Pending U.S. and EU Free Trade Agreements with South Korea: Possible Implications for Automobile and Other Manufacturing Industries

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September 1, 2010

Congressional Research Service
7-5700
www.crs.gov
R41389

CRS Report for Congress
Prepared for Members and Committees of Congress

Summary

South Korea has negotiated free trade agreements (FTAs) with the United States and the European Union (EU), but neither agreement has yet been approved. The U.S. Congress must approve the United States and South Korea free trade agreement (KORUS FTA) and the European Parliament must vote on the European Union and South Korea free trade agreement (KOREU FTA) before the FTAs can take effect. If the FTAs are ratified, it is possible there could be a "first mover" advantage for either the United States or the European Union, depending on which FTA is approved first. Some argue that both agreements have shortcomings and should not be approved.

This report provides U.S. lawmakers with a comparison of the manufacturing components in the KORUS and KOREU FTAs. Congressional interest in an FTA between the European Union and South Korea mostly centers on those U.S. industries competing with European industrial sectors, especially motor vehicles. The two pending FTAs raise questions about what it could mean for U.S. manufacturers if the United States takes longer, or fails altogether, to implement the KORUS FTA, while the European Union and South Korea possibly move ahead to approve and implement their outstanding FTA. In such a case, the possibility exists that the removal of tariff and non-tariff barriers between the European Union and South Korean markets could result in U.S. manufacturers losing South Korean market share to European competitors. On balance, most U.S. and European manufacturing sectors, with some auto manufacturers in particular among notable dissenters, argue that the pending FTAs will be beneficial and are largely supportive. On the other side, labor unions in the United States and the European Union are considerably more skeptical, claiming that South Korean companies could be the biggest beneficiaries, since they could gain even greater access to the significantly larger U.S. and EU markets. Labor union leaders say the FTA will result in further job losses as their respective manufacturing workforces compete for market share with competitive South Korean manufacturers in their own domestic markets.

Various forces will affect how and when each side might move forward on its respective FTA. Congress has a direct role in the approval of the KORUS FTA, but until recently legislative consideration of the agreement had been at a standstill. In June 2010, President Obama directed the United States Trade Representative to initiate new discussions with the South Korean government to resolve outstanding issues in time for the G-20 Summit in Seoul in November 2010, such as autos and beef. Some lawmakers argue that the KORUS FTA provides a greater advantage to South Korean manufacturers than to U.S. manufacturers. Others have expressed their support for economic and national security reasons.

No specific date has been announced by the European Union on when it expects to approve its FTA with South Korea, but the European Commission (the EU's executive charged with negotiating agreements with other countries, among its areas of responsibility) has indicated that it would like to move forward in 2010 or 2011.

Automotive trade is the primary focus of this report because it is one of the most contentious and high-profile manufacturing issues in the KORUS and KOREU FTA deliberations. Additionally, brief overviews are included of other selected U.S. manufacturing sectors that could be affected by these FTAs, such as home appliances, consumer electronics, and pharmaceuticals and medical devices. Trade in agricultural products and services are not covered by this report.

Contents

Tables

Appendixes

Contacts

Introduction

For over 20 years, U.S. trade negotiations have followed two tracks: multilateral talks such as the Doha Development Round of the World Trade Organization (WTO) and bilateral and regional arrangements with other countries, known as free trade agreements (FTAs). To date, the United States has entered into a dozen FTAs with various trading partners including Israel, Canada, Singapore, Chile, and Australia.[1] FTA agreements with Colombia, Panama, and South Korea are pending before Congress now. This report evaluates the implications of the potential U.S. agreement with South Korea for American manufacturers and compares it with a similar pending free trade agreement between South Korea and the European Union (EU).[2] South Korea has already enacted FTAs with countries such as Chile, Singapore, and India, and also is currently negotiating FTAs with other trading partners, including Australia, Canada, Japan, and Mexico. The implications of these arrangements for the United States are not discussed in this report.

A major outstanding issue in the commercial relationship between the United States and South Korea is the three-year old pending FTA, commonly referred to as the KORUS FTA. It was signed by the Bush Administration in 2007, but has yet to be submitted to Congress for approval. If accepted, it would be the second-largest free trade arrangement approved by the United States next to the North American Free Trade Agreement (NAFTA), which entered into force in 1994. In June 2010, President Obama directed the U.S. Trade Representative (USTR) to resolve outstanding issues (most prominently automobiles and beef) by the upcoming G-20 Summit, which is scheduled to be held in Seoul in early November 2010. In a nutshell, the pending KORUS FTA would eliminate tariff and non-tariff barriers for U.S. and South Korean manufacturers in a range of industrial sectors, including automobiles, consumer and industrial products, textiles and apparel, and pharmaceuticals and medical devices.[3]

The main section of this report compares the manufacturing components of the two agreements. In particular, it reviews automotive trade, the most politically and economically sensitive manufacturing sector in both agreements. Also included is a brief overview of the possible implications of the two pending FTAs on other selected industrial sectors affected by the FTAs: home appliances, consumer electronics, textiles and apparel, and pharmaceuticals and medical devices. The report begins by providing a legislative outlook and reviews the positions of key stakeholders. Agricultural and services trade are not covered.[4]

[1] For a detailed discussion on free trade agreements and U.S. trade policy see CRS Report RL31356, *Free Trade Agreements: Impact on U.S. Trade and Implications for U.S. Trade Policy*, by William H. Cooper.

[2] The European Union consists of 27 countries: Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxemburg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the United Kingdom.

[3] A complete discussion on the various provisions contained in the KORUS FTA can be found in CRS Report RL34330, *The Proposed U.S.-South Korea Free Trade Agreement (KORUS FTA): Provisions and Implications*, coordinated by William H. Cooper.

[4] For a discussion of agricultural issues, see CRS Report R40622, *Agriculture in Pending U.S. Free Trade Agreements with Colombia, Panama, and South Korea*, by Remy Jurenas.

Legislative Prospects

The KORUS FTA is a candidate for fast-track legislative consideration (automatic discharge from committee, no amendments, and limited debate) under the Bipartisan Trade Promotion Authority Act of 2002, because the agreement was entered into before July 1, 2007, the date on which the President's authority to enter into qualifying agreements expired.[5] The implementing bill, which would be submitted to Congress by the Administration but, given past practice, would be drafted in consultation with Congress, would include a provision to approve the FTA, as well as provisions "necessary or appropriate" to implement the agreement. Under fast-track procedures, Congress votes on the implementing legislation as submitted and can either approve it or reject it as whole. In areas of concern to some Members of Congress such as automobiles, however, Members might suggest that provisions addressing their concerns be included in the implementing legislation or seek assurances from the executive branch regarding the implementation of the agreement in these areas.[6]

As Congress considers what action it might take on the KORUS FTA, the European Union and South Korea have completed their own negotiations of a comprehensive free trade agreement (KOREU FTA). They initialed the agreement on October 15, 2009.[7] Signing and ratifying the KOREU FTA is a complicated process. The FTA must be formally adopted by the EU Council of Ministers, which represents the national governments and is the European Union's main decision-making body. Thereafter, it can be submitted to the European Parliament, which represents the citizens of the EU, for a vote.[8] The KOREU FTA is the first bilateral trade agreement subject to an up or down vote in the European Parliament under the provisions of the Lisbon Treaty, which became effective in 2009.[9] If approved, it means the FTA is provisionally ratified in the European Union and can enter into force. Provisional application is a common practice in the European Union (EU trade agreements with Mexico (2000) and Chile (2003) were also subject to provisional application).[10] Full ratification of the KOREU FTA requires approval by all 27 member states. In South Korea, the process is easier since only the approval of the National Assembly is required for ratification.

In many ways, the KOREU FTA is a similar agreement to the pending KORUS FTA. It is expected to facilitate manufacturing trade between the European Union and South Korea by

[5] As under previous statutes, Congress granted the President authority to enter into international trade agreements before a given date (July 1, 2007) and granted such agreements a unique "fast-track" approach that guarantees an expedited vote by Congress on these agreements. While the statute sets a deadline for entry into these agreements, the fast-track process does not require that FTA implementing legislation be submitted by a given date. For additional information on the history and use of fast-track procedures, see CRS Report 97-896, *Why Certain Trade Agreements Are Approved as Congressional-Executive Agreements Rather Than as Treaties*, by Jeanne J. Grimmett.

[6] This report does not address legal issues involving congressional consideration of trade agreements or the actions of the KORUS parties under the terms of the agreement.

[7] Initialing the KOREU FTA means the European Union and South Korea completed its negotiations with both sides approving the legal text of the agreement.

[8] For an overview of the European Union and its institutions, see CRS Report RS21372, *The European Union: Questions and Answers*, by Kristin Archick and Derek E. Mix.

[9] The Lisbon Treaty, which entered into force in December 2009, among other things increases the involvement by the European Parliament in the legislative process. For more information, see CRS Report RS21618, *The European Union's Reform Process: The Lisbon Treaty*, by Kristin Archick and Derek E. Mix.

[10] Information on the signing and ratification process of the KOREU FTA in the European Union was provided to CRS by European Commission staff, DG Trade, in an email exchange on May 19, 2010.

eventually removing most customs duties and addressing regulatory obstacles across various sectors, including autos, consumer electronics, and pharmaceuticals. The possible competitive impact on U.S. manufacturers of a KOREU FTA will likely be debated by Congress when it considers whether or not to ratify the KORUS FTA, which could be either in late 2010 or in 2011.

Likewise, the competitive implications of a KORUS FTA for European manufacturers, particularly for European automakers, will be considered as the European Parliament debates whether to approve the KOREU FTA. It remains to be seen if the KORUS FTA or KOREU FTA will be ratified first, or if either agreement will be approved. Some observers speculate that the auto sections of the FTAs may require some form of side agreement or other arrangement, which have yet to be worked out, before either agreement can be passed by the U.S. Congress or the European Parliament.

Stakeholder Perspectives

A large number of U.S. and EU industry observers expect gains for their respective industrial sectors upon the implementation of the KORUS FTA and the KOREU FTA. Various economic impact studies are used to support their positive assessments. One U.S. business advocacy group, the U.S.-Korea FTA Business Coalition, which represents a broad-based group of U.S. companies, concludes the KORUS FTA "will give U.S. exporters and investors a competitive edge."[11] Similarly, U.S. business groups such as the Business Roundtable and the National Association of Manufacturers (NAM) are also supportive of the KORUS FTA.[12] A cross-section of U.S. manufacturing sectors, including information technology, aircraft equipment, medical devices, and pharmaceuticals, stand to gain from the KORUS FTA based on assessments by the U.S. International Trade Commission (ITC) and the U.S. Department of Commerce.[13]

The ITC, which generates official estimates of the likely impacts of proposed trade agreements, estimates that the reduction of tariff and non-tariff barriers to U.S. manufactured and agricultural goods under the KORUS FTA would increase U.S. goods exports to Korea by $10 billion to $11 billion and boost U.S. gross domestic product (GDP) by nearly $12 billion.[14] The Administration estimates that full implementation of the KORUS FTA could add up to 70,000 jobs in the United States.[15]

[11] U.S.-Korea FTA Business Coalition, *Benefits of the FTA*, http://www.uskoreafta.org/about/benefits-fta.

[12] Business Roundtable, "Business Roundtable Statement on South Korea FTA," press release, June 26, 2010, http://www.businessroundtable.org/sites/default/files/Korea%20FTA%206%2026%2010%20FINAL.pdf.

[13] The U.S. ITC issued a widely cited report in 2007 detailing the potential economy-wide impact of the free trade agreement with South Korea for U.S. business, http://www.usitc.gov/publications/docs/pubs/2104F/pub3949.pdf, and the U.S. Department of Commerce's International Trade Administration has produced a series of reports profiling the current U.S.-South Korea trade and tariff environment by major industrial goods sectors, http://www.ita.doc.gov/td/tradepolicy/sectorreports_korea.html.

[14] United States International Trade Commission, *U.S.-Korea Free Trade Agreement: Potential Economy-Wide and Selected Sectoral Effects*, USITC Publication 3949, Washington, DC, September 2007, p. xix, http://www.usitc.gov/publications/docs/pubs/2104F/pub3949.pdf.

[15] The White House, *Progress Report on the National Export Initiative*, July 7, 2010, p. 3, http://www.whitehouse.gov/sites/default/files/exports_progress_report.pdf.

Europe's business federation, Business Europe, has a positive assessment of the pending KOREU FTA stating "the EU-Korea FTA will bring significant benefits to European firms."[16] One study estimates the KOREU FTA would create up to $24.2 billion (€19 billion) in new trade in goods and services for EU exporters.[17] Almost all EU and member states business confederations and sectoral groups support the agreement.

Nevertheless, the business communities in the United States and the European Union are not uniformly in favor of their respective pending bilateral agreements with South Korea. Most prominently, trade in automobiles remains a lingering issue. A key stumbling block to approval of the KORUS FTA has been complaints by Ford, Chrysler, and the United Auto Workers (UAW),[18] that it does not do nearly enough to open the South Korean market to U.S. auto sales. GM is neutral on the KORUS FTA, which can be explained in part by the GM-Daewoo joint venture operations in South Korea.

Views also diverge among European carmakers. Some European car producers are relatively neutral on the KOREU FTA, particularly those that export larger European luxury cars and have created a strong market niche for their automobiles in South Korea (see **Appendix A**). European automakers of smaller and middle-sized cars, such as Fiat, are most often in direct competition with South Korean manufacturers like Hyundai and Kia. Thus, they continue to push for what they deem a balanced and symmetric liberalization of the two auto markets. Beyond a possible competitive threat, some European automakers claim their access to the South Korean market might remain hampered by non-tariff barriers. Ivan Hodac, secretary general of the European Automobile Manufacturers' Association (ACEA), claims 30,000 manufacturing jobs could be lost and 10 plants closed across Europe if the KOREU FTA is implemented.[19]

The steel sectors in the United States and the European Union are also notable dissenters. U.S.-based steel manufacturers argue the KORUS FTA would weaken U.S. trade remedy laws (i.e., antidumping and countervailing duty). EUROFER, the European Union's steel industry representative, has raised concerns about the KOREU FTA stating, "the result is sectoral winners and losers with potential negative effects for steelmaking in Europe."[20]

U.S. and EU labor groups are largely opposed to their respective pending FTAs with South Korea. They view the FTAs as bad deals for their workers, possibly threatening U.S. and EU manufacturing jobs because of the asymmetrical commercial relationship, among other reasons. Unlike the positive data presented by the U.S. government and most business groups, research by the labor-oriented Economic Policy Institute claims the U.S. trade deficit with South Korea would

[16] Business Europe, *Comments on Implementation of the EU-Korea Free Trade Agreement*, March 5, 2010, p. 1, http://www.businesseurope.eu/content/default.asp?PageID=568&DocID=25991. Business Europe represents 20 million companies from 34 countries through 40 member federations.

[17] J.F. Francois, *Economic Impact of a Potential Free Trade Agreement between the European Union and South Korea*, Copenhagen Economics, March 2007, p. 6, http://trade.ec.europa.eu/doclib/docs/2007/march/tradoc_134017.pdf.

[18] The UAW's full name is the International Union, United Automobile, Aerospace and Agricultural Implement Workers of America.

[19] Ivan Hodac, *Hearing on the FTA between EU and South Korea*, European Automobile Manufacturers Association, European Parliament, INTA Committee, June 23, 2010, p. 14, http://www.europarl.europa.eu/activities/committees/hearings.do?language=EN.

[20] EUROFER, "European Steel Industry Deeply Concerned about EU-South Korea Free Trade Agreement," press release, April 23, 2010, http://www.eurofer.org/index.php/eng/News-Publications/Press-Releases/EU-South-Korea-Free-Trade-Agreement.

increase by about $16.7 billion and cost 159,000 American jobs within seven years after the KORUS FTA takes effect.[21]

Strong resistance to the pending KORUS FTA has been expressed by the UAW, which maintains the auto provisions were poorly negotiated. They view the agreement as opening the United States market to more South Korean automotive imports, while allowing South Korea to keep its market effectively closed through a variety of non-tariff barriers to U.S.-built products threatening auto production and jobs.[22] The American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) contends the KORUS FTA is flawed and argues U.S. negotiators "should go back to the table to address the imbalanced market-access provisions in the agreement" to amend it on more favorable terms to U.S. automakers.[23]

In Europe, the European Metalworkers' Federation (EMF) has expressed similar apprehension explaining the pending KOREU FTA would further worsen the already difficult situation of the European car sector and could result in significant job losses.[24] They see the pending KOREU FTA as unbalanced, which could give South Korean automakers a competitive advantage. European trade unions representing textiles, clothing, and leather workers are also on record against the KOREU FTA.[25]

A Possible First Mover Advantage

Manufacturers from the United States and the European Union compete to export their products to South Korea. Each side sells many of the same products to South Korean consumers. In 2009, U.S. goods exports to South Korea totaled $28.6 billion, while EU goods exports to South Korea were about the same at $29.8 billion (see **Table 1**). For U.S. manufacturers, South Korea was the sixth-leading goods export destination behind the larger and more commercially significant markets of the European Union, Canada, Mexico, China, and Japan in 2009. For EU manufacturers, South Korea ranked as the 12th-leading export market, well behind the United States, Switzerland, China, Russia, India, Canada, and Australia, among others, in 2009.[26] Major U.S. merchandise export categories to South Korea are machinery, medical devices, and aircraft and parts, while top EU goods exports to South Korea include machinery, vehicles (cars and trucks), and medical devices. U.S. and EU negotiators paid particular attention to these sectors as they negotiated their respective FTAs with South Korea.

[21] Robert E. Scott, *Free Trade Agreement with Korea Will cost U.S. Jobs*, Economic Policy Institute, July 1, 2010, http://www.epi.org/economic_snapshots/entry/free_trade_agreement_with_korea_will_cost_u.s._jobs/.

[22] UAW, International Trade and Investment Policy, http://www.uaw.org/node/1962.

[23] AFL-CIO, "Statement by AFL-CIO President Richard Trumka on the U.S.-South Korea Trade Agreement," press release, June 29, 2010, http://www.aflcio.org/mediacenter/prsptm/pr06292010.cfm. The AFL-CIO represents 11.5 million members.

[24] European Metalworkers' Federation, "EU Free Trade Agreement with South Korea Despite Its Record of Repeated Labour Rights Abuse," press release, March 9, 2009, http://www.emf-fem.org/Press/Press-releases/EU-Free-Trade-Agreement-with-South-Korea-despite-its-record-of-repeated-labour-rights-abuse. The EMF is an umbrella organization representing 75 metalworking unions from 34 countries, with a combined membership of 5.5 million.

[25] European Trade Union Federation Textiles, Clothing and Leather, "ETUF: TCL rises up in protesting against the EU-South Korea Free Trade Agreement," press release, September 18, 2009, http://www.etuf-tcl.org/index.php?s=7&rs=home&uid=491&lg=en.

[26] The ranking combines the EU-27 countries into a single market and excludes trade among the individual EU countries. The statistics were compiled from the Global Trade Information Services, Inc. (GTI) Global Trade Atlas.

Given this, some argue the implementation of a KORUS FTA or a KOREU FTA could provide a competitive advantage (a so-called first mover advantage) by displacing the other's products in the South Korean market. There is concern among some U.S. manufacturers that they could find themselves at a disadvantage if European goods enter the South Korean market duty-free, or if non-tariff barriers are eliminated for EU manufacturers, before U.S. products receive comparable benefits. If the KOREU FTA takes effect first, business groups such as NAM claim U.S. manufacturers could find themselves locked out of the South Korean market. According to NAM,

> Hundreds of thousands of U.S. jobs depend already on existing exports of manufactured products to Korea. We risk those jobs by not moving forward on the KORUS agreement as quickly as possible—already the EU is close to implementing their own FTA with Korea, which will make their exports far more competitive. We cannot fall behind in crucial markets like Korea.[27]

Table 1. U.S. and EU Goods Trade with Korea, 2009

(by leading exports in billions of U.S. dollars)

United States			European Union-27		
HTS Code			HTS Code		
	Total U.S. Goods Exports	$28.6		Total EU Goods Exports	$29.8
85	Electrical Machinery	$4.6	84	Machinery	$8.5
84	Machinery	$4.4	85	Electrical Machinery	$3.4
90	Medical Instruments	$1.9	87	Vehicles, Not Railway	$2.0
88	Aircraft/Spacecraft	$1.8	90	Medical Instruments	$1.8

Source: Statistics compiled from Global Trade Information Service's Global Trade Atlas and based on two-digit harmonized tariff schedule codes, or HTS codes.

Notes: HTS codes are recognized throughout the world to classify goods in trade for importing and exporting. For more information about the harmonized tariff schedule see the United States International Trade Commission, http://www.usitc.gov/tariff_affairs/about_hts.htm.

Notwithstanding a possible first mover advantage, it seems U.S. and EU manufacturers are likely to benefit less from their respective FTAs with South Korea when compared with the possible gains for South Korean manufacturers in the larger U.S. and EU markets. This is mostly because South Korea is a relatively smaller market with 48.6 million consumers and a gross domestic product (GDP) of $1.4 trillion. The United States market has nearly 310 million people and a GDP of $14.3 trillion, while the European Union market consists of 492 million people with a GDP of $14.4 trillion.[28] Yet, of the three pending FTAs negotiated by the United States, the one with South Korea is the largest.

So far, no data have been released by the U.S. government comparing the possible trade effects on U.S. exporters if the KOREU FTA is implemented before the KORUS FTA. One business advocacy group, the U.S. Chamber of Commerce, funded a study which found the United States

[27] Doug Goudie, *U.S.-Korea Trade, the Next Phase Toward More Jobs, Exports*, National Association of Manufacturers, July 2, 2010, http://shopfloor.org/2010/07/u-s-korea-trade-the-next-phase-toward-more-jobs-exports/12586.

[28] Central Intelligence Agency, *The World Factbook*, https://www.cia.gov/library/publications/the-world-factbook/.

could lose 345,017 jobs, $20.3 billion in export sales, and $40.4 billion in U.S. national output nationwide if the EU and Canada FTAs with South Korea are enacted and the KORUS FTA is not implemented.[29] Another estimate produced by the Ways & Means Committee Republican Staff found that the United States could lose $1.1 billion in exports to South Korea if the pending KOREU FTA is fully implemented and the United States fails to implement the KORUS FTA.[30]

A 2007 U.S. International Trade Commission (ITC) study on the KORUS FTA concluded the United States likely would import more South Korean products such as motor vehicles and parts, textiles and apparel, and footwear if the agreement is implemented.[31] The same pattern is forecast for Europe. Economic studies indicate South Korea will likely increase its exports of goods to the European Union, especially of automobiles and electronics.[32] South Korean-built cars exported to the European Union could be among the major beneficiaries once the KOREU FTA is implemented, as the European Union would eliminate its existing 10% tariff on South Korean-built cars within three to five years. Other South Korean industrial sectors might also gain market share in the European Union. Comparable export and import patterns also mean the KORUS FTA and KOREU FTA tackle many of the same issues because U.S. and European manufacturers compete directly in various industrial sectors. U.S. and EU consumers also stand to benefit from the two pending FTAs as a broader selection of goods, possibly at lower prices, become available due to increased trade with South Korea.[33]

Competing Automobile Manufacturers

Motor vehicles are the most controversial manufacturing issue in both agreements because of the industry's importance as a domestic employer and source of innovation, as well as an export sector for all three trading partners. A perceived imbalance in motor vehicle imports and exports has also raised the motor vehicle profile within the FTAs. In 2009, the United States, Germany, and South Korea ranked as the third, fourth, and fifth leading motor vehicle producers, respectively, worldwide (behind Japan and China).[34] Passenger car production by South Korea's

[29] U.S.-Korea Business Council, *Failure to Implement the U.S.-Korea Free Trade Agreement: The Cost for American Workers and Companies*, November 2009, http://www.uschamber.com/sites/default/files/reports/0911_fta_korea.pdf. This report does not cover the pending bilateral free trade agreement between Canada and South Korea. Negotiations on a Canada-Korea Free Trade Agreement (CKFTA) were launched in 2005. In addition, Canada and the European Union (CETA) launched FTA negotiations in 2009.

[30] U.S. Congress, House Committee on Ways and Means, Republican Staff with technical assistance provided by the U.S. International Trade Commission Staff, *America Falling Behind: As Other Countries Complete Trade Agreements, American Exporters and Workers Get Left Behind*, Results for U.S. Export Sectors that Experience a Decline of at least 5%, http://republicans.waysandmeans.house.gov/UploadedFiles/Copy_of_America_Falling_Behind_2_analysis.pdf.

[31] United States International Trade Commission, *U.S.-Korea Free Trade Agreement: Potential Economy-Wide and Selected Sectoral Effects*, USITC Publication 3949, Washington, DC, September 2007, pp. xix-xxvi, http://www.usitc.gov/publications/docs/pubs/2104F/pub3949.pdf.

[32] Yvan Decreux, Chris Milner, and Nicolas Peridy, *The Economic Impact of the Free Trade Agreement (FTA) between the European Union and Korea*, Report for the European Commission, CEPII/ATLASS, May 2010, p. 8. http://trade.ec.europa.eu/doclib/docs/2010/may/tradoc_146174.pdf.

[33] For more information about the economic effects of trade agreements, including consumption gains, see CRS Report RL31932, *Trade Agreements: Impact on the U.S. Economy*, by James K. Jackson.

[34] International Organization of Motor Vehicle Manufacturers, *2009 Production Statistics*, http://oica.net/category/production-statistics/. This ranking is based on total motor vehicle production (passenger cars, light and heavy trucks, and buses).

four domestic car manufacturers—Hyundai-Kia Motor Group, GM-Daewoo, Ssangyong Motor,[35] and Renault Samsung—was 3.2 million in 2009.[36] The Korea Automobile Manufacturers Association (KAMA) forecasts passenger car production to increase to 3.3 million in 2010, which could allow South Korean carmakers to boost their domestic car sales and their motor vehicle exports to both the United States and European Union as well as to other markets.[37]

An advantage for South Korean carmakers is they export two-thirds of their domestically built cars to the much larger U.S. and EU markets, which are more than 10 times larger than the South Korean market. U.S. light vehicle sales totaled 10.4 million units and new passenger car registration in the European Union added up to 14.5 million units in 2009.[38] This compares with the South Korean auto market where U.S. and EU carmakers vie to sell their domestically built cars in a considerably smaller market of 1.2 million passenger cars in 2009.[39]

A Comparison of U.S., EU, and South Korean Automotive Trade

As reported by the U.S. Commerce Department's Office of Transportation and Machinery, the United States automotive sector posted a trade deficit of $7.9 billion with South Korea in 2009, covering passenger vehicles and light trucks and auto parts.[40] This represented nearly three-quarters of the total U.S trade deficit with South Korea of $10.6 billion. The European Union's trade deficit with South Korea is mainly due to imports of cars and electronics.[41]

South Korea's car industry is export-driven. In 2009, South Korea's automakers exported over 60% of its total passenger car production worldwide.[42] Passenger vehicles built in South Korea are exported to the United States and the European Union in large numbers, even though exports were down considerably in 2009 over the previous year largely due to the overall economic downturn in the auto market. As shown in **Table 2**, South Korean carmakers exported just over 475,000 passenger vehicles and light trucks to the United States in 2009, down 23% over 2008. Exports of South Korean cars to the European Union totaled 350,000 units in 2009, a drop of 22% from 2008.[43]

[35] The Indian manufacturer, Mahindra & Mahindra, signed a memorandum of understanding in August 2010 to acquire a majority stake in Ssangyong Motor. The deal could be completed by November 2010.

[36] Korea Automobile Manufacturers Association (KAMA), *Reports & Statistics*, Summary, http://www.kama.or.kr/eng/R&s/Rsoften_e?key=Production. Passenger car production covers passenger cars and excludes the production of buses, trucks, and special purpose vehicles.

[37] KAMA, *Korean Automobile Industry March 2010*, April 8, 2010, http://www.kama.or.kr/board/Board?cmd=Detail&master_id=months_e&board_id=188.

[38] ACEA, "Passenger Cars: 2009 Registrations Down 1.6% compared to 2009," press release, January 15, 2010, http://www.acea.be/index.php/news/news_detail/passenger_cars_2009_registrations_down_16_compared_to_2008.

[39] KAMA, *Reports & Statistics*, Domestic Sales, http://www.kama.or.kr/eng/R&s/Rsoften_e?key=INDUSTRY&cmd=USER&ymGb=year.

[40] International Trade Administration, U.S. Department of Commerce, Office of Transportation and Machinery, "Automotive (Vehicles and Parts) Trade Data, 2000-2010," http://trade.gov/wcm/groups/internet/@trade/@mas/@man/@aai/documents/web_content/auto_stats_auto_trade_pdf.pdf.

[41] European Commission, DG Trade, *South Korea: EU Bilateral Trade and Trade with the World*, July 19, 2010, http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113448.pdf.

[42] American Automotive Policy Council, *Facts About the Korean Auto Industry and Economy*, Statistical Overview of the Korea Automotive Industry/Market & U.S. Trade Relationship, 2010, http://www.aapc.us/industry-facts.

[43] ACEA, *Trade, Key Figures*, 2010, p. 5, http://www.acea.be/images/uploads/files/20100518_2010_KEY_FIGURES_5_Trade.pdf.

Table 2. Passenger Car Imports from South Korea, 2008 and 2009

(in total units)

	2008	2009	% Change
United States	615,786	476,857	-23%
European Union	446,552	350,259	-22%

Source: International Trade Administration, Office of Transportation and Machinery, *Motor Vehicle Quickfacts,* and European Automobile Manufacturers' Association (ACEA), *Trade, Key Figures*, 2010.

Notes: U.S. passenger car import statistics cover passenger cars and light trucks and EU statistics only cover passenger cars.

The passenger car market in South Korea is dominated by its domestic manufacturers. There is a low import penetration rate: passenger car imports (cars made in the United States, the European Union, and other foreign markets and exported to South Korea) accounted for 5.2% of South Korea's total domestic sales in 2009 of 1.2 million cars, compared with 6.4% the previous year.[44] Cars manufactured by GM-Daewoo or Renault Samsung in Korea and sold in Korea are excluded from this market share figure.

Foreign carmakers exported nearly 61,000 passenger vehicles to South Korea in 2009, as shown in **Table 3**. Of these sales, European luxury vehicles such as BMWs, Mercedes, and Audis comprised over half; six of the top 10 best-selling imported cars by model were European brands, reports the Korea Automobile Importers & Distributors Association (KAIDA, see **Appendix A**). Japanese automakers accounted for 28% of all imported domestic passenger vehicles in 2009. U.S. car manufacturers represented the smallest share at 10% (with no American models among the top 10 best sellers among imported cars in 2009).[45] Based on these figures, some U.S. and European car manufacturers argue an unbalanced trade relationship exists. This has become a central issue for some lawmakers, both in the United States and the European Union. They believe auto trade needs to be more fully addressed before the pending KORUS or KOREU FTAs can be ratified.

On the other side, South Korea's auto industry, and the South Korean government, argues that while the number of imported cars may seem low, there has been a substantial increase in imports of U.S. and European-built cars over the last decade. Exports of U.S. automobiles to South Korea rose by nearly 400%, from 1,214 to more than 6,100, between 2000 and 2009, while European auto exports grew over 1,000% from 3,176 to 37,826 during the same period (see **Table 3**).

[44] KAMA, *Reports & Statistics*. Data calculation based on passenger car production and domestic sales.

[45] Statistics from the Korea Automobile Importers & Distributors Association (KAIDA), *Automotive Key Figures*, http://www.kaida.co.kr/statistics/home.action?programId=117#. In the United States, foreign-based automakers, including South Korean transplants, with manufacturing facilities here might also export some of their cars to South Korea. For instance, Daimler's passenger car unit, Mercedes-Benz U.S. International (MBUSI) in Tuscaloosa, Alabama, ships its SUVs worldwide since these vehicles are produced exclusively in the United States for global distribution. But tracking the sales of exports by U.S. transplants to foreign markets, including South Korean transplants, is not possible from public sources.

Table 3. Imported Passenger Vehicle Sales in the South Korean Market

(by selected year)

	2000	2004	2006	2008	2009
U.S. Manufacturers					
Ford	328	1,388	1,688	2,543	2,957
Chrysler	704	1,736	2,606	3,860	2,717
General Motors	182	385	262	577	466
Total U.S.	**1,214**	**3,509**	**4,556**	**6,980**	**6,140**
European Manufacturers	3,176	12,999	23,769	32,756	37,826
Japanese Manufacturers	0	6,837	12,205	21,912	17,027
Total Import Sales	**4,414**	**23,345**	**40,530**	**61,648**	**60,993**

Source: Korea Automobile Importers & Distributors Association (KAIDA) and the American Automotive Policy Council (AAPC).

Notes: European manufacturers include Jaguar and Land Rover, which are now owned by the Indian company Tata Motors, and Volvo, which as of 2010 is owned by the Chinese automaker Geely. Japanese manufacturers include the Renault-Nissan alliance (Renault owns 44.4% of Nissan and Infiniti is owned by Nissan). In 2009, combined Jaguar and Land Rover sales totaled 1,266 and Volvo sales were 1,724. Nissan sales in 2009 were 4,567. Data for 2000 was provided by AAPC.

Overseas Production by U.S., EU, and South Korean Automakers

Foreign automotive transplants, including South Korean transplants, have built major production facilities in the United States and the European Union. Likewise, U.S. and European automakers manufacture cars in overseas markets like South Korea. These cars are not covered by the tariff or non-tariff provisions in either pending FTA since they are all built domestically, but they represent an important component of automotive trade. Trade flows have been impacted by these investments. Presumably, increased production capacity of South Korean manufacturers within the United States and the European Union would displace some imports from South Korea.

South Korean Auto Production in the United States

South Korean automakers established production facilities in the United States in the mid-2000s. Hyundai started production in 2005 at its Montgomery, AL, plant, where it makes the Sonata and the Santa Fe Sports Utility Vehicle (SUV).[46] It now sources 46% of its U.S. sales with cars built in the United States.[47] A Kia factory opened in West Point, GA, in 2009. Because of these investments, in just five years, South Korea's U.S. transplants doubled their production, reaching

[46] Economic Development Partnership of Alabama, *An Alabama Industry Profile*, May 2007, pp. 3 and 6, http://www.aama.to/auto_profile.pdf.

[47] International Trade Administration (ITA), U.S. Department of Commerce, *The Road Ahead Phase II*, 2010, pp. 12-13, http://trade.gov/static/RoadAheadPhaseIIfinal.pdf.

196,000 light vehicles in 2009.[48] Also sales of U.S.-built cars by Hyundai increased 6% year-over-year from 188,351 in 2008 to 200,371 units in 2009.[49]

South Korean automotive transplants are major employers in the United States. For instance, Hyundai Motor Manufacturing Alabama (HMMA) directly employs more than 2,700 U.S. workers.[50] Kia Motors Manufacturing Georgia (KMMG) began mass production in November 2009; it now directly provides work for more than 1,200 U.S. workers and expects to double its workforce by the end of 2010.[51] HMMA and KMMG manufacturing plants also support thousands of jobs at supplier companies, thus sustaining an additional 5,500 jobs and some 7,500 jobs, respectively.

South Korean Auto Production in the European Union

South Korean car manufacturers also make and sell their passenger cars within the European Union. Kia and Hyundai have produced cars in the Slovak Republic and the Czech Republic since 2007 and 2008, respectively. Each auto plant has the capacity to produce 300,000 vehicles and engines. In 2009, passenger car production at the Kia plant totaled 150,000 and at the Hyundai plant production totaled 118,000.[52] South Korean automakers also make cars at European auto assembly facilities located outside the European Union; in nearby Turkey, for example.[53]

U.S. and European Joint Ventures with South Korean Automakers

U.S. and European automakers also have joint ventures with foreign competitors. GM sold nearly 115,000 cars directly to South Korean consumers through its South Korean subsidiary, GM-Daewoo or GM-DAT, in 2009.[54] The French carmaker Renault sells cars through its subsidiary, Samsung, with a production capacity of 300,000 vehicles a year; its 2009 South Korean sales volume totaled 133,630, the rest being exported.[55]

[48] ITA, Office of Transportation and Machinery, "U.S. Motor Vehicle Industry Domestic and International Trade Quick Facts," 2009, http://trade.gov/mas/manufacturing/OAAI/auto_stat_index.asp.

[49] "U.S. Light Vehicle Sales, December & YTD," *Automotive News*, January 5, 2010, http://www.autonews.com.

[50] Hyundai, *About HMMA*, http://www.hmmausa.com/company.aspx?id=28.

[51] Kia Motors Manufacturing Georgia, "Kia Celebrated Grand Opening of $1 Billion State-of-the-Art Automobile Manufacturing Plant in Georgia," press release, February 26, 2010, http://www.kmmgusa.com/news_02_26_10.aspx.

[52] Margit Koppen, *IMF Working Party on Trade, Employment, and Development*, IG Metall, February 2010, p. 13, http://www.imfmetal.org/files/10022415120510006/KOEPPEN_English.pdf.

[53] OICA, *World Motor Vehicle Production, by Manufacturer, Make, Country, and Type*, 2008-2009, http://oica.net/wp-content/uploads/hyundai-2009.pdf.

[54] General Motors Corporation and Korea's Daewoo Motor Company launched the GM Daewoo Auto & Technology Company, or GM-DAT, on October 17, 2002. GM holds a 72% stake in the Korean carmaker, with the rest of the company controlled by the state-run Korea Development Bank (17%), Suzuki (6.8%), and SAIC (6%). GM-Daewoo operates five manufacturing facilities in Korea and one assembly plant in Vietnam.

[55] Renault, *2009 Annual Report: Promoting Sustainable Mobility for All*, 2009, pp. 11, 31, and 75, http://www.renault.com/en/Lists/ArchivesDocuments/Renault%20-%202009%20Annual%20Report.pdf.

Automotive Tariff and Non-Tariff Barriers

Import duties protect the South Korean car market from foreign imports. Less overt are the technical non-tariff barriers, or so-called NTBs; they are increasingly of greater significance because they may impede exports from the United States and the European Union to South Korea. NTBs can take many forms including a complex regulatory regime, environmental and safety standards, import licenses, tax regimes, and bureaucratic arbitrariness. Customs duties and NTBs are covered in the KORUS FTA and the KOREU FTA.[56]

U.S., EU, and South Korean Automotive Tariffs

Customs duties differ in all three markets and the FTA timelines for their elimination vary. The pending KOREU FTA has a longer transition period, from three to five years depending on the size of the car, giving the European Union car industry a few years to adjust to new market conditions. Higher customs duties will be paid by European Union and South Korean automakers for a greater period of time than under the proposed KORUS FTA following implementation. The KORUS FTA eliminates most automobile tariffs either immediately or over three years (with one notable exception—truck tariffs, which will be phased out over 10 years).

It is unlikely tariff reduction by itself will significantly improve export volumes of U.S. or EU carmakers to South Korea, although U.S. and EU carmakers might be able to reduce their prices in the South Korean market of their higher-priced luxury vehicles such as the Lincoln MKX and MKZ, BMW 528, and Mercedes 3000. The case is different for South Korean automakers. They might increase their exports, or perhaps even raise their profit margins, in the much larger U.S. or EU markets. South Korean cars may appear to many to have a competitive advantage, as they are often more affordable than expensive luxury vehicles and SUVs produced by U.S. and European automakers. Fuel efficiency and generous warranties are other factors which contribute to strong sales of cars made by South Korean manufacturers.

KORUS FTA Auto Tariffs

The KORUS FTA requires South Korea to immediately eliminate its 8% tariff on all imported U.S.-built passenger cars, including hybrid vehicles, with two tariff rate exceptions.[57] In return, the United States would immediately remove its tariff of 2.5% on imported passenger vehicles with gasoline-powered engines up to and including 3,000 cubic centimeter (cc) engines (see **Appendix B**).[58] The 2.5% U.S. tariff on large car imports would be phased out over three years

[56] Technical barriers to trade in the KORUS FTA are found in Chapter 9 of the pending agreement and the sector specific annex in the KOREU FTA deals with trade in automobiles and parts (Annex 2-C).

[57] Korea's 8% tariff on electric vehicles (HSK 8703.90.70) and Other Vehicles (HSK 8703.90.90) is to be phased out over 10 years under the KORUS FTA, rather than immediately as would be the case for all other passenger vehicles. The United States would also maintain its 2.5% tariff on vehicles classified under HTS 8703.90 over 10 years. The KOREU FTA mandates South Korea phase out its 5% tariff on electric vehicles over five years and the European Union would eliminate its 10% tariff within five years. Electric vehicles might become a more important market in the future. The Obama Administration has established a target of putting 1 million plug-in electric vehicles on the road by 2015 as part of its New Energy for America plan, see http://www.barackobama.com/pdf/factsheet_energy_speech_080308.pdf.

[58] One measurement of car engines is displacement. An engine measurement in cubic centimeters shows the volumes displaced by the cylinders through one revolution. The higher the number, typically the more powerful the engine. Engine displacement can also be measured in liters (e.g., a 1.4 liter engine is equivalent to a 1,400 cc and a 1.8 liter (continued...)

on gasoline-powered vehicles with engine displacements greater than 3,000 cc and all diesel-powered passenger cars. As one example, Ford manufactures cars with large engine displacements such as the Explorer, Taurus, or Mustang. South Korea's 8% tariff on imported auto parts would be immediately eliminated, as would the U.S. 2.5% auto parts tariff.

KOREU FTA Auto Tariffs

EU negotiators rejected South Korea's proposal for an immediate abolition of tariffs on certain types of vehicles, particularly small cars. This was largely in response to concerns by EU automakers who worry Hyundai and Kia cars (e.g., vehicles like the Hyundai Accent or Elantra) could flood into Europe if the European Union car tariff of 10% is abolished. European manufacturers of small cars like Fiat are especially worried; its Bravo and Linea both have engine displacements below 1,500 cc. Instead, the KOREU FTA would eliminate customs duties on cars over three to five years in equal cuts depending on engine displacement size.

The European Union small car tariff of 10% for models with engines smaller than 1,500 cc would be eliminated within five years, while its tariffs on medium and larger sized vehicles (with engines larger than 1,500 cc covering cars such as the BMW 740i, Audi A4 2.0 TFSI quattro, or the Mercedes-Benz E300 EL) would be eliminated within three years.[59]

South Korea would phase out its 8% tariff on EU car imports over three or five years, depending on engine displacement size, rather than eliminating it immediately as agreed to under the terms of the KORUS FTA. European Union tariffs on auto parts, which range from 3% to 4.5%, depending on the product, would be eliminated immediately, as would South Korea's 8% tariff on imported auto parts from the European Union.

KORUS and KOREU FTA Truck Tariffs

All three markets maintain high truck tariffs, which are 10% in South Korea, 22% in the European Union, and 25% in the United States as shown in **Appendix B**. The high truck tariffs apply to pickup trucks, panel vans, and commercial vehicles, while many light trucks such as SUVs and minivans are counted as cars. Under the KORUS FTA, South Korea would eliminate its 10% truck tariff immediately, whereas the 25% U.S. tariff on trucks, which is 10 times higher than the U.S. auto tariff, would be phased out over 10 years in equal stages.[60] The KOREU FTA

(...continued)

engine is equivalent to 1,800 cc). A small car engine is generally around 1.6 liter such as the Hyundai Elantra; a larger one is the Ford Fusion at 2.5 liters; and even larger is the Chevy Impala with an engine as large as 5.3 liters.

[59] A comprehensive list of the elimination of customs duties as agreed in the KOREU FTA can be found in Annex 2-A, http://trade.ec.europa.eu/doclib/press/index.cfm?id=443. The European Union tariff reduction schedule for automobiles is found in Chapter 87 (vehicles other than railway or tramway rolling stock, and parts and accessories thereof), pp. 309-316, http://trade.ec.europa.eu/doclib/docs/2009/october/tradoc_145132.pdf and the tariff reduction schedule for South Korea can be found at http://trade.ec.europa.eu/doclib/docs/2009/october/tradoc_145133.pdf, pp. 262-267.

[60] Ford argues by dropping the 25% pickup truck tariff South Korean automakers could be encouraged to increase their domestic production of trucks for export, rather than incentivizing South Korean manufacturers to locate their production in the United States. However, Ford has also stated publicly it is not seeking to undo the United States tariff reductions already negotiated under the KORUS FTA. Ford's F-series model line has been the best-selling vehicle, car or truck, in the United States for 28 consecutive years, with sales of more than 400,000 trucks in 2009. Ford in the News, "Ford F-Series does it Again: Best-Selling Truck for 33 Straight Years; Best-Selling Vehicle for 28 Years," press release, January 7, 2010, http://www.fordinthenews.com/ford-f-series-best-selling-truck-33-years-running/.

stipulates immediate elimination of South Korea's 10% truck tariff on most trucks with some exceptions, whereby tariffs will be eliminated over three or five years. The European Union's 22% truck tariff will be removed over three or five years, depending on the type of vehicle.

Tariff Refund Provisions—Duty Drawback and Snapback

Another difference between the two FTAs is a duty drawback (DD) mechanism, which is only included in the KOREU FTA. The DD provision allows for reimbursement, or a tariff refund, of customs duties under certain conditions.[61] It permits South Korea to provide tariff refunds to South Korean manufacturers on automobile parts when the final product (e.g., an automobile) is exported to Europe. Under this arrangement, a South Korean car manufacturer can buy auto parts from manufacturers in low-cost countries, such as China, and claim the duties back when the vehicles containing the parts are shipped to the European Union market. European Union and South Korean negotiators agreed to cap the refund if there is a significant rise in imported parts and components starting five years after the KOREU FTA takes effect.

So far, there is little research on duty drawback and its consequences. But, some analysts believe South Korean imports of car parts from neighboring low-cost countries like China could increase significantly as a result of the agreement, and could possibly improve the price competitiveness of South Korean exports.[62] For example, Chinese radios could enter the European Union duty-free in South Korean cars using this mechanism, while EU companies will pay a tariff (14%) when importing the same radios from China.

ACEA, Europe's automotive industry trade group, opposes the DD provision. But, the European Commission maintains the impact of the DD system should be small since there is currently a low level of foreign content in South Korean products (below 10%).[63] This provision is being watched closely because it could serve as a model for future European FTAs (see **Appendix C**).

A "snapback" remedy is included in the KORUS FTA, but not in the KOREU FTA. The United States under its automotive dispute settlement procedure would maintain the right to reimpose pre-existing tariffs on cars if South Korea were to engage in unfair trading practices (the snapback provision does not extend to the 25% U.S. truck tariff). Some within the European Union argue the KOREU FTA should have included a KORUS FTA similar snapback provision. The European Parliament's Committee on International Trade has proposed a clause to accompany the KOREU FTA, which would strengthen the safeguard clause in case of an import surge.[64] It would, among other things, allow industry and the European Parliament to request an investigation (this provision applies not just to autos, but to any industries affected by increased imports) and proposes applying safeguard measures at the regional level in exceptional cases.[65] This matter

[61] Generally, a duty drawback is a measure that involves full or partial refund of paid import duties on imported raw materials to produce an exported item. Duty drawbacks are not in violation of WTO rules. The European Union and South Korea currently make use of duty drawbacks, which apply to goods trade and are not limited to automobiles.

[62] "European Auto Industry Set to Lose Out from South Korean Free-Trade Agreement—Analysis," *IHS Global Insight*, October 21, 2009, http://www.ihsglobalinsight.com/SDA/SDADetail17779.htm.

[63] Roberto, Bendini, "Briefing Note – EU-Korea Free Trade Agreement," Directorate General for External Policies Policy Department, September 2009, p. 7-8, http://www.europarl.europa.eu/meetdocs/2009_2014/documents/inta/dv/792/792791/792791en.pdf.

[64] Bilateral safeguard measures are found in the Trade Remedies (Chapter 3) section of the KOREU FTA.

[65] European Parliament, "EU-Korea Free Trade Agreement: Bilateral Safeguard Clause," June 28, 2010, http://www.europarl.europa.eu/oeil/FindByProcnum.do?lang=en&procnum=COD/2010/0032.

remains unresolved, as it raises several sticky issues for the European Union, including whether regional emergency safeguard measures (i.e., imposition of emergency tariffs in a single EU member state or group of countries in the event of an import surge) would violate the European Union's single market rules, and possibly threatens to delay ratification of the KOREU FTA for months.

Non-Tariff Barriers

Even with the final elimination of tariffs if the FTAs are implemented, U.S. and EU carmakers fear their access to the South Korean car market could remain capped because of subtle NTBs, which have been used to protect South Korea's domestic market and limit foreign imports. Often, NTBs can result in a lengthy and costly approval process for non-Korean based producers who export cars to South Korea. While South Korea's safety and environmental standards apply to both domestic and foreign car manufacturers, including U.S. and EU-built cars, South Korean manufacturers are better able to amortize the costs because they sell most of the cars purchased in the domestic market. Anti-import sentiment, used by the South Korean government in the past, is another example of an auto NTB.

Some in the United States and the European Union auto sectors remain skeptical South Korea will faithfully implement its NTB obligations in autos, even if the two pending FTAs are ultimately approved and implemented, given its past haphazard enforcement record. Skeptics maintain two U.S.-South Korea bilateral auto agreements, signed in the 1990s,[66] did little to dismantle long-standing auto NTBs and South Korea never respected its side of these agreements.[67] Ford Motor Company has chronicled the history of barriers to auto imports in South Korea, which was included in a statement to USTR on the pending KORUS FTA. Among other things, in their September 2009 statement Ford noted that despite the two agreements, "Korea continues to frequently enact technical requirements that have a disproportionately adverse impact on importers."[68] The South Korean ambassador to the United States, Ambassador Han Duk-soo, argued in a speech to the Detroit Regional Chamber of Commerce in August 2010 that "there was a time when the Korean auto market was protected. But that time is long gone, and the current perception is not based on current realities."[69]

Automotive Safety Standards

For years, unique South Korean automotive safety and environmental standards have been a major concern for U.S. and European carmakers. Some of the flagged technical import barriers include front tow hooks, headlamp standards, tinted rear-windows, and vehicle emissions changes. Safety and environmental standards have the potential to add costs associated with

[66] For more information about the 1995 and 1998 U.S.-Korea Memorandum of Understanding see Trade Compliance Center, *Korea Memorandum of Understanding Regarding Foreign Motor Vehicles*, http://tcc.export.gov/Trade_Agreements/Exporters_Guides/List_All_Guides/exp_005689.asp.

[67] Jeffrey J. Schott, "FTAs and the Future of US-Korean Trade Relations," Peterson Institute for International Economics, November 2009, p. 10, http://www.piie.com/publications/papers/schott200911.pdf.

[68] Ford Motor Company, Statement on the Free Trade Agreement with the Republic of Korea (KORUS-FTA), *Submitted to the Interagency Trade Policy Staff Committee*, Office of the United States Trade Representative, September 15, 2009, p. 12.

[69] Ambassador Han Duk-soo, speech before the Detroit Regional Chamber of Commerce, August 18, 2010, p. 6.

compliance, thus both the KORUS and KOREU FTAs include provisions to address those standards viewed as unfair by some U.S. and EU automakers.

Globally, two main systems regulate motor vehicle safety standards:

- U.S. and Canadian auto safety standards are based on a self certification system (in the United States it is the Federal Motor Vehicle Safety Standards, or FMVSS, and in Canada there is an analogous regulation called the Canada Motor Vehicle Safety Standard, or CMVSS, which is largely similar to and patterned after the FMVSS).

- In most of the rest of the world, auto safety standards are based on the main international standardizing body for automotive products, which are set by the United Nations Economic Commission for Europe (UNECE).[70]

There is also a third way. A country like South Korea can decide to require compliance with its own standards, making it expensive for foreign-based manufacturers to export cars to the relatively smaller South Korean market, or in some cases effectively shutting foreign producers out of the market altogether. Some in the United States government and industry claim South Korean auto standards are "unique, non-transparent and out of sync with international standards."[71] Yet, at the same time, it is important to recognize the United States adheres to its FMVSS system and distinctively does not recognize UNECE approvals, which are used in most countries. Thus, cars cannot be imported or exported between the United States and most of the rest of the world without appropriate modifications. Both FTAs deal with this issue.

KORUS FTA

Reflecting differences in standards setting, the United States approach differs from that of the European Union, and most other countries. Distinct from the KOREU FTA, the KORUS FTA permits "low-volume seller exemptions," which allow each U.S. automaker to sell up to 6,500 vehicles per year in South Korea built to U.S. safety standards without any additional modification.[72] The low-volume seller exemption nearly equals the number of cars sold by all three U.S. automakers combined in South Korea in 2009 (see **Table 3**). Some worry the exemption could act as a ceiling and effectively become a disincentive for U.S. carmakers to export more cars to South Korea.

[70] The UNECE standards are established by the World Forum for Harmonization of Vehicle Regulations often referred to as a working party, WP.29, which is assigned the task of creating a uniform set of regulations for vehicle design covering matters such as vehicle safety, environmental protection, and energy efficiency. These standards are designed to facilitate international trade and there seems to be momentum to develop true global technical regulations (GTR) (already there are nearly a dozen approved GTRs). More information about worldwide harmonization of vehicle regulations can be found on the International Organization of Motor Vehicle Manufacturers website, see http://oica.net/category/worldwide-harmonization/.

[71] U.S. International Trade Commission, *U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects*, Investigation No. TA-2104-24, Washington, DC, September 2007, pp. 3-76, http://www.usitc.gov/publications/docs/pubs/2104F/pub3949.pdf.

[72] Office of the United States Trade Representative, *KORUS FTA: Opportunities for Automotive Exports*, October 2008, p. 2, http://www.ustr.gov/sites/default/files/uploads/factsheets/2008/asset_upload_file500_15206.pdf.

KOREU FTA

Under the KOREU FTA, South Korea commits to recognize UNECE regulations for automotive products as equivalent to South Korean domestic standards for core safety once the agreement enters into force.[73] Another 29 standards covering such technical regulations as seat belts, passenger seats, headlamps, and rearview mirrors will be harmonized with UNECE regulations within five years. All other standards not subject to harmonization or equivalence are expected to be applied in a manner which does not limit market access. Any new standards would be based on UNECE standards, and going forward new features and technologies are required not to hinder trade.[74]

The European Commission claims the agreement contains strong provisions guaranteeing an almost complete harmonization of technical standards and rules between the two parties of the agreement. For example, safety standards such as crash tests in compliance with European standards will be recognized by South Korea.

Others argue the KOREU FTA does not fully acknowledge international standards and South Korea will continue to apply its own unique rules. ACEA maintains EU access to the South Korean car market will continue to remain limited even with the implementation of the KOREU FTA because an approved and tested EU car cannot be sold directly in South Korea without costly modifications.[75]

In the safety standards realm, the European Union seems to be trying to win equal, if not better, footing against U.S. automakers in the South Korean market. Common auto norms could help EU car manufacturers develop products, reduce costs, and improve their economies of scale when exporting to South Korea. USTR has committed to a closer examination of these differences to fully understand the possible commercial implications for U.S. manufacturers of autos.

Environmental Protection Standards

Environmental protection standards are another way a country can impede trade. U.S. and EU-built cars exported to South Korea must adhere to South Korean environmental norms, which include local standards on vehicle emissions. Environmental standards are addressed in both pending FTAs. Each covers measures related to emission standards, such as South Korea's Ultra Low Emission Vehicles requirements and on-board diagnostics, or OBD systems, which monitor the emission control in a car. Despite the provisions in both FTAs, there is concern by U.S. and EU automakers that they will continue to incur significant additional costs to meet South Korean environmental standards. They also worry about the potential consequence of new environmental standards that might be adopted in the future.

[73] The automotive standards are listed in Appendix 2-C-3 and cover such things as steering control, seating systems, head restraints, sun visor impact, and lighting and signaling systems, http://trade.ec.europa.eu/doclib/docs/2009/october/tradoc_145157.pdf.

[74] European Commission, DG Trade, *EU-Korea FTA: A Quick Reading Guide*, October 20, 2009, p. 3, http://trade.ec.europa.eu/doclib/docs/2009/october/tradoc_145203.pdf.

[75] ACEA, The EU is Negotiating an FTA with South Korea – Facts and Figures, http://www.acea.be/images/uploads/files/20090714_Facts_on_FTA_with_South_Korea.pdf.

Other Automotive-Related Non-Tariff Barriers

Several other auto-related non-tariff barriers impact automotive trade, including South Korea's tax structure for automobiles, rules of origin, and the negative perception (or anti-import sentiments) on the part of some South Korean consumers about imported vehicles. KORUS FTA and KOREU FTA provisions related to remanufactured goods and the Kaesong Industrial Complex also affect automotive trade.

Automotive-Specific Taxes

Specific taxes assessed on motor vehicles are seen as another barrier to foreign car sales in South Korea since these taxes play an important role in determining the final price of a vehicle. A special consumption tax, an educational tax, a value-added tax, a registration tax, and a subway bond are among the taxes which apply to automobiles. These taxes are often based on engine size, with higher taxes assessed on vehicles with larger engines (2,000 cc or larger) which tend to be foreign cars built in the United States or the European Union. The 2008 World Trade Organization (WTO) trade policy review on South Korea reported that "the effect of multiple automotive taxes raises the effective rate of protection to above 12%,"[76] which is viewed by European and U.S. car industry associations as unfair.

Automotive-specific taxes are approached differently in the KORUS and KOREU FTAs. The KORUS FTA specifically addresses South Korea's motor vehicle tax system and includes provisions to reduce aspects of South Korea's Special Consumption and Annual Vehicle Taxes.[77] The KOREU FTA simply affirms any modification to South Korean auto taxes will be made on a "most favored nation" basis with any changes to South Korea's regulatory or tax structure applying to all WTO members.[78]

Dispute Settlement

Expedited automotive dispute settlement mechanisms are a part of both FTAs, but they vary. Differences include how quickly each panel would reach a decision and the remedies open to the parties involved. A final arbitration ruling under the KOREU FTA would be shorter (reduced to 75 days from 120 days); this compares to the 141 days it could take for a final report under the KORUS FTA.[79] Analysts point out while the KOREU FTA could produce a faster decision, the KORUS FTA has stronger remedy provisions, including a "snapback" from zero to the MFN tariff for the aggrieved party, which is 2.5% in the case of the United States.

Automotive working groups are established by both agreements and would meet at least once a year; their objective is to serve as an early warning system for potential trade barriers related to

[76] World Trade Organization, *Trade Policy Review Republic of Korea 2008*, October 8 and 10, 2008, p. 109, http://www.wto.org/english/tratop_e/tpr_e/tp_rep_e.htm.

[77] For more information about Korea's Special Consumption Tax and Average Vehicle Tax, see CRS Report RL34330, *The Proposed U.S.-South Korea Free Trade Agreement (KORUS FTA): Provisions and Implications*, coordinated by William H. Cooper, see pp. 16-17.

[78] Most Favored Nation commits one country to offer non-discriminatory access to another on a reciprocal basis.

[79] The dispute settlement provisions related to automobiles can be found in Annex 22-A of the KORUS FTA and Annex 2-C of the KOREU FTA.

testing and certification standards and the implementation of future standards and requirements related to autos.[80] U.S. automakers have already raised new NTB concerns about South Korea's Low Carbon Green Growth Act, which some believe might result in more environmentally stringent standards for foreign-built cars.[81] Such concerns may be handled by a working group established under the KORUS FTA.

Rules of Origin

Rules of origin are used to verify that products are eligible for duty-free status under preferential trading programs, including free trade arrangements. A local content test is required to ensure that a product contains a minimum percentage of domestic value-added in the originating country and is thus eligible to receive a tariff benefit.[82] The levels of permissible foreign content for autos under the KOREU FTA were raised from the current EU standard rule of 40% to 45%. The rules of origin foreign content provision in the KORUS FTA is 35%.[83]

South Korean Anti-Import Sentiments

The United States and South Korea have been working to resolve negative perceptions regarding auto imports into South Korea and to eliminate specific South Korean government and industry anti-import activities. Among the ways in which South Korean consumers have been discouraged from purchasing foreign motor vehicles are tax audits when a foreign car is purchased or banning foreign automobiles at company parking lots. A 1998 memorandum of understanding (MOU) between the United States and South Korea was concluded to improve the perception of foreign-produced cars and to address anti-import policies that discourage the purchase of imported motor vehicles. Foreign auto manufacturers like Ford claim South Korea's anti-import bias still exists.

Remanufacturing

The issue of remanufactured goods also impacts the auto industry, in particular the auto parts sector, as well as other industries. Remanufactured goods are a niche market for U.S. exporters, which extend across the range of manufactured products including auto parts, tires, furniture, laser toner cartridges, computers, cellular phones, medical equipment, electrical equipment, and other devices.[84] The Department of Commerce defines remanufactured goods as those products "that are partially made from components recovered from end-of-life products combined with

[80] Office of the United States Trade Representative, *KORUS FTA: Opportunities for Automotive Exports*, October 2008, p. 2, http://www.ustr.gov/sites/default/files/uploads/factsheets/2008/asset_upload_file500_15206.pdf.

[81] Office of the U.S. Trade Representative, *2010 National Trade Estimate Report on Foreign Trade Barriers*, Korea. p. 8.

[82] For a detailed discussion on rules of origin, see CRS Report RL34524, *International Trade: Rules of Origin*, by Vivian C. Jones and Michael F. Martin.

[83] The KORUS FTA uses three rule of origin methodologies: net cost, adjusted value/build-up, and adjusted value-build-down. The regional value content levels assigned for vehicles considered eligible for FTA treatment are: 35% for the net cost method; 35% for AV-build-up; and 55% for AV-build-down. Rules of origin provisions are found in Chapter 6-A of the pending KORUS FTA agreement.

[84] Statistics on how much trade is involved in remanufactured goods are hard to come by because trade statistics do not include a separate product classification for these products.

new components in place of certain worn or damaged products that are no longer useable. The process transforms the recovered and new components into "like-new" goods."[85]

The automotive industry is particularly interested in the FTA provisions related to remanufactured goods. This is because worldwide the remanufactured automotive parts industry is estimated to be valued at about $85 to $100 billion, and at about $40 billion in the United States alone in 2009.[86] Remanufactured goods are treated differently under the KORUS and KOREU FTAs. South Korea currently allows imports of remanufactured goods, unlike many countries which limit trade in remanufactured products, with requirements on certain goods, particularly medical devices. The KORUS FTA would permit free trade in these goods, while the KOREU FTA does not cover these products. This could provide U.S. remanufacturers with better market opportunities and greater certainty, predictability, and transparency in their trade with South Korea than would be present between the European Union and South Korea, where the treatment of an originating good would be decided on a case-by-case basis.

Kaesong Industrial Complex

The Kaesong Industrial Complex (KIC) was established in North Korea in 2002 as a way to provide North Korea with hard currency earnings. Over half the products produced in the KIC are textiles and clothing; metals and machinery together comprise another 20% of the KIC's current production. From the auto industry perspective, more automobile parts manufacturing plants might be established in the KIC over time if it expands as planned.[87]

How KIC-produced goods will be treated under the pending KORUS and KOREU FTAs requires clarification. In both instances, a Committee on Outward Processing Zones (OPZ) on the Korean Peninsula would be established. Under the KORUS FTA, the OPZ's purpose is to consider whether the KIC products will receive duty-free treatment, which would be evaluated using various criteria such as environmental standards, labor standards, or management practices prevailing in the KIC or progress on denuclearization of the Korean Peninsula, among others. While the KOREU FTA contains a similar provision on the KIC, there are some differences. The pending KORUS FTA would require legislative approval of the OPZ committee's recommendations by South Korea and the U.S. Congress. The KOREU FTA does not require additional legislative approval of products from the KIC. It also does not specify what criteria would be used to evaluate the inclusion of goods from the KIC.

Overview of Other Selected Manufacturing Sectors

Beyond automobiles, other manufacturing sectors could also be impacted if the KORUS and KOREU FTAs are implemented. For U.S. manufacturers, South Korea is an important market. In 2009, South Korea ranked as the 10th-largest market for U.S. manufactured goods by country.[88]

[85] U.S. Department of Commerce, International Trade Administration, Office of Transportation and Machinery, *On the Road: U.S. Automotive Parts Industry Annual Assessment*, U.S. Department of Commerce, 2010, pp. 14-16, http://trade.gov/wcm/groups/internet/documents/article/auto_reports_parts2010.pdf.

[86] Ibid., p. 14.

[87] For a detailed discussion on the KIC, see CRS Report RL34093, *The Kaesong North-South Korean Industrial Complex*, by Dick K. Nanto and Mark E. Manyin.

[88] World Trade Organization, "Leading Exporters and Importers of Manufactures, 2008," Table 11.31. Global Trade (continued...)

Both U.S. and EU manufacturers must pay tariffs of 5% or greater on almost 80% of all industrial products when exporting to South Korea, with most of the tariffs ranging from 5% to 15% (see **Table 4**).[89] The elimination of South Korean tariffs on manufacturing products under the KORUS and KOREU FTAs should provide greater price competitiveness for U.S. and EU exporters of manufactured goods across a range of industries. South Korean manufacturers could benefit as the United States and the European Union reduce or eliminate their industrial tariffs. The two FTAs also address non-tariff barriers, which remain challenging across various manufacturing sectors.

This section of the report provides a brief overview of the proposed tariff reductions. It also examines how non-tariff barriers would be addressed in selected manufacturing sectors, namely household appliances, consumer electronics, textiles and apparel, and pharmaceuticals and medical devices.

Table 4. Selected South Korean Industrial Tariffs

Product	Tariff
Large Appliances/Consumer Electronics	8%
Pharmaceuticals	6.5% to 8%
Medical Devices	6.5% to 13%
Textiles	8% to 13%

Source: CRS, compiled from the South Korean tariff schedule and the U.S. International Trade Commission.

Home Appliances

The home appliance, or white goods, sector is a concentrated globalized industry mainly comprised of major U.S., European, and South Korean manufacturers. U.S.-headquartered Whirlpool and GE Consumer and Industrial compete against appliance manufacturers located in Europe (e.g., Electrolux, Bosch and Siemens Hausgeräte) and South Korea (e.g., LG Electronics and Samsung). South Korea's export-oriented appliance manufacturers appear to hold a much larger U.S. and EU market share compared with the rather insignificant share for U.S. and EU companies in the South Korean market.[90] Some Members of Congress have expressed concerns about Whirlpool's difficulties in selling U.S.-made refrigerators in South Korea.[91] In its 2007 review of the KORUS FTA, the ITC noted that exports of U.S. appliances to South Korea have been encumbered by an 8% tariff and standards and conformity assessment requirements.[92]

(...continued)

Information Services provided CRS with 2009 statistics based on the WTO's definition for manufactures.

[89] Foreign Affairs and International Trade Canada, "A Free Trade Agreement with Korea: Industrial Sector Opportunities," http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/korea-coree/FTA-Industrial-Fact-Sheet.aspx?lang=en.

[90] Letter from American Chamber of Commerce EU, February 13, 2008, http://www.amchameu.eu/. CRS contacted Appliance Magazine.com for country-specific market share data and they confirmed that market share data in this highly competitive industry are not available.

[91] Whirlpool produces appliances in several U.S. locations, including Ohio and Michigan. However, in the last few years, it has shuttered U.S.-based production facilities in Tennessee, Mississippi, and most recently, Indiana.

[92] United States International Trade Commission, *U.S.-Korea Free Trade Agreement: Potential Economy-Wide and* (continued...)

Also, in recent years, South Korean appliance manufacturers have located production facilities in North America and the European Union. For instance, LG Electronics operates plants in Mexico to be closer to their U.S. customer base.[93] Samsung is also establishing a manufacturing presence in Europe, through the recent acquisition of the home appliance manufacturer, Amica, which should help it to sell appliances in the European market, estimated at around $50 billion.[94]

U.S. and European exporters of household appliances should benefit from the pending FTAs through the immediate elimination of South Korea's 8% tariff on large home appliances (compared to tariffs which are either zero or well below 4% for most large appliances in the United States or European Union). The two pending agreements also focus on non-tariff barriers including standards and conformity assessment procedures, which currently obligate importers to duplicate cumbersome and expensive testing and certification procedures. Also, the technical barriers to trade chapters in the KORUS and KOREU FTAs provide for greater cooperation and transparency in the standards setting process.[95]

Whether the KORUS or the KOREU FTAs will provide greater benefits to U.S. or European appliance makers remains to be seen. In both markets, the competitive advantage appears to favor South Korean manufacturers. For example, U.S. exports of household appliances to South Korea totaled $46.7 million, while appliance imports from South Korea were substantially higher at $1.7 billion in 2009 (South Korea was the United States's third-largest source of imports after China and Mexico).[96] Notwithstanding the competitiveness of South Korean appliance makers, higher transportation costs and greater competition from lower-priced Chinese appliance manufacturers are among the factors that also act as restraints on export flows from South Korea to the U.S. and EU markets.

Consumer Electronics

The U.S. electronics industry is largely supportive of the KORUS FTA, and advocates its implementation through their various industry associations like the Information Technology Industry Council. The European digital technology industry has expressed its reservations about the KOREU FTA.[97] Its concerns center on the largely closed South Korean market for electronics, while highly competitive South Korean companies such as Samsung and LG stand to improve their access to the European market. Their particular concerns are rules of origin and duty

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Selected Sectoral Effects, USITC Publication 3949, Washington, DC, September 2007, pp. 3-72 and 3-73, http://www.usitc.gov/publications/docs/pubs/2104F/pub3949.pdf.

[93] LG Electronics operates three plants in Mexico, which make mobile phones, refrigerators, and LCD panels. Most of the products produced there are exported to the United States, http://www.lg.com/us/about-lg/corporate-information/overview/global-operations.jsp?Area=Global|NA&Nation=MX.

[94] Samsung, "Samsung Acquires Amica's Refrigerator and Washing Machine Manufacturing Facilities in Poland," press release, December 23, 2009, http://www.samsung.com/us/aboutsamsung/news/newsIrRead.do?news_ctgry=irnewsrelease&news_seq=16078.

[95] The technical barriers to trade chapters are chapters 9 and 4, respectively, in the KORUS and KOREU FTAs.

[96] Household appliance exports and imports are based on North American Industry Classification System (NAICS) 3352, Household Appliances and Misc. Machines, National Elsewhere Specified or Included (NESOI), as reported by the U.S. Department of Commerce, Office of Trade and Industry Information, http://tse.export.gov/TSE/TSEhome.aspx.

[97] Europe's digital technology industry is represented by the European Industry Association for Information Systems, Communication Technologies and Consumer Electronics (EICTA).

drawback.[98] Despite this, Europe's technology industry is not actively lobbying against the KOREU FTA.[99]

Tariff elimination is expected to have minimal impact on exports to South Korea since the majority of information technology and electronics products, such as semiconductors, telecommunications equipment, and computer equipment, already receive duty-free access to the South Korean market under the WTO's Information Technology Agreement (ITA).[100] Manufacturers of electronic products not covered by the ITA such as digital cameras and color TVs could increase their exports as South Korea's 8% tariff on these products will be eliminated immediately upon implementation of the KORUS and KOREU FTAs. The impact on TV manufacturers located in the United States is likely to be non-existent since there is none. General Electric stopped manufacturing televisions in the United States in 1984; Zenith ended its U.S. production in 1992; and, more recently, Sony shuttered its last U.S. TV manufacturing facility located in Pennsylvania.[101] South Korean consumer electronics makers stand to gain from the immediate elimination of the small number of existing EU and U.S. tariffs on consumer electronics, with a small number of exceptions for products such as microwave ovens in the case of the European Union.

Included in the KOREU FTA is a special annex on non-tariff barriers related to consumer electronics. One provision allows most EU manufactures to sell their products in South Korea based on a manufacturers' declaration of conformity with the relevant standards in South Korea (i.e., the firm selling a product would be responsible for certifying the product meets South Korean standards). That process would not require them to undergo duplicative and expensive testing and certification procedures. This should make it easier and less cumbersome for EU manufacturers to export consumer electronics to South Korea, effectively reducing their costs and cutting back on bureaucratic hurdles. A three-year transition period will apply to some products during which time third party certification will still be required. Some exceptions continue under the KOREU FTA for a limited number of products involving electrical safety because of the potential risks for human health and safety. For these products—numbering just over 50 including switches, power transformers, vacuum cleaners, and dishwashers—third party certification may still be required (covering about 15% of EU exports).[102] Separate provisions on standards, testing, and certification for consumer electronics exports from the United States to South Korea is not a part of the KORUS FTA.

Textiles and Apparel

Textiles and apparel is another example of a sensitive manufacturing sector in the trade relationship among all three markets. The International Trade Commission points out that experts in the South Korean textile and apparel industry agree that it would benefit substantially under the

[98] Digital Europe, "EICTA Position on EU-Korea Free Trade Agreement," press release, September 17, 2008, http://www.digitaleurope.org/index.php?id=34&id_article=273&.

[99] Information obtained by CRS from an email exchange with Digital Europe on April 12, 2010.

[100] More information about the Information Technology Agreement can be found at http://www.wto.org/english/tratop_E/inftec_e/itaintro_e.htm.

[101] Martyn Williams, "Sony to Close Last U.S. TV Factory," *Computerworld*, December 10, 2008, http://www.computerworld.com/s/article/9123160/Sony_to_close_last_U.S._TV_factory.

[102] A complete list of all products covered under this arrangement are included in Appendix 2-B-3 of the KOREU FTA, http://trade.ec.europa.eu/doclib/docs/2009/october/tradoc_145149.pdf.

FTA and that some U.S. domestic production will likely be displaced.[103] Tariffs are in place in the United States and the European Union to protect their respective textile and apparel manufacturers. The average U.S. Most Favored Nation (MFN) tariff on textiles is 8% and the European Union also maintains an MFN applied duty of 6.6% on textiles.[104] The South Korean average applied MFN tariff on textiles is higher than the average U.S. and EU tariffs at 9.1%. Apparel tariffs in the three markets range from 11.5% to 12.6%.[105]

Implementation of the two FTAs would result in the abolition of most tariffs on textiles and apparel, the overwhelming majority of which will be implemented immediately upon enforcement. This should provide U.S., EU, and South Korean textile and apparel manufacturers greater access to each others markets, with South Korean textile manufacturers likely to increase their exports to the United States and European Union markets.

Textile and apparel trade is governed by complex rules of origin. The KORUS FTA adopts the "yarn forward" rule, which means generally apparel using yarn and fabric from the United States and South Korea qualifies for preferential tariff treatment. A special textile safeguard is included, which allows the United States to impose tariffs on certain goods should injury occur due to import surges.[106] The KOREU FTA will maintain the European Union's standard rules of origin on textiles with only a small number of exceptions. The KORUS FTA provides for the establishment of a Committee on Textile and Apparel Matters to respond to concerns, whereas the KOREU FTA does not include a separate committee or working group on textiles among the six specialized committees and seven working groups that would be established.

As discussed earlier, textile and apparel products manufactured in the KIC are significant, but these products are not covered explicitly in the KOREU FTA due to political sensitivity regarding labor issues. Likewise, the proposed KORUS FTA does not seem to provide for duty-free entry into the United States for products made in the KIC, including textiles and apparel.

The U.S. textile and apparel industry appears split on their views of the KORUS FTA according to the industry's submission to the Industry Trade Advisory Committee on Textiles and Clothing (ITAC-13).[107] Some U.S. textile and apparel manufacturers are concerned about increased competition from South Korea's large, efficient textile industry, and see little in the way of increased access to the South Korean market from what they believe is an extremely one-sided agreement. Several textile and apparel groups, including the National Textile Association, the National Council of Textile Organizations, and the American Fiber Manufacturers Association maintain the textile chapter in the KORUS FTA will "open up the United States market to a massive one-way flow of South Korean textiles, apparel, and home furnishings in the United

[103] United States International Trade Commission, *U.S.-Korea Free Trade Agreement: Potential Economy-Wide and Selected Sectoral Effects*, USITC Publication 3949, Washington, DC, September 2007, pp. 3-51 and 3-52, http://www.usitc.gov/publications/docs/pubs/2104F/pub3949.pdf.

[104] MFN refers to the Most Favored Nation principle in the World Trade Organization. Under WTO rules, when a country grants another country a tariff reduction or other concession, that country has to extend the reduction to all other WTO countries. In the case of the pending KORUS or KOREU FTAs, tariffs could be lowered below MFN levels, as it is a bilateral agreement, not a multilateral agreement.

[105] World Trade Organization, *World Tariff Profiles*, 2009.

[106] Office of the United States Trade Representative, *Free Trade with Korea*, Summary of the KORUS FTA, April 2007, p. 2, http://www.cptech.org/ip/health/c/korea/ustrfactsheet.pdf.

[107] Industry Trade Advisory Committee on Textiles and Clothing, (ITAC-13), April 27, 2007, http://ustraderep.gov/assets/Trade_Agreements/Bilateral/Republic_of_Korea_FTA/Reports/asset_upload_file656_12766.pdf.

States."[108] They argue the KORUS FTA is deficient in three areas (tariff phase-out schedules are nonreciprocal and benefit South Korean producers; rules of origin need to be strengthened for certain components; and customs enforcement must be improved). Also they note that U.S. exports to South Korea are subject to a 10% Valued Added Tax (VAT) with no comparable VAT on imports to the United States from South Korea. On the other side, the American Apparel & Footwear Association has expressed its general support for the KORUS FTA, with the footwear industry strongly supportive of the KORUS FTA.

Europe's textile sector is anxious about the likely repercussions of the KOREU FTA because of concerns about more jobs losses.[109] The European Trade Union Federation: Textiles, Clothing, Leather (ETUF: TCL) is strongly opposed to the KOREU FTA citing concerns about the duty drawback provision and rules of origin.[110] EURATEX, the European Apparel and Textile Confederation, seems to be more supportive of the agreement and views it as a means to further develop trade between the two regions. EURATEX signed a cooperation agreement in December 2009 with the Korea Federation of Textile Industries which would, among other things, permit a better exchange of information and a closer monitoring and surveillance of the KOREU FTA, particularly on rules of origin and duty-drawback utilization.[111]

Pharmaceuticals and Medical Devices

South Korea is one of the most significant markets for pharmaceuticals and medical devices in Asia. It relies heavily on imports from the United States and the European Union, along with Japan, to supply demand. The South Korean pharmaceutical and medical device (P&M) sectors are forecast to grow in the years to come as its population ages. According to one industry report, South Korea's pharmaceutical market was valued at around $9 billion in 2008.[112] Foreign-based pharmaceutical manufacturers account for approximately 30% of the pharmaceutical market in South Korea, with industry experts forecasting that this share could rise in coming years.[113] Similarly, future growth for U.S. and EU medical device companies is expected to come from emerging markets like South Korea.

Data from 2009 show South Korea imported $3 billion in pharmaceutical products; the European Union comprised over 50% ($1.5 billion) of these sales and the United States constituted 19% ($586 million). Swiss and Japanese pharmaceutical manufacturers were also a significant

[108] Letter from American Manufacturing Trade Coalition, National Council of Textile Organizations, and National Textile Association, et al. to Ron Kirk, United States Trade Representative, August 4, 2010.

[109] European Apparel and Textiles Organization, *Annual Report*, Activities of the Year, 2008, July 1, 2009, p. 21, http://developpement.euratex.org/news-and-publications/63. http://developpement.euratex.org/news-and-publications/30

[110] European Trade Union Federation Textiles, Clothing, and Leather, "ETUF: TCL Rises Up in Protesting against the EU-South Korea Free Trade Agreement," press release, September 21, 2009, http://www.etuf-tcl.org/index.php?s=7&rs=home&uid=491&found=1&lg=en.

[111] Euratex, "Euratex-KOFOTI MOU Official Ceremony," press release, December 10, 2009, http://www.euratex.org/content/euratex-kofoti-mou-official-ceremony.

[112] *The South Korean Pharmaceutical Market Outlook to 2014: Healthcare Regulation and Reforms, Disease Burden and Market Dynamics*, May 1, 2010, http://www.companiesandmarkets.com/Summary-Market-Report/the-south-korean-pharmaceutical-market-outlook-to-2014-healthcare-regulation-and-reforms,-disease-burden-and-market-dynamics-297263.asp.

[113] "South Korea: Healthcare and Pharmaceuticals Report," *Economist Intelligence Unit*, October 20, 2009, p. 5.

presence, selling $261 million and $220 million in South Korea, respectively, in 2009.[114] Given the popularity of foreign-branded drugs, South Korea's pharmaceutical trade deficit grew in the past five years, jumping from $1.3 billion in 2005 to $2.1 billion in 2009.

South Korea's medical equipment and supplies market, which is broader than just medical devices, was worth $2.1 billion in 2009 and is predominantly supplied by imports (77%), according to one estimate.[115] A market research study by Espicom found that South Korea will be one of the fastest growing medical device markets in Asia, forecasting a market growth rate of 11.2% between 2009 and 2014.

U.S. trade groups, like the Pharmaceutical Research and Manufacturers of America (PhRMA), favor the KORUS FTA because they expect it will facilitate increased trade with the easing of tariff and non-tariff barriers between the United States and South Korea.[116] U.S. industry maintains current South Korean government policies appear to largely favor South Korean manufacturers (e.g., through pricing and reimbursement policies), the regulatory regime often seems non-transparent, and foreign manufacturers complain about unethical business practices. The EU pharmaceutical industry complains about the same policies. Thus, both agreements include chapters (or annexes) on pharmaceuticals and medical devices to remove barriers to trade.[117]

Provisions to eliminate tariffs on pharmaceutical products and medical devices are also included, although they are not the major export obstacles for U.S. or EU manufactures.[118] Many of South Korea's tariffs on imports of pharmaceutical products of 8% are to be phased out immediately upon implementation of the pending KORUS and KOREU FTAs; others will be eliminated within three years. Tariffs for medical device exports would also be removed – immediately for most products, phased in over three years for others, and over a longer period of time for a few selected products. For example, South Korea's 8% tariff on medical magnetic resonance imaging apparatus and ultrasonic scanning apparatus would be eliminated in five years under the KOREU FTA and 10 years under the KORUS FTA. If the European Union implements its agreement with South Korea before the United States, EU-made medical devices might be more cost competitive than U.S.-made products.

The two pending FTAs tackle NTBs, as they are among the most important barriers to trade in pharmaceutical products and medical devices. In the pending KORUS FTA, among other things, the NTB provisions aim to improve transparency in the reimbursement process; put less complex regulatory policies in place; and, ensure adequate enforcement of pharmaceutical patent rights to specifically protect proprietary data that manufacturers must submit for market approval.

[114] These statistics were compiled by CRS from the Global Trade Information Services (GTIS) Global Trade Atlas.

[115] Episcom, *The Outlook for Medical Devices in South East Asia*, April 30, 2010.

[116] Korea-U.S. Trade Partnership, *Benefits by Industry/Sector—Pharmaceuticals*, U.S. Pharmaceutical Industry Supports the KORUS FTA, http://www.koreauspartnership.org/facts/pharmaceuticals.htm.

[117] The pharmaceuticals and medical devices chapter can be found in Chapter 5 of the KORUS FTA and Annex 2-D in the KOREU FTA.

[118] South Korea is not a party to the zero-for-zero tariff elimination initiative for pharmaceutical products, unlike the United States and the European Union who are among the signatories to the WTO Pharmaceutical Agreement. For more information see industry initiatives on pharmaceuticals on USTR's website at http://www.ustr.gov/trade-topics/industry-manufacturing/industry-initiatives/pharmaceuticals.

Additionally, if ratified, the KORUS FTA would establish a Medicines and Medical Devices Committee, which would meet at least once a year, to promote cooperation and to monitor the implementation of the agreement. The KOREU FTA would also establish a Working Group on Pharmaceutical Products and Medical Devices to help further regulatory cooperation.

Appendix A. Best-Selling Car Imports in the South Korean Market

It has been 10 years since any U.S. imported car model ranked among the top 10 imported cars in the South Korean market. Only European or Japanese cars ranked as the top 10 best-selling imports in 2009 (see **Table A-1**). A decade ago, Chrysler's Grand Caravan and Grand Cherokee LTD ranked among the top 10 imported models, and in earlier years several Ford models were also among the best-selling imported cars in the South Korean market.

Table A-1. Best Selling Car Imports in the South Korean Market, 2009

Rank	Brand	Model	Units
1	BMW	528	3,098
2	Lexus	ES350	2,371
3	Audi	A4 2.0 TFSI quattro	1,926
4	Mercedes-Benz	E 3000	1,814
5	Honda	Accord 3.5	1,591
6	Infiniti	G37 Sedan	1,522
7	Mercedes-Benz	C 200	1,405
8	BMW	740	1,378
9	Volkswagen	Gold 2.0 TDI	1,361
10	Honda	CR-V	1,358

Source: Korea Automobile Importers & Distributors Association.

Appendix B. Comparison of Automobile Tariff Reductions

Table B-1. Comparison of Automobile Tariff Reductions: Proposed Tariff Reductions and Time Frame for Tariff Elimination under the Pending KORUS FTA and KOREU FTA

	South Korea		European Union		United States	
	Base Tariff Rate	Time Frame	Base Tariff Rate	Time Frame	Base Tariff Rate	Time Frame
Passenger Cars	8%	KORUS FTA: Eliminated immediately. KOREU FTA: Eliminated over 3 or 5 years depending on engine size.	10%	KOREU FTA:[a] Eliminated over 3 or 5 years depending on engine size.	2.5%	KORUS FTA:[b] Eliminated immediately or over 3 years.
Trucks[c]	10%	KORUS FTA: Eliminated immediately. KOREU FTA: Eliminated immediately or 3 to 5 years depending on truck size.	22%	KOREU FTA: Eliminated over 3 or 5 years depending on truck size.	25%	KORUS FTA: Eliminated over 10 years.

Source: CRS, compiled from South Korean, EU, and U.S. Tariff Schedules.

a. The European Union 10% tariff would be phased out over three years for some passenger vehicles that fall into certain HTS codes like passenger vehicles with engines over 3,000 cc (HTS 8703.24) or five years for those cars with engines over 1,000 cc, but not over 1,500 cc (HTS 8703.22) under the terms of the KOREU FTA. South Korea would also eliminate its tariffs over three to five years, depending on engine size.

b. The United States 2.5% tariff would be phased out over three years for passenger vehicles with gasoline-powered engines with engines over 3,000 cc and all diesel-powered passenger vehicles rather than immediate tariff reduction as is the case with other passenger cars in the pending KORUS FTA.

c. Tariffs on trucks cover pickup trucks, panel vans, and commercial vehicles. Many light trucks (i.e., SUVs and minivans) are counted as cars.

Appendix C. Agreements between South Korea and Various Partner Countries

Beyond their commercial engagement with the United States, the European Union and South Korea are also exploring free trade agreements with other trading partners. For example, the European Union is in the midst of negotiating a new generation of FTAs with several countries including Canada, India, and Singapore.[119] Vietnam is another possible preferential trade agreement partner for the European Union. Also underway are negotiations on a new Partnership and Cooperation Agreement (PCA) between the European Union and China. As shown in **Table C-1**, South Korea is also seeking free trade deals with several countries, which include Australia, Canada, India, Japan, and Mexico. The possibility of a free trade arrangement between South Korea and China is also under consideration. South Korea already has FTAs with Chile, Singapore, the European Free Trade Association (EFTA), and the Association of Southeast Asian Nations (ASEAN).[120] Proliferation of FTAs and other preferential arrangements could present challenges for U.S. exporters if they ultimately find themselves disadvantaged in foreign markets.

Table C-1. Trade Agreements Between South Korea and Various Partner Countries, In Force, Signed or Initialed, or Under Negotiation

Country	In Force	Signed or Initialed	Under Negotiation
Asian and Pacific Trade Agreement (APTA)	1976		
Chile	2003		
EFTA	2006		
Singapore	2006		
ASEAN	2007		
India	2010		
United States		2007	
European Union		2009	
Japan			X
Canada			X
Mexico			X
Australia			X
New Zealand			X

Source: European Commission (DG Trade) and WTO (2010).

Notes: APTA, formerly known as "Bangkok Agreement"; entry into force of the amended agreement: September 1, 2006. Current members are Bangladesh, China, India, South Korea, Lao People's Democratic Republic, and Sri Lanka.

[119] European Commission, *EU Trade: Overview of FTA and Other Trade Negotiations*, May 5, 2010, http://trade.ec.europa.eu/doclib/docs/2006/december/tradoc_118238.pdf.

[120] Asia Regional Integration Center, *FTA Trends*, Table 6. FTA Status by Country, 2010, http://aric.adb.org/ftatrends.php.

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