehicles with engine displacement up to 3000 cc. It would also phase out the same rate of duty on South Korean imports with larger engine capacity or that are diesel-powered over three years. The 25% duty on pickup trucks, a residual rate dating from an earlier trade dispute with Europe, would be phased out on South Korean products over ten years.[43] However, the FTA, in Annex 22-A, also establishes a special bilateral dispute settlement panel, designed to resolve automotive issues within six months. "If panel finds a violation of an auto-related commitment or the nullification/impairment of expected benefits, the complaining Party may suspend its tariff concessions on passenger cars and assess duties at the prevailing MFN rate (i.e., 'snap-back' any tariff

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[39] Examples of how specific South Korean automotive standards discourage imports were provided by Stephen J. Collins, President of the Automotive Trade Policy Council, in testimony to the U.S. House. Committee on Ways and Means. Subcommittee on Trade (March 20, 2007), pp. 3-5. Dr. Thomas Becker of the German Verband der Automobilindustrie confirmed that European exporters confront the same problem in South Korea (CRS interview, March 12, 2007).

[40] Quoted from letter of South Korean Minister H.C. Kim to USTR Schwab (June 30, 2007), p. 1.

[41] USTR. "Summary," p. 2.

[42] USTR. *Text of U.S.-Korea Free Trade Agreement*, p. 9-9. The details of the FTA on automotive technical barriers are summarized in Office of the USTR. "Fact Sheet on Auto-Related Provisions in the U.S.-Korea free Trade Agreement," *Trade Facts* (April 3, 2007); and, USITC. *U.S.-Korea FTA*, p. 3-80 (Box 3.4).

[43] Ibid., Box 3.4.

reductions provided by the FTA)."[44] The USITC notes in its report that, "The dispute settlement provisions restrict the [U.S.] snapback penalty on light trucks ... to the rate for passenger cars, 2.5%," while South Korea could snap back to 8%.[45]

Expected Impact and Industry Reaction. The USITC simulation model of the KORUS FTA estimates that while U.S. automotive exports to Korea would increase by a range of 45% to 59%, this would only amount to about $300-400 million because of the low current baseline.[46] It states that tariff elimination "would likely have a positive effect on U.S. exports ... further, the overall tax burden on the South Korean consumer who purchases an imported vehicle would be reduced, more or less equalizing the total taxes paid on imported and domestic vehicles."[47] It particularly emphasizes the potential gain for U.S.-exported hybrid vehicles to Korea, though failing to note that most hybrids in the U.S. market today are imported from Japan.[48] However, as the Detroit-based U.S. manufacturers have plans to increase their hybrid fleets and there are no South Korean-produced hybrid vehicles at present, the U.S. manufacturers could have a head start on these products (assuming Japanese-owned companies in the United States do not also export hybrids from their incipient U.S. production to the South Korean market).

With respect to automotive imports from South Korea into the United States, the USITC simulation estimates an "increase by $1.3-1.7 billion (9-12%)." However, it also finds that "approximately 55-57% [would be] represented by diverted imports from other trade partners."[49] Jeffery Schott states that South Korea gave a "priority to eliminating the small U.S. tariff" primarily because of Japanese competition. Since 2001, the won has strengthened against the U.S. dollar, while the Japanese yen has weakened, creating a disadvantage in the U.S. market for Hyundai, whose vehicles must compete against Japanese companies' vehicles on price. One result has been reported significant declines in Hyundai earnings.[50] The USITC also notes plans by Hyundai to begin producing vehicles based on hybrid technology, indications that Hyundai and Kia were studying the development of pickup trucks, and actual exports of a small number of pickups to third markets by Ssangyong, a

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[44] USTR, "Auto-Related Provisions," p. 1; USITC. *U.S.-Korea FTA*, p. 3-80 (Box 3-4).

[45] Ibid., p. 3-82 and Box 3.4.

[46] Ibid., Table 2.2.

[47] Ibid., p. 3-78.

[48] Ibid.

[49] Ibid., pp. 2-12 and 3-82, and Table 2.2. Dr. Nam's simulations from the paper cited above produce somewhat more modest results. He estimates a net Korean export gain of about $900 million, a U.S. gain of about $130 million, leading to an increase in the U.S. bilateral deficit of about $770 million. As with the ITC findings, he concludes, "bilateral tariff elimination between Korea and the United States ... will increase the two countries' exports and imports of automobiles and parts at the expense of other countries;" p. 10.

[50] Jeffrey J. Schott. *The Korea-US Free Trade Agreement: A Summary Assessment.* Peterson Institute Policy Brief No. PB07-7 (August 2007). p. 4.

smaller producer.[51] Hyundai and Kia do already produce small pickup-type vehicles in Korea, but they would not appear to be suitable in design or style for the United States.[52]

U.S. industrial interests' views on KORUS FTA may be described as follows:

- The Detroit "Big Three" are split. Ford and Chrysler are opposed, while General Motors (GM) is neutral.
- Automotive parts suppliers were reported to support the FTA.
- Broader-based industry organizations are favorable, despite the opposition of two major motor manufacturers and some other sectoral groups.

These views were reflected in the April 2007 report of the Industry Trade Advisory Committee on Automotive and Capital Goods (ITAC 2) to USTR of April 2007. The chair noted that, "Generally, the manufacturers of capital goods see [the FTA] as an important milestone in providing market access to a country and region historically protectionist ... However, in terms of U.S. automotive equipment manufacturers, the outcome is mixed."[53]

Both the U.S. motor vehicle industry representatives and the whole of ITAC 2 initially recommended an "unconventional" approach on automotive issues in the negotiations. It would have "precondion[ed] the phase-out of U.S. automotive tariffs on the demonstration of South Korean market openness in terms of improved import penetration that is on par with that of other OECD countries."

Fifteen Members of Congress, including Representative Charles Rangel, chair of the House Ways and Means Committee, wrote President Bush on March 2, 2007, with a proposal along the lines of the "performance metric" approach suggested by ITAC 2. Their proposal would have delayed full elimination of the U.S. import tariff cut for at least 15 years, while U.S. representatives assessed South Korea's performance in opening its market to U.S. exports. A formula would be used each year to determine the number of South Korean-produced vehicles that would receive duty-free treatment in return. They also proposed a "snapback" safeguard provision on the U.S. tariff should South Korean imports in the U.S. market be judged to increase too rapidly. The 25% U.S. tariff on pickup trucks would remain in place, subject to a multilateral agreement on automotive trade at the World Trade Organization.[54]

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[51] USITC. *U.S.-Korea FTA*, p. 3-83.

[52] According to *Ward's Automotive Yearbook*, in 2006, Hyundai produced 98,000 "Porters," and Kia produced 72,000 "Bongos," both described as pickups.

[53] ITAC 2 report, p. 1.

[54] Letter to President George W. Bush from Reps. Rangel, Levin, Dingell, Kildee, Kind, Tauscher, Upton, Knollenberg, Candice Miller, McCotter, and Ehlers, and Senators Levin, Voinovich, Bayh, and Stabenow (March 1, 2007).

Despite the fact that the final agreement did "not include a performance metric approach," most ITAC 2 members supported KORUS FTA anyway.[55] The Ford Motor Company disagreed. In its statement appended to the report, Ford accepted that "some progress was achieved with respect to existing non-tariff barriers (NTBs)." But it noted that many of the exemptions for U.S.-made vehicles with respect to NTBs were very limited in volume or were temporary, that South Korea could continue to use a mix of U.S. and European standards, and that taxation rates were still exceptionally high for the types of product foreign companies would most likely export to South Korea. On the other hand, the immediate lifting of the U.S. 2.5% tariff on most South Korean imports would be a "lopsided benefit" that in effect "will reward South Korean manufacturers for 20 years of unfair trade practices by the South Korean Government."[56]

By contrast, a GM statement appended to the ITAC-2 report concluded that the proposed FTA "has addressed the auto industry's concerns." But "given the current imbalance in trade between the two countries," GM foresaw that in the "near term" South Korea would be the greater beneficiary, and therefore GM would be neutral on the agreement. It noted that tax policy changes promised by the South Korean government would reduce the overall burden on the automotive sector and that there were no caps on U.S.-exported vehicles meeting compliance with California emission standards, because South Korea committed to establish emission requirements on the same basis. GM also commented that the sector-specific "snapback" rule on tariff reductions was a unique and positive addition to U.S. FTAs.[57] It should be added that GM's position is probably influenced by the fact that it has become a major investor in the South Korean motor industry through its acquisition of Daewoo. Since the acquisition, GM has increased Daewoo production from 310,000 in 2003 to 1.3 million in 2007.[58] GM in 2007 sold 67,000 Chevrolet Aveos in the United States that were imported from its South Korean affiliate.[59]

The United Auto Workers (UAW) union is strongly opposed to the FTA, and its literature on the subject includes a joint statement of opposition issued together with the South Korean Metal Workers' Union (KMWU).[60] In testimony before the House Ways and Means Committee's Trade Subcommittee, UAW Legislative Director Alan Reuther endorsed the negotiating strategy proposed by Members of

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[55] ITAC 2 report, p. 2.

[56] "Ford Motor Company Assessment of the Automotive Provisions of the US-Korea FTA," appended to ITAC 2 report.

[57] "General Motors Corporation Assessment of the Automotive Provisions of the US-Korea FTA," appended to ITAC 2 report.

[58] Detroit News (*http://www.detnews.com*), "Korea Becomes GM's Global Growth Engine" (May 9, 2008).

[59] Automotive News, 2007automotive sales data.

[60] "KMWU-UAW Joint Declaration in Opposition the Proposed Korea-U.S. Free Trade Agreement," issued at Seoul, Korea (May 1, 2007), available at UAW website.

Congress, described above.[61] He stated that the final agreement as contemplated instead "would exacerbate the totally one-sided auto trade imbalance between South Korea and the U.S. and jeopardize the jobs of tens of thousands of American workers."[62] Reuther further criticized the labor rights record of South Korea as "very problematic." He noted "numerous areas of worker rights violations in South Korea," cited in the U.S. Department of State's 2005 *Country Reports on Human Rights Practices* and the arrest of the KMWU president in 2006 in a protest against government efforts to change South Korean labor laws in a manner unfavorable to the union movement there.[63] In a February 2008 speech in Washington, UAW President Ron Gettelfinger criticized the proposed FTA in these terms: "That's not free trade and that's not fair trade. That is the theft of American jobs."[64]

Both the management side and the labor side of the domestically owned U.S. automotive industry have used the word "unbalanced" to describe the benefits that may flow from the implementation of KORUS FTA. This may seem odd, given that the agreement has many provisions in various chapters dealing with specific South Korean policies and practices, and virtually none on the U.S. side, beyond the elimination of tariffs. This could be because the global competitive problems currently affecting the unionized, domestically owned sector of the U.S. motor vehicle industry go well beyond the scope of this FTA to solve.[65] Indeed, given major differences in the profiles of the U.S. and South Korean motor vehicle markets, it would appear unlikely that the Detroit Big Three, which tend to specialize domestically in the production of larger vehicles, could ever gain more than a fractional position there through exports from the United States. Thus, the UAW, Ford, and Chrysler oppose KORUS FTA as potentially only adding to the severe competitive pressure their side of the domestic U.S. industry is facing. GM has secured a solid investment position in South Korea that it is integrating into its global strategy. But possibly it may not want to antagonize its unionized U.S. employees, and has taken a neutral position.

Textiles and Apparel

Textiles and apparel are a small and dwindling portion of U.S. imports from South Korea. In 2006, textiles accounted for 2.2% of total U.S. imports from South

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[61] U.S. House of Representatives. Committee on Ways and Means. Subcommittee on Trade. Testimony of Alan Reuther (March 20, 2007), p. 3.

[62] Quoted from letter of Alan Reuther to all members of the House (April 18, 2007), p. 2. A similar letter was sent to all members of the Senate. It may be noted that, while all Detroit-based "Big Three" parts manufacturing and assembly plants are organized by the UAW or other unions, there are virtually no union-organized U.S. motor vehicle assembly plants operated by foreign-owned companies, including the Hyundai plant in Alabama; see CRS Report RL32883, pp. 37-43.

[63] Reuther testimony, pp. 6-7. The Reuther letters to the House and Senate makes the same point more briefly.

[64] *Detroit Free Press*, "South Korea Called Threat: UAW Chief Says Market Steals U.S. Jobs," February 4, 2008.

[65] See esp. Schott, pp. 5-6.

Korea and apparel accounted for 1.2%. In 2006, the United States imported $1.0 billion in apparel and $0.6 billion in textiles from South Korea. South Korea's shares of the U.S. market for textiles and apparel has shrunk in relative and absolute terms over the years. In 1991, for example, South Korea was the fourth largest source of U.S. imports of apparel with an 8.0% share, but by 2006, it had dropped to the 23rd largest source with a 1.2% share. This decrease came largely as the result of the surge in China's share of U.S. apparel imports, which grew from 15.1% in 1991, to 29.4% in 2006. South Korea's share of U.S. imports of textiles has held relatively steady. In 1991, South Korea was the 3rd largest source of U.S. textile imports with 8.4%but had dropped to the 4th largest source with 8.0% by 2006.[66] The United States exports small volumes of textiles and apparel to South Korea — $56.1 million of apparel and $231.4 million of textiles in 2006.[67]

KORUS FTA would eliminate U.S. tariffs immediately on 52% (in terms of value) U.S. imports of South Korean textiles and apparel, and would phase out U.S. tariffs on 21% over five years and on the remaining 27% over 10 years.[68] Currently, the average U.S. MFN tariff on textiles is 7.9% with a maximum applied tariff of 34.0% and with 16.1% of textiles categories already entering the United States duty free. The average applied U.S. MFN tariff on apparel imports is 11.5% with a maximum tariff of 32%, and 3.3% of the tariff lines entering duty free.[69]

The average South Korean applied tariff on textiles is 9.2% with a maximum of 13% and 0.3% of tariff lines entering duty free. The average South Korean tariff on apparel is 12.6% with none entering duty free and with a maximum tariff of 13%.[70] The KORUS FTA, would eliminate South Korean tariffs immediately on 77% (by value) of U.S. exports of textiles and apparel and would phase out tariffs on 13% over three years and the remaining 10% over five years.[71]

The KORUS FTA, with some exceptions, would use the yarn-forward rule of origin for apparel imports; that is, apparel made from yarn or fabric originating in either the United States or South Korea would be eligible for duty-free treatment under the FTA. The FTA also includes a special safeguard provision whereby, if imports of textiles or wearing apparel to one KORUS FTA partner country from the other increases at such a rate as to cause or threaten to cause serious injury to the domestic industry of the importing country, the importing country can suspend further reduction of tariffs, or it can increase the duty on the imported product to (the lesser of) the MFN rate applicable at the time the action was taken or the MFN duty

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[66] Calculations by Global Trade Information Systems, Inc. based on U.S. Department of Commerce data.

[67] Ibid.

[68] United States International Trade Commission. *U.S.-Korea Free Trade Agreement: Potential Economy-Wide and Selected Sectoral Effects.* USITC Publication 3949. September 2007. p. 3-52.

[69] World Trade Organization. Tariff Profiles 2006. Located at [http://www.wto.org].

[70] Ibid.

[71] USITC. p. 3-52.

that was in force when the FTA went into effect. The safeguard action can be in place for two years with a possible extension of two years but no more than a total of four years. However, the importing country will have to compensate the exporting country by making additional trade liberalizing concessions equivalent in value to the additional duties expected to result from the safeguard action. The concessions would be limited to textiles and apparel unless the two countries agree otherwise.

The USITC has estimated that, if implemented, the KORUS FTA would over time lead to an increase in U.S. imports of South Korean textiles of $1.7 billion to$1.8 billion and of apparel of $1.0 billion to $1.2 billion, with the major portion of the increase being diverted from other countries. The USITC also has estimated that KORUS FTA would lead to an increase in U.S. exports of textiles of $130 million to $140 million and of apparel of $39 million to $45 million to South Korea.[72]

The KORUS FTA would allow some fibers, yarns, and fabrics originating out side of the United States and South Korea to become eligible for preferential treatment if the product is not available domestically in commercial quantities in either country. The agreement also provides for the establishment of a Committee on Textile and Apparel Trade Matters to raise concerns under the FTA regarding mutual trade in these products.

The textile and apparel industry appears split on their views of the KORUS FTA according to the Industry Trade Advisory Committee on Textiles and Clothing (ITAC-13).[73] Some representatives of the textile producers support the yarn-forward rule as benefitting their industry and also conforming to provisions in other U.S. FTAs but also argue that it should be broader by including sewing thread, narrow fabrics and pocketing fabrics, which are excluded from the rule. Others, including some textile representatives and representatives from the apparel industry with supply chains in other countries, have criticized the yarn-forward rule as being restrictive and limiting trade opportunities

Members of the industry are also divided on the lack of cumulation provisions in the FTA, that is provisions which allow preferential treatment for limited amounts of apparel woven from components outside the FTA area. Textile producers supported the lack of cumulation provisions while apparel producers would have wanted them included. They also split on the phase-out periods for tariffs with textile producers arguing that some sensitive products were given immediate duty-free treatment. Apparel producers argued that all apparel and textiles should have been given immediate duty-free treatment. Footwear and travel goods are also covered under the FTA. Producers of both categories strongly support the FTA and how their products would be treated.[74]

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[72] Ibid. p. 3-53.

[73] Report of the Industry Trade Advisory Committee on Textiles and Clothing (ITAC-13) on the South Korea/U.S. (KORUS) Free Trade Agreement. April 27, 2007.

[74] Ibid.

Other Manufactured Goods

The provisions of KORUS FTA affect a wide range of other industries beyond the automotive sector and textiles and apparel. Cross-sectoral trade associations that represent broad ranges of U.S. manufacturers have indicated their support for the agreement, not only because of the general elimination of South Korean tariffs on U.S. exports, but also because of such provisions as those promising to increase cooperation in the reduction of technical barriers to trade and the improvement in South Korea of the protection of U.S. companies' intellectual property rights.[75] Similarly, most sectoral trade associations expressed support, although some noted reservations with specific provisions.[76] The steel industry in particular was a notable dissenter.

Capital Goods Machinery and Equipment. U.S. machinery exports could be the largest single sectoral gainer from the FTA with South Korea. According to the US ITC's simulation analysis, the sector stands to gain nearly $3 billion in exports if the agreement is approved.[77] The tariffs on U.S. machinery and equipment imported into South Korea range from 3% to 13%, but U.S. products are already competitive in many cases, and already account for 15-20% of total South Korean imports. (A specific example is U.S.-made computer-numerically controlled machine tools.) Most machinery tariffs would be immediately eliminated; others would be phased out over three to ten years.[78] As noted in the previous section on autos, the capital goods machinery industry representatives in ITAC 2 split with the motor vehicle industry representatives and supported the agreement. The ITAC report specifically cited, "U.S. manufacturers of electrical equipment [who] will benefit substantially by South Korean tariff reductions and eliminations, where the sector has already returned to running a trade surplus with South Korea."[79] The USITC report further noted the export potential of electrical-power generating equipment, for which South Korean duties range up to 8% currently. U.S. exporters are nonetheless already leading suppliers of turbines, generators and nuclear reactors to South Korea.[80] The National Electrical Manufacturers Association (NEA) stated that U.S. exports to South Korea had risen steadily, by a total of 62%, since 2002, and that there was a U.S. surplus in bilateral trade. It calls for:

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[75] National Association of Manufacturers (NAM). "Support the U.S.-Korea Free Trade Agreement," *ManuFacts*(September 2007); U.S. Chamber of Commerce, "Chamber Welcomes Announcement of U.S.-Korea Free Trade Agreement" news release 07-57 (April 2, 2007), and "U.S. Chamber Welcomes Signing of U.S.-Korea Free Trade Agreement" news release 07-126 (June 30, 2007); Business Roundtable, "Business Roundtable Applauds Deal on U.S.-Korea Trade" (April 2, 2007).

[76] Thus, in its submission to the ITC, the NAM indicated, "the FTA is not perfect and noted concerns expressed by U.S. automakers about the FTA's tariff and nontariff provisions and the questions raised by the U.S. steel industry about trade rules and other barriers." USITC. *U.S.-Korea FTA*, p. 3-73.

[77] Ibid., Table 2.2.

[78] Ibid., pp. 3-68 and 3-71.

[79] ITAC 2, p. 1.

[80] USITC. *U.S.-Korea FTA*, p. 3-71.

> ... Legislators in both countries to ratify the Agreement as soon as possible. While the U.S. electrical equipment industry still has concerns relating to non-tariff barriers and intellectual property protection in South Korea, the overall FTA package would improve conditions for selling there by featuring the elimination — most of it immediate — of remaining tariffs on goods in NEA's product scope.[81]

Another major capital goods item in which the United States has a strong bilateral trade position is aircraft. Total 2006 aircraft and parts exports to South Korea were $2.4 billion. However, civilian aircraft imports are already duty-free in South Korea.[82]

Electronic Products and Components. Both South Korean and U.S. tariffs on most electronics products, such as semiconductors, telecommunications equipment, and computers, are already zero, as they are included in the multilateral Information Technology Agreement eliminating tariffs among more than 50 countries. The United States already has a substantial surplus with South Korea in semiconductors: $4.3 billion in 2006 exports, versus $2.9 billion in imports. The United States has a small deficit in computer equipment, plus large imports of computer and office equipment parts and accessories ($2.1 billion) and communications equipment ($5.6 billion).[83]

Sectoral organizations representing these industries supported KORUS FTA. It was argued the FTA would extend tariff-free treatment to consumer electronics products and could guarantee improvements for U.S. products in South Korea with respect to intellectual property protection, technical barriers, government procurement and competition policy.[84]

One information technology organization supportive of KORUS FTA, the Semiconductor Industry Association, did caution that the trade remedies chapter of KORUS FTA could undermine U.S. industry's use of antidumping and countervailing duty (AD-CVD.) laws (see below). In 2003, the USITC found that Micron Corporation, the last remaining U.S.-based producer of dynamic random access mode semiconductors (DRAMs, widely used as memory chips in computers) was materially injured by government-subsidized DRAM semiconductors produced by Hynix Corporation of Korea. The Commerce Department subsequently established a 44% penalty tariff on Hynix DRAMs imported into the United States.[85]

Steel. The American steel industry registered a strongly negative position on KORUS FTA through its industry advisory body to USTR, ITAC 12 (Steel). Its report noted that the agreement "does not provide for changes in U.S. AD-CVD

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[81] NEMA. "U.S.-South Korea Free Trade Agreement," *NEMA Issue Brief* (April 2007).

[82] USITC. *U.S.-Korea FTA*, p. 3-68 and Table 3.13.

[83] Ibid., Table 3.13.

[84] Ibid., pp. 3-68 through 3-73.

[85] USITC Investigation no. 701-TA-431. *Federal Register*, XVIII: 154 (August 11, 2003), pp. 47546-7, 47607.

statutes" and that each party retains its full rights under World Trade Organization rules. However, ITAC 12 objected to "changes to the related legal processes" in the KORUS FTA chapter on trade remedies with respect to three "key areas:"

- By Article 10.7.3, parties are required to notify each other whenever an AD-CVD application is filed, and prior to initiation of a formal investigation. They must afford the other government an opportunity to consult on the application. The steel industry objects to "improperly politicizing] the consideration of a trade remedy provision filed by a U.S. industry, in a process that is already transparent and open," particularly in antidumping cases.

- In Article 10.4, either party must afford to the other an adequate opportunity for, and due consideration of price undertakings by respondent companies, "which, if accepted may result in suspension of an investigation" without imposition of penalty duties. The steel industry is concerned that the provision "would encourage the use of suspension agreements and the injection of foreign governments into the trade law process."

- The steel industry opposes the provision to establish a bilateral Commission on Trade Remedies (Article 10.8) as "unprecedented, unnecessary and would provide yet more opportunities for South Korea to weaken U.S. trade law enforcement."[86]

The specific details of the trade remedies chapter are discussed elsewhere in this report. Beyond these specific issues ITAC 12 also made a number of other critical points. It argued that the rules of origin provisions did not follow earlier precedents and there were concerns with products eventually being produced in the Kaesong Industrial Complex of North Korea. (See the section on the Kaesong Industrial Complex.) It objected to the proposed KORUS FTA's ignoring currency manipulation issues. They also supported their U.S. automotive customers' view that the FTA failed to insure adequately access to the South Korean market for U.S.-made motor vehicles. On these grounds, "especially with regard to the proposed AD-CVD provisions, ITAC 12 cannot conclude at this time that the KORUS FTA promotes the economic interests of the United States and provides for equity and reciprocity within the steel sector."[87]

Pharmaceuticals and Medical Devices

While pharmaceuticals and medical devices (P&M) are a relatively small part of U.S.-South Korean trade, they are products in which U.S. producers compete well in the South Korean market and ones in which manufacturers see increasing export opportunities as the South Korean economy matures. For years, the U.S. industry and government have complained about a number of South Korea's pharmaceutical

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[86] Office of the USTR. Industry Trade Advisory Committee on Steel (ITAC 12). *The U.S.-Korea Free Trade Agreement* (April 27, 2007). Main views are summarized in pp. 1-2.

[87] Ibid., p. 2.

policies that allegedly are designed to protect South Korean industry, which predominately produces generic drugs.

South Korea is among the world's top 12 largest markets for pharmaceuticals, accounting for about $8 billion in sales annually.[88] The South Korean market for medical devices accounts for roughly $2.5 billion in sales annually and is expected to grow 10-15 % each year in the next several years, in part due to the rapid aging of the population.[89] While potentially lucrative, South Korea is a market in which U.S. P&M manufactures claim government regulations have limited their ability to penetrate that market.

In 2006, the United States exported $493 million in medical devices to South Korea, accounting for 2.1% of total U.S. exports of those products and 1.5% of total U.S. exports to South Korea. In 2006, the United States exported $325 million in pharmaceuticals to South Korea accounting for 1.0% of total U.S. exports of pharmaceuticals and 1.0% of total U.S. exports to South Korea. In the same year South Korea exported $214 million in medical devices and $61 million in pharmaceuticals to the United States.

Of major concern was the South Korean government's May 2006 change in how it determined reimbursement amounts. Prior to the change, it maintained a "negative list" system, under which products would be eligible for reimbursement unless they appeared on the list. With the change, the South Korean government has switched to a "positive list" requiring a product to be listed before it would be eligible making it potentially more difficult for a product to become eligible. Announcement of the policy came without prior notification to U.S. officials or affected U.S. manufacturers and occurred at an early point in the negotiations placing a cloud over them. Despite complaints from the United States, South Korea went ahead with implementing its positive list system.

P&M manufacturers also have cited the South Korean government's policies on reimbursements for pharmaceuticals and medical devices under its single-payer health insurance program. U.S. manufacturers have argued that the policies discriminate against innovative pharmaceuticals because they establish relatively low reimbursement amounts for medicines thus not taking into account the costs that producers of leading-edge pharmaceuticals incur and that are reflected in higher prices. The manufacturers wanted the KORUS FTA to establish transparency as an important principal in South Korea's development and implementation of reimbursement policies, including an appeal process for decisions going against U.S. manufacturers.

In response, South Korea agreed in the KORUS FTA to allow U.S. pharmaceutical makers to apply for increased reimbursement levels based on safety and efficacy. South Korea also agreed to publish proposed laws, regulations, and procedures that apply to the pricing, reimbursement, and regulation of pharmaceuticals and medical devices in a nationally available publication and to

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[88] USITC. p. 3-64.

[89] Ibid. p. 3-91.

allow time for comment. In addition, South Korea agreed to establish a process for U.S. manufacturers to comment on proposed changes in laws and regulations and for them to obtain a review of administrative determinations that adversely affect them.

Intellectual property rights protection in South Korea has been a critical issue for U.S. pharmaceutical manufacturers. Specifically, the failure of the South Korean government to protect from competitors proprietary data that manufacturers must submit for market approval. 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.[90] In part for these reasons, the USTR has continued to place South Korea on the special 301 "Watch List."[91]

In response, under the KORUS FTA's data exclusivity provisions, South Korea would not allow a third company, such as a generic drug manufacturer, from marketing a new pharmaceutical using the safety and efficacy data, supplied by an original U.S. manufacturer as part of the market approval process, without the permission of the original U.S. maker for five years from the date of marketing approval for the original product. In addition, if a third party submits safety or efficacy information for a product that an FTA partner government had already approved, the government is to notify the original patent holder of the identity of the third party and is to prevent the marketing of the third party's product on its territory if permission had not been granted by the original patent holder. In a side letter, the United States and South Korea agreed to not invoke the data exclusivity provision until the FTA has been in effect 18 months. Furthermore, South Korea agreed of a patent-linkage system; that is, neither government is to approve the marketing to a generic drug while the original patent is still in effect. Another provision, known as patent-term extension, would require each FTA government to adjust the length of the effective period for patents on pharmaceuticals to take into account delays incurred in receiving patent approval and marketing approval. The KORUS FTA states that no provision would prevent either government from taking measures to protect the public health of its residents from HIV/AID, tuberculosis, malaria, and other epidemics, by ensuring access to medicines. The FTA would reaffirm each country's commitment to the WTO TRIPS/heath Declaration.

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[90] 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. p. 6.

[91] Office of the USTR. *Special 301 Report.* April 2007. "Special 301" refers to Section 182 of the Trade Act of 1974. Since the start of the Special 301 provision in 1989, the USTR has issued annually a three-tier list of countries judged to have inadequate regimes for IPR protection, or to deny access: (1) priority foreign countries are deemed to be the worst violators, and are subject to special investigations and possible trade sanctions; (2) priority watch list countries are considered to have major deficiencies in their IPR regime, but do not currently warrant a Section 301 investigation; and (3) watch list countries, which maintain IPR practices that are of particular concern, but do not yet warrant higher-level designations. See CRS Report RL34292, *Intellectual Property Rights and International Trade*.

Reactions within the pharmaceutical and medical devices industries were somewhat split on the KORUS FTA. Makers of innovative products supported the provisions that are designed to preserve the rights of patent holders and provisions that are designed to make the South Korean regulatory, pricing, and reimbursement process more transparent and open to comments and procedural reviews. At the same time, industry representatives remain critical of South Korea's new reimbursement procedures and argue that the new system does not take into account the benefits of innovative drugs that cause drug prices to be higher. Generic drug manufacturers argue that the KORUS FTA does not contain provisions guaranteeing the availability of affordable drugs.[92]

Financial and Other Services

South Korea was the seventh largest U.S. market for cross-border trade in services in 2006.[93] U.S. service providers exported $12.4 billion in services to South Korea. Among them were South Korea travel to the United States ($2.8 billion) other transportation, such as freight services ($2.8 billion); royalties and license fees ($2.1 billion); and other private services, such as professional services, business services, banking, insurance, and other financial services ($3.8 billion).[94] However, this amount probably undervalues the total volume of U.S. sales of services to South Korea as services are also sold through three other modes of delivery: by U.S. companies with a long-term presence in South Korea, by U.S. providers to South Korean residents located temporarily in the United States; and by U.S. providers temporarily located in South Korea.

In 2006, the United States imported $8.2 billion in services, including other transportation ($3.2 billion), U.S. travel to South Korea ($1.4 billion), expenditures by U.S. military ($1.7 billion), and other travel ($1.0 billion).[95] This figure does not include services sold to U.S. residents by South Korean firms through the other modes of delivery.

U.S.-South Korean trade in services cuts across several chapters of the KORUS FTA — Chapter 12 (cross-border trade in services); chapter 13 (financial services); and Chapter 15 (telecommunications); chapter 11 (foreign investment); among others. A major U.S. objective in the KORUS FTA negotiations was to obtain South Korean commitments to reduce barriers to trade and investment in its services sector, especially in professional, financial, and telecommunications services. A South Korean goal was to get the United States to ease restrictions on the issuance of visas for South Korean business representatives. The visa issue — along with South Korea's request to be added to the Visa Waiver program — was addressed in

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[92] Report of the United States Industry Trade Advisory Committee for Chemicals, Pharmaceuticals, Health/Science Products, and Service (ITAC-3) on The United States-South Korea Trade Promotion Agreement. April 24, 2007.

[93] Ibid., 4-1.

[94] Data obtained from U.S. Department of Commerce. Bureau of Economic Analysis.

[95] Ibid.

discussions outside of the KORUS FTA negotiations. (For more information on the visa waiver issue, see Appendix C.)

In general the two countries would commit to:

- provide national treatment and most-favored-nation treatment to the services imports from each other;
- promote transparency in the development and implementation of regulations in services providing timely notice of decisions on government permission to sell services;
- prohibit limits on market access, such as a caps on the number of service providers, on the total value of services provided, on the total quantity of services provided, and on the total number of persons that can be employed by services providers;
- prohibit foreign direct investment requirements, such as export and local content requirements and employment mandates; and
- prohibit restrictions on the type of business entity through which a service provider could provide a service.

U.S. and South Korean negotiators agreed to several concepts under the KORUS FTA that could apply the agreements provisions to a broad scope of services. The two countries agreed to the "negative list" approach in making commitments in services. That is, the KORUS FTA is to apply to all types of services unless identified as an exception in the relevant annexes. In addition, the commitments are racheted — when new services emerge in the U.S. or South Korean economies, those services are automatically covered by the FTA unless identified as an exception; if either country unilaterally liberalizes a measure that it had listed as an exemption, it is automatically covered under the FTA. Furthermore, if one KORUS FTA partner extends preferential treatment to service providers from a third country under another FTA, it is to extend the preferential treatment to its KORUS FTA partner.

The United States sought greater reciprocity in the treatment of **professional services** and thereby gain increased access to the South Korean market for U.S. providers. The United States and South Korea agreed to form a professional services working group to develop methods to recognize mutual standards and criteria for the licensing of professional service providers. Under the KORUS FTA, South Korea would allow U.S. law firms to establish representative offices in South Korea no later than two years after the KORUS FTA entered into force. South Korea would also permit U.S. legal representative offices to establish cooperative operations with a South Korean firm to handle matters pertaining to domestic and foreign legal matters, and, no later than five years after the agreement's entry into force, would allow U.S. law firms to establish joint ventures with South Korean firms. However, South Korea would still reserve the right to restrict the activities of foreign lawyers.

Regarding **financial services**, under the KORUS FTA, if a domestic provider in one partner country develops and sells a new financial service in its home market, providers from the FTA partner country would be able to sell a like service in that market. The agreement would allow an FTA partner government to impose restrictions on the sale of financial services by providers from the other partner country for prudential reasons, for example, to protect investors, depositors, policy

holders, or persons to whom a fiduciary duty is owed. The FTA would also permit either partner government to restrict monetary transfers in order to ensure the soundness of financial institutions.

The South Korean **insurance** market is the seventh largest in the world. The USITC estimates, therefore, that U.S. insurers would be poised to obtain sizeable gains in a liberalized South Korean services market.[96] U.S. insurance companies have been concerned that the state-owned Korea Post and the cooperative insurance providers — the National Agricultural Cooperative Federation and the National Federation of Fisheries Cooperative — are not regulated by the Korean Financial Supervisory Commission or by the Financial Supervisory Service, while both private-sector foreign and domestic providers are so regulated.[97] Under the KORUS FTA, South Korea agreed that those entities would be subject to an independent state regulator as opposed to being self-regulated.[98] In addition, Korea Post would not be allowed to offer new insurance products. The two countries would allow a partner country financial services provider to transfer electronically information from its territory as necessary in the course of doing business.[99] This is a provision that the U.S. industry highlighted as being particularly important.

In **telecommunications services**, South Korea would reduce government restrictions on foreign ownership of South Korean telecommunications companies. Two years after the KORUS FTA enters into force, U.S. companies would be able to own up to 100% of voting shares in domestic South Korean telecommunications companies, and those companies would be able to own up to 100% of a facilities-based licensee.[100] These provisions do not apply to KT Corporation nor to SL Telecom Co for which a 49% foreign ownership limit would remain. In addition, each KORUS FTA partner would ensure that telecommunications providers from the other would have access to and use of its public telecommunications network for purposes of interconnection under non-discriminatory conditions and would guarantee dialing portability among other conditions.[101]

Those who represent U.S. services providers have been enthusiastic about the KORUS FTA and have urged its approval. In a statement, Robert Vastine, President of the Coalition of Services Industries claimed:

> We commend Ambassador Schwab and the team of negotiators who secured significant benefits for U.S. services providers in this agreement.... Korea is a key market for U.S. service companies, and this is a very high-quality agreement

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[96] USITC. p. 4-8.

[97] Office of the United States Trade Representative. *2007 National Trade Estimates Report — Foreign Trade Barriers.* p. 366.

[98] The United States-Korea Free Trade Agreement (KORUS FTA). Report of the Industry Trade Advisory Committee on Services and Finance Industries (ITAC 10) April 2007.

[99] The Free Trade Agreement Between South Korea and the United States (KORUS FTA). Chapter 13 (Financial Services) — Confirming Letter.

[100] Annex -I (Korea)

[101] KORUS FTA Chapter 14 Telecommunications.

that merits swift passage by the Congress because it creates new commercial opportunities that will support new jobs.[102]

General Provisions

The KORUS FTA text contains a number of provisions that cut across in many sectors in bilateral trade. Many of these provisions have become standard fare and have become part of the template for FTAs in which the United States participates.

Trade Remedies

Trade remedies, laws and actions designed to provide relief to domestic industries that have been injured or threatened with injury by imports, are regarded by many in Congress as an important trade policy tool to mitigate the adverse effects of lower priced imports on U.S. industries and workers.

The three most commonly used trade remedies are *antidumping* (AD), *countervailing duty* (CVD), and *safeguard* actions. Antidumping (19 U.S.C. § 1673 *et seq.*) actions provide relief from the adverse impact of imports sold at prices shown to be less than fair market value, and countervailing duty (19 U.S.C. § 1671 *et seq.*) actions provide similar relief from goods that have been subsidized by a foreign government or other public entity. Safeguard actions (19 U.S.C. § 2251 *et seq.*) are designed to give domestic industries an opportunity to adjust to new competition and are triggered by import surges of fairly traded goods. The relief provided in a safeguard case is a temporary import duty, temporary import quota, or a combination of both, while the relief in an antidumping or countervailing duty action is an additional duty placed on the dumped or subsidized imports. These actions are authorized by the WTO as long as they are consistent with the rights and obligations of Article XIX of the General Agreement on Tariffs and Trade (GATT) 1994, the WTO Agreement on Safeguards and Countervailing Measures (Subsidies Agreement), and the WTO Agreement on Implementation of Article VI of the GATT 1994 (Antidumping Agreement).[103]

Many Members of Congress have expressed support for maintaining and strengthening U.S. trade remedy laws in the face of growing import competition. As a result, the preservation of U.S. authority to "enforce rigorously its trade laws" was a principal negotiating objective included in presidential Trade Promotion Authority (TPA) in the 107th Congress.[104]

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[102] Coalition of Service Industries. *Coalition of Service Industries Expresses Strong Support for U.S.-Korea FTA; Urges Swift Congressional Passage.* Press release. June 30, 2007.

[103] For more information, see CRS Report RL32371, *Trade Remedies: A Primer*, by Vivian C. Jones.

[104] P.L. 107-210, Trade Act of 2002, Section 2102(b)(14).

According to news reports, the "single most important South Korean demand" in the bilateral talks was changes to U.S. antidumping rules..[105] This may be due, in part, to the significant number of U.S. trade remedy cases brought by U.S. industries on South Korean goods. As of July 15, 2007, antidumping duties were being collected on 15 South Korean imports (mostly on stainless steel specialty products such wire rod and pipe fittings), and countervailing duties were being assessed on 5 South Korean products, while South Korea had 2 antidumping measures in place against U.S. products.[106] The U.S. global safeguard cases imposed on steel in February 2000 (line pipe) and March 2002 (many steel products) also significantly reduced South Korean steel imports to the United States.[107] Of the 13 WTO dispute resolution complainant cases South Korea has brought to date, seven have been disputes against U.S. trade remedy actions.[108] South Korea is also a member "Friends of Antidumping" group in the WTO Doha Round that insists on implementing changes to the Antidumping and Subsidies Agreements in any new multilateral agreement.

In the bilateral negotiations between the United States and South Korea, talks broke down in early December 2006 when South Korea presented the United States with a list of specific changes to U.S. antidumping laws on a "basically" take-it-or-leave-it basis,[109] but in mid-January 2007, South Korean officials softened their stance after accepting the assurances of U.S. negotiators that Trade Promotion Authority had granted the Bush Administration only limited flexibility to make concessions on trade remedy issues.[110]

The KORUS FTA, just as in earlier FTAs the United States has entered into, proposes that each party to the agreement would retain all rights and obligations under the WTO agreements — meaning that the trading partners would be permitted to include each other in global safeguard actions (although, as in other FTAs, it does

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[105] "South Korea Retracts Key Demand in Anti-Dumping Rules: Leaked Government Report," *Yonhap* (South Korea), January 19, 2007.

[106] USITC. "Antidumping and Countervailing Duty Orders In Place As of July 20, 2007, by Country." Available at [http://www.usitc.gov]. Korea Trade Commission, TR Measures, available at [http://www.ktc.go.kr/en/kboard_child/list.jsp?bm=86&pg=1].

[107] Schott, Jeffrey J., Bradford, Scott C., and Moll, Thomas. *Negotiating the Korea - United States Free Trade Agreement,* Institute for International Economics, June 2006.

[108] World Trade Organization dispute settlement statistics, [http://www.wto.org/english/tratop_e/dispu_e/dispu_by_country_e.htm]. South Korea was one of the complainants in the WTO dispute brought against the U.S. safeguard measures on steel, as well as that against the Continued Dumping and Subsidy Offset Act ("Byrd Amendment").

[109] "Cutler says U.S.-Korea Talks Hit Snag in Three Negotiating Groups, *FDA Week*, December 8, 2006. Although the particulars of South Korean demands were not made public, according to news reports, one of Korea's demands was to be excluded from the cumulation of imports used to determine injury in a safeguards case, if its share of imports into the U.S. are below a certain threshold.

[110] "South Korea Retracts Key Demand on Anti-dumping Rules: Leaked Government Report." *Yonhap*, January 19, 2007.

extend a possible exemption from global safeguard measures to either party if its imports are not a substantial cause of serious injury) and to implement AD and CVD actions against each other. Additionally, as in earlier FTAs, the trade remedies article would also authorize either party to the agreement to apply a transitional safeguard measure against imports of the other party if, as the result of the reduction or elimination of a duty mandated by the agreement, a product is being imported in increased quantities as to be a substantial cause of serious injury to a domestic industry that produces a like or directly competitive good.[111]

In the case of a safeguard, the party imposing it must provide a mutually agreed-upon amount of compensation. If the parties do not agree, the other party may suspend concessions on imports of the other party in an amount that has trade effects substantially equivalent to the safeguard measure.[112]

As such, the agreement does not seem to require any changes to U.S. AD, CVD, or global safeguard laws, or substantially change administrative procedures required to implement these actions.[113] However, in an apparent departure from previous FTAs, the KORUS FTA seems to require a few additional administrative steps prior to initiation of a trade remedy investigation involving goods from the other party. First, each party would have to notify the other if an antidumping petition is received regarding the other party's imports, as well as provide an opportunity for a meeting between the parties before an investigation is initiated.[114] Additionally, the party initiating an AD or CVD investigation would be required to provide written information regarding its procedures for negotiating a price or quantity undertaking (known in U.S. law as a suspension agreement[115]), and, after a preliminary affirmative determination is reached, "provide due consideration and adequate opportunity for consultations regarding proposed price undertakings" which could result in suspension of the investigation without imposition of duties provided a mutually agreeable undertaking is reached.[116]

The KORUS FTA would also establish a Committee on Trade Remedies (which would meet at least once a year) made up of representatives from each party who have responsibility for trade remedies matters. Committee functions would include enhancing knowledge of the parties' trade remedy laws and practices, overseeing the implementation of the trade remedies chapter of the agreement, improving

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[111] See Chapter 10, Section A, Article 10.1 Application of a Safeguard Measure and Article 10.5 Global Safeguard Actions.

[112] Article 10.4, Compensation.

[113] USITC. *U.S. Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects.* Publication 3949, September 2007, p. 6-1.

[114] Chapter 10, Section B. Antidumping and Countervailing.

[115] CVD: 19 U.S.C. 1671c; AD: 19 U.S.C. 1673c. Under these statutes, a quantitative restriction or price offset suspension agreement must completely eliminate the injurious effect of the dumping or subsidy, must be in the public interest and must be able to be effectively monitored by U.S. authorities.

[116] Chapter 10, Section B. Antidumping and Countervailing Duties, Article 10.7, paragraphs 3 and 4.

cooperation between the parties, developing educational programs on trade remedy laws, and providing a forum for exchange of information on trade remedies and other topics of mutual interest.[117]

As discussed earlier, the Industry Trade Advisory Committee on Steel (ITAC 12), believes that the procedural concessions made on trade remedies could politicize trade remedy actions, thus possibly weakening U.S. trade laws. In particular, the ITAC 12 stated that the U.S. AD-CVD investigative process is already transparent and that the pre-initiation notification and consultation requirements would delay and politicize the process.[118] It also objected to the "undertakings" provisions, saying that these provisions would encourage the use of suspension agreements and introduce actions of foreign governments into trade remedy procedures.[119] (For more information on the steel industry's reaction, see discussion in section on "Other Manufactured Goods.")

The ITAC 12 also opposes the establishment of a Committee on Trade Remedies, saying that it such a forum would give South Korea an opportunity to attempt to further try to weaken U.S. trade remedy laws.[120] Speaking in April 2007, Assistant U.S. Trade Representative for Korea, Japan, and APEC Wendy Cutler, the chief U.S. negotiator, implied that the consultative committee would focus on information sharing and "will not provide a forum to discuss specific cases."[121] She also mentioned that the committee could be a benefit to the United States by providing a platform for discussing certain industrial subsidies that the South Korean government may be supplying to manufacturing firms, and that negotiators worked out an "accommodation" that was beneficial to both sides' needs on a very contentious part of the negotiations.[122]

Kaesong Industrial Complex[123]

A consistent and significant goal for South Korea in the FTA talks was securing preferential treatment for products made in the Kaesong Industrial Complex (KIC) in North Korea, a position the United States adamantly throughout most of the negotiations. 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. The factories of 15 South Korean manufacturing firms began operating when the site opened in 2004. As of November 2007, this number had increased to 52 firms, which employed about 20,000 North

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[117] Chapter 10, Section C. Committee on Trade Remedies, Article 10.8, paragraph 2.

[118] ITAC (12) on Steel, Advisory Committee Report, April 27, 2007, p. 7.

[119] Ibid, p. 4

[120] Ibid.

[121] "Trade Remedy Piece of Korea FTA Ignores Korean AD Demands," *Inside U.S. Trade*, April 13, 2007.

[122] Ibid.

[123] For more, see CRS Report RL34093, *The Kaesong North-South Korean Industrial Complex*, by Dick Nanto and Mark Manyin.

Korean workers. There are plans to expand the zone dramatically. The South Korean Unification Ministry expects that by the end of 2010, about 450 South Korean manufacturers and 100,000 North Korean workers will be in the KIC.[124] The KIC arguably has become the centerpiece for South Korea's "sunshine policy" of engaging North Korea.

In the final KORUS FTA agreement, the two sides reached a compromise on the KIC. One year after the KORUS FTA enters into force, a binational committee will be formed to study the possibility of eventually including products from "Outward Processing Zones" (OPZs) using North Korean labor sometime in the future.[125] The agreement identifies three general categories for which the committee is to develop more detailed criteria: progress in the denuclearization of North Korea, developments in intra-Korean relations; and wages, the environment, and labor standards. For the third category of issues, the committee is to consider relevant international norms as well as the "situation prevailing elsewhere on the Peninsula." After the committee has developed criteria, the OPZ provisions in the FTA lay out a three step process by which products made in the KIC could be incorporated into the FTA. First, the committee must deem that an outward processing zone meets the criteria it has established. Second, the two governments must agree that the FTA should be amended accordingly. Third, each government must seek "legislative approval for any amendments to the Agreement with respect to outward processing zones." The agreement does not lay out the size or composition of the committee, or how committee members will be chosen, or the procedures by which the committee is to arrive at decisions.[126]

In the KORUS FTA negotiations, the United States backed away from the principle of its initial position of not ever expanding the KORUS FTA to North Korea-made products, a significant achievement for South Korea. At the same time, the United States appeared to give up little in substance in the near-to-middle term. The United States apparently would be able to control the decision to and pace of any move to grant preferential treatment to North Korea-made products. Any perceptions of foot-dragging by the United States, however, may come at a diplomatic price if future South Korean governments push for more rapid integration of North Korean industrial zones into the FTA.

Two important issues for the United States in considering South Korea's demand were 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 at Kaesong are far better than those in the rest of North Korea. Additionally, the

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[124] Ministry of Unification, "Current Status of Operation in the Gaeseong Industrial Complex," November 23, 2007.

[125] Chapter 22, Annex B, Committee on Outward Processing Zones on the Korean Peninsula.

[126] April 2007 interviews with U.S. and Korean officials; remarks by Assistant U.S. Trade Representative for Japan, Korea and APEC Affairs Wendy Cutler at an April 5, 2007 Korea Economic Institute forum; "Behind the Korea FTA Negotiations," *Washington Trade Daily*, April 12, 2007.

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*). To date, these revenue streams are likely to be relatively small, though not insignificant, given the small size of the North Korean economy and its shortage of hard currency. If the most ambitious goals for the Kaesong project are realized, by the middle of the next decade the North Korean government would likely derive tens if not 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.[127] Some South Koreans caution that the uncertainties over the future course of the KIC project make such projections highly speculative.

Foreign Investment

Foreign investment is becoming an increasingly significant element in the U.S.-South Korean bilateral economic relationship. Over the past 10 years, the stock of U.S.-South Korean foreign direct investment (FDI), valued on an historical cost basis, has increased substantially, due in no small part to the market-oriented reforms South Korea undertook after its 1997 financial crisis. In 1997, the value of stock of U.S. FDI in South Korea was $6.5 billion and had increased to $22.3 billion by the end of 2006. In 2006, 43% of U.S. FDI in South Korea was in manufacturing, especially in computers and electronic products, chemicals, and other manufacturing facilities. The remainder of the FDI was in services, with U.S. FDI in banking and other financial services accounting for much of this investment. South Korean FDI in the United States has also increased substantially in the last 10 years, albeit from a much lower base. In 1997, the stock of South Korean FDI in the United States was valued at $0.6 billion and had increased to $8.6 billion by the end of 2006. $7.2 billion, or 84% of this investment was in wholesale trade, perhaps reflecting the sharp retail facilities to sell South Korean-made vehicles in the United States.[128]

Foreign investment has been a sensitive issue in U.S.-South Korean relations for many years as U.S. investors have tried to make inroads into the South Korean economy. U.S. investors' criticisms have included restrictions on foreign investment in key sectors, such as communications and lack of adequate protection for intellectual property. (See section on IPR provisions of the KORUS FTA.) Efforts to establish bilateral rules have failed in the past. In the 1990s, the two countries tried to negotiate a bilateral investment treaty (BIT), that would commit each party to provide national treatment to the investments from the other party and abstain from performance requirements for foreign investments from the other party. But the negotiations collapsed largely over U.S. opposition to South Korea's so-called screen quota on domestic films and the latter's resistence to lifting or reducing it. (The South Korean government reduced the screen quotas by half just before the KORUS FTA negotiations were launched in February 2006.) The KORUS FTA chapter on

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

[128] CRS calculations based on data from U.S. Department of Commerce. Bureau of Economic Analysis. [http://www.bea.gov].

investment essentially contains the commitments that would otherwise have been in a BIT.

The FTA sets down general principals for the treatment by South Korea and the United States of investors and investments from one partner in the territory of the other.[129] The principle of national treatment — that one party to the agreement will treat covered investments and investors from the other party no-less favorably than it treats domestic investors and investments — is paramount. The FTA allows each party to make exceptions to the national treatment principle, but those exceptions must be specified in the relevant annexes to the agreement.[130] A second fundamental principal is most-favored-nation treatment (MFN) — the two parties agree to treat investors and investments from the other no less favorably than it treats investors and investments from third, non-party countries. A third principle is minimum standard of treatment, that is, each party shall accord to all covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security.

The KORUS FTA would set limits on government expropriation of covered investments — that they be only for public purpose and carried out in a non-discriminatory manner, and affected investors would be provided with prompt and adequate compensation (fair market value). It also would require each KORUS FTA partner-country government allow for the free transfer of financial capital pertaining to covered investments both into and out of the country with exceptions, such as cases related to criminal offenses. The KORUS FTA would prohibit the U.S. and South Korean governments from imposing performance requirements (domestic content requirements, export-ratios, import limits, etc.) on the investments from the other. It would allow exceptions for measures intended to accomplish social objectives, such as to increase employment in certain regions of the country, promote training of workforce, and protect the environment. The agreement would also prohibit a requirement that senior managers be of a particular nationality but would allow a requirement that the majority of board of directors be of a particular nationality.

Similar to other U.S. FTAs, the KORUS FTA would establish procedures for the settlement of investor-state disputes involving investments covered under the agreement where the investor from one partner-country alleges that the government of the other partner-country is violating his rights under the FTA. The FTA stipulates that the two parties should try to first resolve the dispute through consultations and

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[129] A range of factors determine the climate for foreign investment — government regulations, skills of local labor, general economic conditions, intellectual property rights protection, among others. Therefore, U.S.-South Korean investment ties could be affected by not only the provisions of the investment chapter of the agreement, but other chapters as well.

[130] The USITC report on the KORUS FTA points out that South Korea's list these "nonconforming measures" in the KORUS FTA is longer than in previous FTAs that the United States has signed; however, industry representatives generally believe that the KORUS FTA would still render significant opportunities for U.S. investors. USITC. p. 6-5.

negotiations. But, if that does not work, the agreement would provide for arbitration procedures and the establishment of tribunals as provided under the "Convention on the Settlement of Investment Disputes Between States and Nationals of Other States."

The USITC concluded that U.S. investors, especially investors in financial services, would likely gain from the KORUS FTA.[131] (See section on financial and other services.) The United States has been the predominate partner in terms of foreign investment and stands to gain the most from the protections provided by the KORUS FTA. However, South Korean investments in the United States are increasing, and therefore, South Korea could benefit as well.

Intellectual Property Rights

In addition to those sections addressing pharmaceutical manufacturing (see discussion above), the KORUS FTA contains other provisions on intellectual property rights (IPR) protection in U.S.-South Korean trade. Under the FTA the United States and South Korea would reaffirm their commitments under the WTO Trade-Related Aspects of Intellectual Property Rights (TRIPS) agreement and other international agreements and conventions on intellectual property. But the two countries would make IPR commitments beyond those agreements with provisions that would:

- require each government to extend national treatment to IPR holders from the other country;[132]
- require transparency through the publication of regulations and laws regarding intellectual property rights;
- facilitate the registration of and protection of trademarks and established limitations on the use of geographical indications;
- ensure the right of authors, performers, producers of recordings to determine use of copyrighted products;
- require copyright protection for no less than 70 years; thus, South Korea agrees to extend its copyright protection term, an objective of U.S. copyright holders;
- protect copyrighted material against piracy and provide penalties for those who abet piracy including the seizure and destruction of pirated and counterfeit products;
- protect copyrighted performances on the internet; and
- protect encrypted programming over satellites and cable signals.

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[131] USITC. p. 6-5.

[132] A national treatment exception is made with respect to the secondary uses of recordings by means of analog communications, including over-the-air broadcasts, whereby a Party can limit the rights of performers and producers of sound recordings from the other Party on its own territory. The is exception was a disappointment to U.S. industry, which otherwise praise the agreement. *Korea-U.S. Free Trade Agreement: Benefits to America's Entertainment Industries.* Testimony Before the U.S. International Trade Commission by Greg Frazier, Executive Vice-President Worldwide Government Policy Motion Picture Association of America. June 6, 2007. p.7.

Labor Rights and Conditions

On May 10, 2007, a bipartisan group of congressional leaders and the Bush Administration released a statement that provided language to be included in pending and future FTAs, including KORUS FTA. Among other things, the statement, or framework, called "The New Trade Policy for America," requires U.S. FTA partners to commit to enforcing the five basic international labor standards and would require that the commitment be enforceable under the FTA.[133] Neither country is to waive or otherwise derogate from its labor statutes that reflect the five labor rights in a manner that affects trade or investment between the two FTA countries. Each country is to ensure that those affected by their respective labor laws have access to tribunals that enforce their rights under those laws.

Under the KORUS FTA the two countries are to form a Labor Council made up of officials responsible for labor matters in each country, that will meet within the first year after the agreement enters into force. At least one session of the Council will be devoted to meeting with the public in each country to discuss matters related to the enforcement of the labor provisions of the FTA. Disputes regarding labor matters under the FTA are to be resolved first by consultations, but if those fail, the parties in dispute may take the matter to the Labor Council and eventually to a dispute settlement panel if these mechanisms fail to resolve the dispute. The KORUS FTA also calls for the establishment of a Labor Cooperation Mechanism whereby the two countries would develop and work in areas pertaining to labor rights in each country.

To many outside observers, South Korea's labor rights regime is generally considered to be strong for regular workers. South Korea ranks in the top third of the OECD's thirty members in terms of employment protection for regular workers.[134] Indeed, for years, a major complaint of U.S. multinationals is that restrictions in the South Korean labor market, such as mandatory severance pay, significantly raise the cost of investing and doing business in Korea. In contrast, U.S. union representatives argue that recent changes to make South Korean labor markets more flexible are

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[133] The FTA would require each Party to adopt and maintain five internationally-accepted labor rights that are contained in the ILO Declaration on Fundamental Principles and Rights at Work and Its Follow-Up (1998) (ILO Declaration) Article 19:2 specifies these rights as the freedom of association, the effective recognition of the right to collective bargaining, the elimination of all forms of compulsory or forced labor, the effective abolition of child labor and the elimination of discrimination in respect of employment and occupation. The framework also requires FTAs to adhere to seven major multilateral environmental agreements and for this commitment to be enforceable under the FTA. "The Trade Policy for America" was completed after President Bush notified the Congress on April 1, 2007 of his intention to sign the KORUS FTA but prior to the signing on June 30. At first, South Korean officials balked at opening negotiations to add the language but eventually agreed to do so. After, the two sides held negotiations, they included the language in the final text that was signed on June 30, 2007.

[134] OECD, *Economic Survey — Korea 2007*, p. 138.

reducing the rights of South Korean workers.[135] Korea's unions have earned a reputation for activism; the number of working days lost to strikes is regularly among the highest in the OECD. Hyundai Motors, for instance, has experienced a strike every year since 1994. Moreover, strikes in South Korea are notable in that they are sometimes accompanied by violence and the occupation of workplaces and public spaces (such as highways), to which the government often responds with police action. In its comments on the KORUS FTA, the Labor Advisory Committee for Trade Negotiations and Trade Policy (LAC), criticized South Korea for the imprisonment of around 200 unionists who were "exercising basic labor rights" and for mobilizing riot police against union activity.[136]

Korea's labor pool is divided into two segments: 1) South Korean "salarymen" (salaried workers, overwhelmingly men, in large corporations) who comprise less than one-third of the workforce. Over half of this segment of the workforce is represented by powerful unions. 2) The remainder of the workforce, comprised of employees in small-scale firms plus the country's temporary and day laborers. Few of these workers are unionized. The proportion of temporary workers has grown markedly, to nearly one-third of the workforce, one of the highest rates in the industrialized world.[137] These workers tend to receive low wages and receive limited coverage by the social safety net, points highlighted by the LAC. Labor markets are notoriously rigid.

Government Procurement

A great deal of business is conducted by governments through the purchase of goods and services for their own use. Most governments, including the United States have laws (The Buy American Act) which require such goods and services to be of domestic origin. However, the General Agreement on Tariffs and Trade (GATT) and now the WTO have some provisions, the WTO Government Procurement Agreement (GPA), under which the countries agree to open up some of their government procurement business, to foreign companies as a way to promote trade. This agreement is plurilateral, that is it only applies to those WTO members that have signed it. The United States and South Korea are among the 39 signatories to the GPA. The GPA established rules for governments to publish information about contract tenders, including technical specification, about qualification for suppliers, the awarding of contracts, with a specific emphasis on nondiscrimination and transparency in the conduct of government procurement.

The KORUS FTA reaffirms the GPA as a baseline for government procurement but would expand the criteria to include more contracts. The GPA applies to contracts valued at around $193,000 and above. The KORUS FTA would apply agreement to contracts valued at $100,000 and above, potentially increasing the value of bilateral government-procurement trade. The GPA applies only to contracts

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[135] Report of the Labor Advisory Committee for Trade Negotiations and Trade Policy (LAC) on the KORUS FTA, April 27, 2007, p. 9.

[136] *Ibid*.

[137] OECD, *Economic Survey — Korea 2007*, p. 128-40.

tendered by 79 U.S. Federal government agencies and by 42 South Korean central and subcentral agencies listed in the annex. Under the KORUS FTA, South Korea would add nine more agencies to be covered.

Environment Protection

In keeping with the May 2007 agreement on labor and the environment between the Bush Administration and congressional leaders, under the KORUS FTA, the United States and South Korea would commit to enforce a list of seven multilateral environmental agreements to which both are parties and to add to the list when other agreements enter into force. (See the Labor Rights and Conditions section above.)[138]In addition, the FTA would prevent the two countries from easing environmental standards in order to allow firms on their territory from gaining a competitive trade advantage. Furthermore, violations of the environmental provisions are to handled in the same manner as commercial provisions through the dispute settlement mechanism of the KORUS FTA and subject to trade sanctions, unprecedented for U.S. FTAs.

Transparency

Making information publically available is a fundamental principle imbedded in international trade rules and in each of the FTAs that the United States has entered into. For years U.S. exporters and trade negotiators identified the lack of transparency of South Korea's trading and regulatory systems as one of the most significant barriers to trade with South Korea, in almost every major product sector. Under KORUS FTA, the United States and South Korea would commit to publish relevant regulations and administrative decisions as well as proposed regulations; to allow persons from the other party to make comments and to ask questions regarding proposed regulations; to notify such persons of administrative proceedings and to allow them make presentations before final administrative action is taken; and to allow such persons to request review and appeal of administrative decisions.

Institutional Provisions and Dispute Settlement

The KORUS FTA would provide several options for the United States and South Korea to resolve disputes arising under the agreement, in addition to the special dispute settlement provisions under the foreign investment chapter and other chapters. KORUS FTA would require the two countries to establish a joint committee chaired by the USTR and the Minister of Foreign Trade or their designees to supervise the implementation of the agreement. The committee would establish a panel to adjudicate disputes between the two countries under the agreement, if consultations do not lead to a resolution of the dispute. Annex 22A of the KORUS FTA contains provisions for the settlement of disputes regarding motor vehicles,

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[138] The seven agreements are: the Convention on International Trade in Endangered Species; the Montreal Protocol on Ozone Depleting Substances; the Convention on Marine Pollution; the Inter-American Tropical Tuna Convention; the Ramsar Convention on the Wetlands; the International Convention for the Regulation of Whaling; and the Convention on Conservation of Antarctic Marine Living Resources.

specifically the snap-back provision. (See discussion in section on auto trade.) Annex 22-B provides for eventual discussion of the inclusion of products made in outward processing zones in North Korea. (For more information, see discussion in Kaesong Industrial Park section.)

Other Technical Provisions

The KORUS FTA includes other sets of provisions intended to facilitate market access. **Technical barriers to trade** are standards and regulations that are intended ostensibly to protect the health and safety of consumers and for other legitimate non-trade purposes but may through design and implementation discriminate against imports. The KORUS FTA would commit both countries to uphold their obligations under the WTO Agreement on Technical Barriers to Trade (TBT). In addition, South Korea and the United States would promote transparency, by allowing persons from the other party to participate in the development of standards, technical regulations, and conformity assessment procedures.

Regarding **customs administration and trade facilitation**, the KORUS FTA would promote joint cooperation to ensure compliance with each other's customs laws and regulations. For example, it would require the two countries to adopt procedures and regulations to facilitate express delivery shipments.

Rules of origin define what are goods that originate in the FTA region and therefore are eligible for preferential treatment. (Textiles and apparel have separate rules of origin). The KORUS FTA would require that goods must be wholly obtained or produced in the territory of both countries or country. The FTA would set a regional value threshold to be met to be considered originating in the FTA territory and provides formulas for determining the regional values.

National **competition laws and regulations** are intended to ensure that one firm does not so dominate a sector of the economy as to inhibit market entry and stifle competition. Among other things, the KORUS FTA would require that the United States and South Korea inform persons, who are subject to administrative actions, of hearings and provide them the opportunity to make their case. The two countries would cooperate in enforcing competition laws through the exchange of information and consultation. In addition, designated monopolies and state-enterprises would have to operate in conformance with the agreement and in accordance with commercial considerations.

The KORUS FTA includes provisions to facilitate trade via electronic commerce (**e-commerce**). They would prohibit discrimination against digital products and imposing customs duties on these products. They would also require the recognition of electronic authentication and electronic signatures and would promote consumer access to the Internet.

Next Steps, Implications, and the Emerging Debate

The United States concluded and entered into (signed) the KORUS FTA within the parameters of the Trade Promotion Authority (TPA) under the Bipartisan Trade Promotion Act of 2002. (P.L.107-210). Therefore, any implementing legislation would be subjected to expedited procedures, that is mandatory congressional consideration, limited debate, no amendments, and an up-or-down vote. TPA does not impose a deadline on the President to submit the draft implementing bill. It is generally assumed that the President would do so only when he expects to have sufficient support in Congress to pass it, although he could submit the bill without that assurance and risk the bill's failure. The April 2008 bilateral agreement allowing for the resumption of U.S. beef sales to South Korea removes the last impediment to sending the KORUS FTA to Congress, according to Administration officials. Some Members of Congress have signaled they will now watch to see how Korea moves to implement this commitment.

In terms of broader U.S. trade policy, an FTA with South Korea would build on the Bush Administration policy of "competitive liberalization" that uses free 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. The Bush Administration was also responding to criticisms that FTAs that the United States has entered into since NAFTA that have had only minuscule effects on trade flows and on the U.S. economy. The Administration was also using the KORUS FTA to respond to the increasing economic influence of China which is also pursuing FTAs in East Asia. Some observers have suggested that the KORUS FTA could spark interest of other East Asian countries, such as Japan, to negotiate FTAs with the United States in order not to lose their share of the huge U.S. market to South Korea.

In South Korea, the KORUS FTA must be approved by a majority vote in the unicameral National Assembly to take effect. Unlike in the United States, trade agreements are not subject to any fast-track time lines. President Lee Myung Bak, who was elected in December 2007, has made passage of the KORUS FTA a priority for his government. However, his goal of securing National Assembly approval by the end of the legislative session in May 2008 appears unlikely to be met. Korea's leading opposition party is refusing to vote on the agreement, due in part to complaints about the April 2008 beef deal. If the Assembly does not vote on the KORUS FTA before its session ends, the agreement must be resubmitted during the next legislative session, which begins in June. When the Assembly reconvenes, President Lee's Grand National Party will control a majority of seats.

Most opinion polls show a majority of South Koreans in favor of the agreement, though opposition has been intense from rural interests, among others. The KORUS FTA was not a significant issue in the 2007 presidential election campaign, despite the fact that one of the major candidates opposed the agreement or the April 2008 parliamentary elections.

For South Korea, entering an FTA with the United States meshes with a number of Roh and Lee's economic and strategic goals. Ongoing competitive pressure from Japanese firms, increased competition from Chinese enterprises, and the rapid aging of the South Korean workforce has heightened the sense of urgency to boost national long-term competitiveness, particularly in the services industries, where South Korean productivity typically lags compared to other industrialized countries. Indeed, President Roh and other South Korean officials have argued that the KORUS FTA is essential for South Korea's economic survival.[139] Similarly, if less grandiosely, President elect-Lee has argued that passage of the KORUS FTA will help revitalize South Korea's economy. To accelerate Korea's reform efforts — and also to avoid being left out from other FTAs being created globally and in Asia — President Roh pursued an aggressive effort to negotiate FTAs 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 the European Union.[140]

The United States and South Korea negotiated the KORUS FTA in part as a means to restore the health of a critical foreign policy and national security alliance.[141] While the talks were ongoing, the KORUS FTA sometimes was discussed as a possible counterweight to the bilateral friction that was occurring over issues such as how to manage relations with North Korea and re-positioning of U.S. troops in South Korea. These tensions decreased markedly in 2007, following the Bush Administration's decision to place greater emphasis on engagement and negotiations with North Korea. The December 2007 election of conservative party leader Lee Myung-Bak, who has stressed the importance of rebuilding U.S.-South Korean ties, is expected to further improve relations. Thus, with the alliance apparently on firmer ground, the KORUS FTA no longer appears as an exceptional area of bilateral cooperation.

However, although the FTA's utility as an acute salve for the alliance has been reduced, over the medium and longer term, it could help to boost the alliance by deepening bilateral economic and political ties. The tensions over North Korea policy, which may resurface, have revealed the extent to which the two countries view North Korea differently. Most South Koreans' sense of threat from North Korea has declined over the past decade, even as Americans' threat perceptions have risen. With the central rationale for the alliance — deterring a North Korean attack — now open to question in South Korea, and with many South Koreans opposed to allowing U.S. troops in South Korea to deploy to other parts of Asia (such as the Taiwan Strait) in the event of a crisis, the future utility and form of the U.S.-South

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[139] 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. (Han was Finance Minister when he made these remarks.) South Korean Blue House, "Address to the Nation," April 2, 2007.

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

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

Korean alliance is being debated. Entering into an FTA, some argue, is a way to help reorient the alliance to adapt to the changes on the Korean Peninsula and in East Asia.

Another implication of the signing of the KORUS FTA is that it has become something of a symbol of the depth of the U.S. commitment to the U.S.-South Korean alliance and to the U.S. forward presence in East Asia. Many Asians believe that the United States is disengaging from the region. If the South Korean National Assembly approves the pact and the FTA either is rejected or not introduced in the United States, many Koreans and Asians may regard this as an additional sign of U.S. disengagement, at a time when other great powers like Japan and China are increasing their economic diplomacy. It may also discourage other countries from negotiating FTAs with the United States.

In the United States, the KORUS FTA could become as controversial as NAFTA has turned out to be. While a broad swath of the U.S. business community supports the agreement, but some groups — auto and steel manufacturers, and labor, for example — are strongly opposed. With U.S. beef sales to South Korea to resume by-early June 2008, much of the agricultural community favors the agreement. Differences over the implications of the KORUS FTA between the White House and the Democratic leadership in the Congress have made the timing and even the likelihood of the President's submission and the Congress's subsequent consideration of implementing legislation uncertain.[142]

As discussed earlier, the agreement has generated strong support and opposition in various quarters. Supporters point to South Korean commitments to eliminate tariffs on most manufactured and agricultural goods, liberalize trade in services, reduce barriers to foreign investment, and strengthen protection of intellectual property rights. Supporters have also cited the FTAs that South Korea has signed or is negotiating, such as the one with the European Union, arguing that failure to approve the KORUS FTA would place U.S. firms and investors at a competitive disadvantage in South Korea with their counterparts from those other countries. Some proponents also argue that the KORUS FTA is important to uphold the U.S.-South Korean alliance, the bilateral relationship would be harmed if the agreement were not approved.

On the other hand, some opponents of the KORUS FTA assert that South Korea does not go far enough to address U.S. problems with access to the its market and that failure to resolve these issues, such as barriers to the auto market, would constitute a wasted opportunity; therefore, the agreement needs to be renegotiated before it can be approved by Congress. Others oppose the KORUS FTA on more general grounds. Some trade experts, for example, assert that FTAs undermine efforts to build a multilateral trade system under the WTO and create tangled webs of conflicting trade rules that impede rather than promote trade. Others are skeptical or opposed to trade liberalization per se because they assert trade does more harm

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[142] It is also possible that the next President could submit the implementing legislation, if President Bush has not done so by the end of his term.

than good to U.S. workers and to the U.S. economy in general. Clearly, any debate on the merits of the KORUS FTA will involve many factors for Members to weigh.

Appendix A: South Korea's Rules on Imports of U.S. Beef

On April 18, 2008, U.S. and South Korean negotiators announced an agreement on the revised rules that Korea will apply to all beef imports from the United States. These are expected to take effect by early June 2008, replacing the terms of an earlier agreement. This represented the last step in the more-than-two-year effort by the U.S. government to regain access to South Korea's lucrative beef market for the U.S. cattle and beef processing sectors.

Background

South Korea's concern about the potential human health impacts of U.S. beef dates back to December 2003, when its government banned imports of U.S. beef after a Canadian-born cow in Washington state tested positive for bovine spongiform encephalopathy (BSE) or mad cow disease. The loss of the third largest export market together with other major foreign markets for U.S. beef contributed to a sharp fall in U.S. cattle prices. In 2003, the $815 million (246,595 MT) in U.S. beef exports to South Korea had accounted for 21% of the $3.9 billion in beef products shipped worldwide. Subsequent talks over the terms that would apply before sales could resume took two years to complete. In January 2006, South Korea agreed to only allow imports of U.S. **boneless** beef from cattle **less than 30 months old**. U.S. negotiators had signaled this type of response was necessary before negotiations with South Korea on a comprehensive FTA could begin. However, in late 2006 South Korean inspectors rejected the first three shipments of U.S. beef, after discovering small bone fragments in a few boxes of packaged frozen boneless beef. U.S. efforts to resolve this and related issues of beef access to the Korean market subsequently became contentious as FTA negotiations continued. USTR decided not to participate for several weeks in the FTA's sanitary and phytosanitary working group. Also, bilateral discussions on this issue moved from the technical level to high-level meetings as both sides raced to conclude KORUS FTA by the end of March 2007 deadline.

Although the beef issue was not resolved in the FTA talks, then-South Korea's President Roh on April 1, 2007, stated he had personally promised President Bush that his government would "uphold the [yet to-be-released] recommendations" of the World Organization for Animal Health (OIE)[143] on the BSE risk status of the United States and "open the Korean [beef] market at a reasonable level." On May 22, 2007, the OIE formally found that the United States is a "controlled risk" country for the spread of mad cow disease. This means that internationally recommended, science-based measures are in place to effectively manage any possible risk of BSE in the U.S. cattle population. The U.S. Department of Agriculture (USDA) immediately requested South Korea to amend its import requirements for U.S. beef within a

[143] OIE is the French acronym and commonly used to refer to this organization. The Office of International Epizootics is the international scientific body recognized by the WTO as the international reference for matters of animal disease and health. One OIE responsibility is to develop health standards that countries can use to protect against the introduction of animal diseases without setting up unjustified sanitary trade barriers.

specified time frame to reflect this risk determination and to reopen its market to all U.S. cattle and beef products. In response, South Korea's animal health regulatory agency began an 8-step process to assess the BSE risks of the U.S. beef sector in light of the OIE finding, with the intent to negotiate a revised bilateral agreement that would lay out import rules applicable to U.S. beef. Initial expectations were that this process would be completed by late September 2007, but was postponed by the third discovery of prescribed risk materials in some boxes of U.S. beef (see below). Because of the political controversy generated by the prospect of further opening the Korean market to U.S. beef, President Roh's government's decided to defer negotiations until after the December 2007 presidential election. Then, newly inaugurated President Lee Myung-bak decided to wait until after the April 9, 2008 parliamentary elections took place. Both decisions effectively pushed off negotiations with the United States on a revised agreement on beef import rules until April 11.

Against the backdrop of these developments during 2007, U.S. boneless beef exports to South Korea resumed. From late April through early October 2007, Korea's quarantine regulatory agency inspected and cleared for retail sale most U.S. boneless beef shipments, applying its interpretation of the January 2006 agreement. Even with partial-year exports, South Korea ranked as the 4th largest market for U.S. beef in 2007 ($119 million, or 25,165 MT). With a third discovery of bone and/or spinal matter in a box of packaged beef, South Korean authorities announced on October 5, 2007 they would not conduct any more inspections of U.S. beef shipments until both sides conclude formal negotiations to revise the 2006 protocol. In an effort to move toward that goal, bilateral technical-level talks held October 11-12, 2007, failed to bring both sides closer to an agreement. South Korean officials sought rules that were reportedly more strict than OIE guidelines, intended to reportedly correct four shortcomings in the U.S. measures taken to limit BSE risks. The U.S. stance was that current rules already meet OIE standards.[144]

Key Positions

The longstanding U.S. position was to press for full access in one step for U.S. beef in South Korea's market. This would mean expanding the scope of the 2006 agreement to also include exports of **bone-in** beef and coverage of all U.S. beef from cattle **regardless of age**, as long as BSE-risk materials are removed during processing. South Korea argued for a "two-phased" approach to a full opening. The first step would allow imports of both boneless and bone-in (rib) beef cuts from U.S. cattle less than 30 months old, as long as risk materials are removed following OIE's guidelines. Korea's trade minister had argued this would give the United States about 80% of its market share before the late 2003 restrictions took effect. The second step would permit imports of beef from older cattle, as long as risk materials are removed according to OIE's specifications.[145] In preparing to take office, South Korea's President-elect Lee Myung-bak signaled an interest in moving quickly to

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[144] *Inside U.S. Trade*, "U.S., Korea Beef Market Access Talks Fail Over Level Of Access," October 19, 2007, p. 6.

[145] *Inside U.S. Trade*, "Korean Minister Sees Open Beef Market In Two Steps, Delay In FTA Approval," November 16, 2007, p. 5.

resolve the beef issue. His transition team instructed the Ministry of Agriculture to advocate strengthening import rules, such as placing Korean inspectors at U.S. meat processing plants to conduct "on-the-spot" inspections.[146]

April 2008 Agreement

The agreement, reached just hours before President Lee met President Bush at Camp David on April 18, 2008, spells out South Korea's health requirements that will apply to imports of U.S. beef and beef products. Expected to take effect on May 15, 2008, Korea will allow entry to all cuts of U.S. beef (**bone-in** or ribs, and **boneless**) and other beef products from cattle **irrespective of age**, that meet all other specified conditions. These rules significantly expand upon the January 2006 protocol, which only permitted imports of boneless beef from cattle less than 30 months old. The agreement excludes the entry of specified risk materials (SRMs); all mechanically recovered and mechanically separated meat; and advanced meat recovery (AMR) product from the skull and vertebral column of cattle 30 months of age and over at the time of slaughter. These exclusions reflect scientists' conclusions that these materials can harbor the BSE agent in cattle and in turn infect humans if these products are consumed.[147] Other terms prescribe which other beef products may or may not enter South Korea.[148]

While the agreement text reflects in part the two-phased approach sought by South Korea (discussed above), the issuance of the final animal feed ban rule by the U.S. Food and Drug Administration (FDA) on April 23, 2008, automatically triggers a change in the scope of the agreement to cover U.S. beef and beef products from the edible parts of **all cattle**, even if they are older than 30 months. This rule bars the use in animal feed and pet food of specified risk materials from cattle that have "the highest risk for carrying the agent thought to cause BSE." FDA states that these measures will strengthen existing safeguards that have been adopted against BSE.[149]

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[146] Korea Times, "Election Politics Cloud KORUS FTA Ratification," January 7, 2008.

[147] Specified SRM's are "tonsils and distal ileum from cattle of all ages; and [the] brain, eyes, spinal cord, skull, dorsal root ganglia and vertebral column (excluding vertebrae of the tail, transverse processes and spinous processes of the cervical, thoracic and lumbar vertebrae, median crest and wings of the sacrum) from cattle 30 months of age and over at the time of slaughter." For more information, see CRS Report RL32199, *Bovine Spongiform Encephalopathy (BSE, or "Mad Cow Disease"): Current and Proposed Safeguards*, by Sarah A. Lister and Geoffrey S. Becker.

[148] AMR product that is free of SRMs and central nervous system tissues is allowed. Ground meat, processed products and beef extracts may contain AMR but must be free of SRMs and all mechanically recovered or separated meat.

[149] Prohibited materials include the brains and spinal cords from cattle 30 months of age and older, the entire carcasses of BSE-infected cattle, the entire carcass of cattle that has not been inspected and passed for human consumption that is 30 months of age or older from which brains and spinal cords were not removed, tallow derived from BSE-infected cattle and from other prohibited cattle materials, and mechanically separated beef derived from the same prohibited materials. Department of Health and Human Services, Food and Drug Administration, "Substances Prohibited from Use in Animal Food or Feed," published in (continued...)

The rule reportedly falls short of South Korean negotiators' initial demands for a broader ban on the materials that should be banned in animal feed, a requirement that ranchers report cattle with BSE-symptoms to the USDA, and that the United States implement a mandatory national animal identification system.[150]

Among its provisions, the agreement: (1) requires the United States to implement measures that meet or exceed OIE guidelines for controlled-risk status to detect and prevent the introduction and spread of BSE, (2) allows all U.S. meat establishments operating under USDA inspection to sell beef and beef products to Korea,[151] (3) details the process that USDA will follow to handle instances of "serious non-compliance" by an establishment with the agreement's health requirements and U.S. regulations, (4) allows Korean government inspectors to conduct on-site audits of facilities that export to Korea, and (5) establishes procedures to be followed if Korea's import quarantine inspection agency detects a "food-safety hazard" that results in the rejection of a "lot" of U.S. beef or beef product.

Reaction to Agreement

The U.S. beef sector and U.S. policymakers welcomed news of the agreement. The National Cattlemen's Beef Association noted that South Korea "potentially represents a $1 billion market and could grow to be the United States' top beef customer." The American Meat Institute commended U.S. negotiators for their efforts to communicate "the interlocking safeguards in place in the United States that make the U.S. beef supply among the safest in the world." The National Meat Institute emphasized that the agreement's most important aspect is "the reduced risk of failure," leaving "few opportunities for the types of technical non-compliance" that caused problems when Korea last allowed U.S. beef to enter.

President Bush at Camp David thanked South Korea's President Lee for the decision to reopen that country's market to U.S. beef "consistent with international standards." Some Members of Congress welcomed the announcement, expressed their desire to see commercially meaningful quantities of U.S. beef on Korean store shelves, and stated this step will improve the atmosphere for considering the KORUS FTA.

In South Korea, announcement of the beef import agreement with the United States was met with street protests sparked by Internet-spread rumors that U.S. beef is not safe, calls by opposition political parties for the government to nullify or renegotiate the terms of this agreement, and calls by farmers for the National

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[149] (...continued)
Federal Register, April 25, 2008, p. 22720.

[150] *Inside US Trade*, "Feed Ban Opens Beef Market Despite Failing to Meet Korean Demands," April 25, 2008, p. 4.

[151] However, during the first 90 days, South Korea reserves the right to audit and/or reject U.S. decisions on the listing of new plants eligible to export beef to Korea or the re-listing of plants that had lost their eligibility to export because of problems with previous shipments.

Assembly to reject the KORUS FTA when considered during a special session later in May 2008. Opponents argued that the South Korean government moved too quickly to strike a deal, and did not secure enough safeguards against the dangers of mad cow disease. The intensity of the early May protests prompted Korean government officials to go on the defensive to reassure the public that U.S. beef is safe. Lengthy nationally televised press conferences were held and government officials appeared before a parliamentary committee examining the agreement's details. The South Korean government has maintained that it will not reopen this agreement, and will resume inspections of U.S. beef shipments intended for retail sale once updated sanitary rules are published. But in light of mounting public concerns, President Lee on May 7 stated his government will immediately stop imports of U.S. beef if public health is threatened and then work out countermeasures. Korea's Agriculture Minister further stated quarantine inspections of U.S. beef imports would be suspended if another case of mad cow disease is detected in the United States, even if that step risks trade friction.[152]

In another effort to defuse Korean public criticism and to clarify the scope of the agreement without formally renegotiating it, Korea's trade minister and U.S. Trade Representative on May 19 exchanged letters that affirmed Korea's right as a WTO member to protect its citizens from health and safety risks under Article XX of the General Agreement on Tariffs and Trade and the Agreement on the Application of Sanitary and Phytosanitary Measures. The letter exchange also addressed Korea's concern that the SRMs specified in the agreement did not included two SRMs from cattle over 30 months old that are identified in U.S. regulations as to what must be removed from all beef and beef products, whether destined for U.S. consumption or export. The United States recognized Korea's right to reject any beef shipment that also contains these additional SRMs, and to block all future shipments from a U.S. processor that violates the expanded list of SRMs twice. While this exchange does not specifically allow for the Korea to prohibit U.S. beef should another case of mad cow disease occur in the United States, the U.S. recognition that Korea can exercise broad recourse permitted under existing multilateral agreements to protect its citizens' health appears to give the Korean government some cover.

Recognizing the impact of the opposition to the agreement, President Lee in a nationwide address on May 22 apologized for his government's lack in efforts to sound out public opinion on resuming U.S. beef imports and accepted criticism for his negligence "in carefully reading the public's mind" on this issue. At the same time, he called on the political opposition that holds the majority in the National Assembly to set aside partisanship on this issue and approve the KORUS FTA in the remaining few days of a special session. On May 26, Korea's Agriculture Ministry announced another delay in issuing updated rules to apply to U.S. beef imports until it reviews the report of inspectors who had just toured U.S. beef processing plants

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[152] Under the revised agreement's terms, South Korea can only suspend imports of U.S. beef and beef products if the occurrence of an additional case or cases of BSE in the United States results in the OIE downgrading the safety rating of the U.S. cattle sector. The agreement states that if there is a case of BSE, the U.S. government is required to immediately conduct a thorough epidemiological investigation, inform the Korean government of the results, and consult with it on the investigation's findings.

and the government holds meetings with cattle producers to discuss support measures that could be adopted to assist them adjust to cheaper beef imports from the United States. With the expectation that these rules will be released on May 30, the trade expects Korea's quarantine inspection agency to begin processing for clearance into the retail sector some 5,300 MT of U.S. boneless beef during the first week of June.

Appendix B: South Korean Motor Vehicle Manufacturing

South Korea came late to the table of major motor vehicle manufacturing nations. The 1980 edition of the *Automotive News Market Data Book*, an authoritative industry source, listed no South Korean production in its world table covering the period 1946-78, and no South Korean company among the top 50 global producers. By 1988, according to the same publication's 1990 edition, total South Korean car and truck production exceeded one million units. In the 2007 edition, total South Korean production of cars and trucks in 2006 is given as more than 3.8 million units, which ranks South Korea as the global number five national producer, behind, in order, Japan, the United States, China and Germany. Yet South Korea remains only a mid-level consumer of motor vehicles. Its national sales of 1.2 million ranked its market not only well behind the top three leading producers, but also behind each of the five largest western European nations, plus Russia, Brazil, India, and Canada, and just ahead of Mexico. Exports account for about 70% of Korea's motor vehicle production volume, a figure that is matched by no other major motor vehicle producing country.

South Korea has aggressively developed and protected a nationally owned automotive manufacturing base. Motor vehicle imports were prohibited in South Korea until 1987, and imports from Japan were banned until 1999.[153] Originally the South Korean government promoted the development of a fleet of domestically owned producers, but this strategy failed. In the shakeout after Korea's economic crisis of 1997-98, only one major South Korean-owned company was left, Hyundai, which also took control of the number-two producer by volume, Kia. Others were marginalized, out of the business altogether, or controlled by foreign companies. Korea's third producer, and their only other major manufacturer left in the business, Daewoo, is now controlled by General Motors.[154] The lone major South Korean-owned producer, the Hyundai-Kia combination, in 2006 produced 3.8 million vehicles worldwide, ranking it number six globally. Of this output, 2.7 million vehicles were manufactured in South Korea, 72% of the country's total output of cars and light trucks, and more than double the total sales of all vehicles in South Korea.[155]

While Hyundai is a world-class global competitor, with current and planned assembly operations in the United States and other countries, it is questionable whether Hyundai, or any other South Korean-owned firm, could maintain an independently operated market base in South Korea without continued formal and informal protection from the national government. Comparative analysis of motor vehicle import and sales data by CRS from the *Automotive News Global Market Data*

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[153] USITC. *Industry and Trade Summary: Motor Vehicles* (USITC Publication 3545, September 2002), p. 60.

[154] Ibid., pp. 60-61; Graeme P. Maxton and John Wormald, *Time for a Model Change*: *Re-Engineering the Global Automotive Industry*. Cambridge, U.K.: Cambridge University Press, 2004. p. 101-2; CRS Report RL32883, p. 75-76.

[155] *Automotive News 2007 Global Market Data Book*, p. 29.

Book and *Ward's Motor Vehicle Facts & Figures* indicates that import penetration in the South Korean market in 2005 was equal to 3% of sales, even lower than the 5% level in Japan. By comparison, the U.S. level was 39% (20% if imports from Canada and Mexico are excluded), and in major European producer countries, Canada, and Mexico, the shares of imports were 50% or higher. The British authors Maxton and Wormald believe that the South Korean industry may be fated to become a "networked" producer in the long run, i.e., surviving only by linkages to other major market producers.[156]

Jeffery Schott of the Peterson Institute for International Economics has presented an analysis of South Korean automotive production and shipments in 2005, based on Korean official statistics, which illustrates that large shares of South Korean vehicles of all types are exported. Among passenger cars, however, the significance of exports tends to decline with the size of the vehicle. The export share of South Korean-produced vehicles officially described as "light" was 69%, and of "small" vehicles was 82%. For "medium" cars, the export share dropped to 62%, and for "large" cars, the share was 53%. Schott noted that Ford and Chrysler representatives "argue that South Korean tariff and nontariff barriers have restricted the supply of imported large vehicles — which traditionally have higher profit margins — to reserve a large share of the market for domestic producers ... a surprisingly high percentage of South Korean production of larger cars is sold in the domestic market rather than exported, and these are cars that most directly compete with imports."[157]

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[156] Maxton and Wormald, pp. 101-2.

[157] Schott (August 2007), table 2 and p. 4. It may be argued that Hyundai's U.S. sales of its Sonata sedan, which may be considered a "medium" or "large" vehicle in Korea, were sourced out of its Alabama assembly plant starting in 2005, thus reducing the export share of that product. However, according to *Ward's Automotive Yearbook*, only 91,000 Hyundai vehicles were produced in the U.S. in the startup year of 2005.

Appendix C: South Korea's Entry into the Visa Waiver Program

A priority issue for Seoul that was not formally part of the FTA talks was South Korea's status in the U.S. Visa Waiver Program (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.[158] Although South Korea's participation in the VWP was not formally part of the KORUS FTA talks, any changes made by the United States in this area are likely to play a political role in selling the agreement in Seoul. South Korea is one of the United States' largest sources of foreign visitors. In FY2006 there were 750,360 short term visitors for business or pleasure from South Korea. For years, Korean-American groups and American multinationals operating in South Korea also have called for South Korea to be added to the VWP. Since at least 2005, the VWP issue has been a regular feature of summit meetings between President Bush and South Korean President Roh. During their November 2005 summit, 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, making South Korea one of 13 "roadmap" countries.[159]

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%.[160] According to State Department officials, South Korea's nonimmigrant visa refusal rates have consistently been over this threshold. The FY2005 rate was 3.7% and the FY2006 rate was 3.6%.[161] Meeting the refusal rate is not the only requirement. A country's

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[158] 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

[159] Some of the roadmap countries have complained that since the "road maps" do not contain milestones or time tables, it is difficult to measure the amount of progress made towards fulfilling the criteria for VWP membership. Moreover, others contend that since U.S. consular officers are the ones that approve or disapprove applications for visas, it is extremely difficult for countries to affect their visa refusal rates, limiting the ability of a country to follow a defined set of steps to meet the required VWP criteria. For example, on February 8, 2006, the Heritage Foundation held an event entitled *Fighting a More Effective War on Terrorism: Expanding the Visa Waiver Program*, available at [http://www.heritage .org/Press/Events/ev020806a.cfm].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.

[160] 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).

[161] Department of State, *Adjusted Refusal Rate- B-Visas Only by Nationality, Fiscal Years 2006 and 2007*, available at [http://travel.state.gov/pdf/refusalratelanguage.pdf], visited

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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.[162]

In the summer of 2007, Congress passed and President Bush signed H.R. 1 (P.L. 110-53), the Implementing the 9/11 Commission Recommendations Act of 2007, which includes a provision (§711) that reforms the VWP by, among other measures, allowing the Secretary of Homeland Security to waive the refusal rate requirement However, P.L. 110-53 specifies that the refusal rate waivers can only be granted after the United States implements an exit system at its airports that can verify the departure of not less than 97% of foreign nationals that exit through U.S. airports, and after the United States establishes an electronic system of travel authorization (ESTA).[163] Although South Korean news sources have reported that the country will be admitted to the VWP by the end of 2008,[164] it is unclear when these conditions will be met and the waiver will be available.[165] Currently, South Korea is ineligible for the VWP without a waiver of the refusal rate requirement.

On April 18, 2008, DHS and South Korea signed a Memorandum of Understanding (MOU) regarding the VWP and related enhanced security measures.[166] The MOU attempts to lay the framework for South Korea to be admitted to the VWP, by reaching agreement on using the ESTA, sharing security related information, reporting lost and stolen passports, and repatriating citizens with final orders of removal. In addition, by signing the MOU, South Korea agreed to use specified security features in their travel documents[167] and to allow in-flight security officers (i.e., air marshals) on flights between the United States and South Korea. Importantly, although the two countries signed the MOU, when the waiver authority becomes available or South Korea's refusal rate declines to below 3%, DHS will

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[161] (...continued)
February 8, 2008.

[162] However, it is likely that Greece will be added to the program in 2008.

[163] For more, see CRS Report RL32234, *U.S. Visitor and Immigrant Status Indicator Technology (US-VISIT) Program*, by Lisa M. Seghetti and Stephen R. Vina.

[164] For example, see South Korean Ministry of Foreign Affairs and Trade, "Korea to Sign Memorandum of Understanding with the U.S. on its Joining the U.S. VWP," Korea.net, April4, 2008. Available at [http://www.korea.net/News/news/newsView.asp?serial_no=20080404018&part=101&SearchDay=], accessed May 9, 2008.

[165] Troy Stangarone, "U.S. Senate Passes Visa Waiver Reform," *Korea Insight*, Volume 9, Number 4, April 2007, Korea Economic Institute.

[166] The other MOU countries are the Czech Republic, Estonia, Latvia, Hungary, Lithuania, Slovakia, and Malta. Office of the DHS Press Secretary, *DHS Signs Visa Waiver Program Agreement with Korea*, April 18, 2008. Available at [http://www.dhs.gov/xnews/releases/pr_1208545066700.shtm], accessed May 9, 2008.

[167] The security features include time-limits for emergency passports, and issuing travel documents with a unique, non-recurring identifier that is affixed at the time of creation.

conduct a country review to assess the suitability of South Korea's participation in the VWP. Country reviews tend to take at least several months.[168]

[168] For example, the review of Greece for the VWP began in November 2007. As of May 9, 2008, no decision has been made on their admission.