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

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Summary

On June 30, 2007, U.S. and South Korean trade officials signed the proposed U.S.-South Korean Free Trade Agreement (KORUS FTA) for their respective countries. If approved, the KORUS FTA would be the second-largest FTA that South Korea has signed to date, after the agreement with the European Union (EU). It would be the second-largest (next to North American Free Trade Agreement, NAFTA) in which the United States participates. South Korea is the seventh-largest trading partner of the United States and the United States is South Korea's third-largest trading partner.

Various studies conclude that the agreement would increase bilateral trade and investment flows. The final text of the proposed KORUS FTA covers a wide range of trade and investment issues and, therefore, could have substantial economic implications for both the United States and South Korea. The agreement will not enter into force unless Congress approves implementation legislation. The negotiations were conducted under the trade promotion authority (TPA), also called fast-track trade authority, that Congress granted the President under the Bipartisan Trade Promotion Act of 2002 (P.L. 107-210).

Under TPA the President has the discretion on when to submit the implementing legislation to Congress. President Bush did not submit the legislation because of differences with the Democratic leadership over treatment of autos and beef, among other issues. Early in his Administration, President Obama indicated the need to resolve those issues before he would submit the implementing legislation. On December 3, 2010, after a series of arduous negotiations and missed deadlines, President Obama and President Lee announced that their negotiators reached agreement on modifications in the KORUS FTA, and that they were prepared to move ahead to getting the agreement approved by the respective legislatures. The White House is expected to send implementing legislation to the 112th Congress and has indicated that it would like to see Congress approve the agreement by July 1 of this year.

The modifications are in the form of changes in phase-out periods for tariffs on autos, a new safeguard provision on autos, and concessions by South Korea on allowing a larger number of U.S. cars into South Korea under U.S. safety standards than was the case under the original KORUS FTA provisions. The issue of full U.S. beef access was not resolved because of the political sensitivity of the issue in South Korea. In 2008, when President Lee reached a separate agreement with the United States to lift South Korea's ban on U.S. beef imports, massive anti-South Korean government protests forced the two governments to renegotiate its terms. The U.S. beef sector has largely supported the KORUS FTA.

A broad swath of the U.S. business community supports the KORUS FTA . With the modifications in the agreement reached in December, this group also includes the three Detroit-based auto manufacturers and the United Auto Workers (UAW) union. It still faces opposition from some labor unions and other groups, including Public Citizen. Many U.S. supporters view passage of the KORUS FTA as important to secure new opportunities in the South Korean market, while opponents claim that the KORUS FTA does not go far enough to break down South Korean trade barriers or that the agreement will encourage U.S. companies to move their production offshore at the expense of U.S. workers. Other observers have suggested the outcome of the KORUS FTA could have implications for the U.S.-South Korean alliance as a whole, as well as on U.S. Asia policy and U.S. trade policy, particularly in light of an FTA signed in by South Korea and the EU that is expected to go into effect on July 1, 2011.

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On June 30, 2007, U.S. and South Korean officials signed the proposed U.S.-South Korean Free Trade Agreement (KORUS FTA) for their respective countries.[1] If approved, the KORUS FTA would be the second-largest FTA South Korea has signed to date (next to the agreement with the European Union (EU)).[2] It would be the second-largest (next to the North American Free Trade Agreement) in which the United States currently participates. South Korea is the seventh-largest trading partner of the United States and the KORUS FTA, if enacted, is expected to expand bilateral trade and investment flows according to some studies.

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

Congress will have to approve implementation legislation for the KORUS FTA before it can enter into force. The negotiations were conducted under the trade promotion authority (TPA), also called fast-track trade authority, that Congress granted the President under the Bipartisan Trade Promotion Act of 2002 (P.L. 107-210). The authority allows the President to enter into trade agreements that receive expedited congressional consideration (no amendments and limited debate). The TPA sets no deadline for the President to submit implementing legislation to Congress.

On June 26, 2010, President Obama directed U.S. Trade Representative Ron Kirk to work with his South Korean counterpart to resolve outstanding issues—primarily pertaining to autos and beef—on the KORUS FTA by the time he and South Korean President Lee Myung-Bak were to meet again in Seoul for the November 2010 G-20 meeting. The two sides failed to meet the deadline, but on December 3, the U.S. and South Korean leaders announced that they had reached agreement on modifications to the KORUS FTA.

The modifications are mostly to auto provisions and include changes in phase-out periods for tariffs on autos, a new safeguard provision on autos, and concessions by South Korea on allowing a larger number of U.S. cars into South Korea under U.S. safety standards than was the case under the original KORUS FTA provisions. The issue of full U.S. beef access was not resolved because of the political sensitivity of the issue in South Korea. In 2008, when President Lee reached a separate agreement with the United States to lift South Korea's ban on U.S. beef imports, massive anti-South Korean government protests forced the two governments to renegotiate its terms. The U.S. beef sector largely supports the KORUS FTA because of the projected benefits it expects to gain, if the agreement is enacted. The White House is expected to

[1] For more specific information, you may contact the following CRS analysts: William Cooper, x7-7749 (general questions on the KORUS FTA); Michaela Platzer, x7-5037 (autos and other industrial goods); Remy Jurenas, x7-7281 (agricultural trade); and Mark Manyin, x7-7653 (the U.S.-South Korean bilateral relationship and security issues).

[2] On October 15, 2009, the EU and Korea initialed a free trade agreement which consists of 15 Chapters, 3 protocols and several annexes and appendices. The EU free trade agreement with South Korea was approved by the European Parliament on February 17, 2011, which clears the way for the FTA to come into operation on a provisional basis (pending ratification by the EU member states) on July 1, 2011. The EU-27 market is larger than the U.S. market when measured by population (500 million vs. 300 million) and GDP ($14.9 trillion vs. $14.4 trillion)

send implementing legislation to the 112th Congress and has indicated it would like congressional approval by July 1 of this year.

Presidents Obama's Statements on the KORUS FTA

President Obama and South Korean President Lee Myung-bak met for the first time on April 2, 2009, in London on the sidelines of the G-20 summit. Afterward, an Obama Administration official said that President Obama told Lee he wants to "make progress" on the agreement, and that the two leaders agreed that the two countries' staffs should "discuss how to move forward."[3]

The two presidents met again on June 16, 2009, in Washington, DC. In a joint statement released at the summit, they said: "We will continue to deepen our strong bilateral economic, trade and investment relations. We recognize that the Korea-U.S. (KORUS) Free Trade Agreement could further strengthen these ties and we are committed to working together to chart a way forward." In answering a question at a joint press conference, President Obama stated, "What I have done is to affirm to [South Korean] President Lee that we want to work constructively with the Republic of Korea in a systematic way to clear some of these barriers that are preventing free trade from occurring between our two countries."[4] However, President Obama did not indicate a timeframe for consideration of legislation to implement the KORUS FTA.

At a joint press conference with President Lee in Seoul in November 2009, President Obama said the agreement "holds out the promise of serving our mutual interests. And together, we're committed to working together to move the agreement forward." President Lee said the two leaders agreed to "redouble" their efforts toward this end.[5] Prior to his meeting with President Lee, President Obama said in a Fox News interview that "I want to get the deal done.... Overall, I think it's a potential good deal for US exporters. But there's certain sectors of the economy that aren't dealt with as effectively and that's something that I'm going to be talking to President Lee about."[6]

During his January 27, 2010, State of the Union address, President Obama, without mentioning the KORUS FTA per se, expressed the need for the United States to strengthen its trade ties in Asia "with partners like South Korea." During a question-and-answer session at the January 29, 2010, House Republican issues conference, the President referred to the need to seize trade opportunities, mentioning South Korea in particular.

On June 26, 2010, President Obama announced that he would direct U.S. Trade Representative Ron Kirk to work with the South Korean trade minister to resolve outstanding issues on the KORUS FTA by the time President Obama and South Korean President Lee meet again in Seoul in November 2010 for the G-20 summit. The President said that he intends "in the few months" after the November meeting to present Congress with the implementing legislation for the agreement. The President made the announcement at a joint press conference following his meeting with President Lee prior to the G-20 summit in Toronto.

On November 11, 2010, in Seoul, after the two presidents announced that the two sides had not resolved the outstanding issues, President Obama said that the U.S. and South Korean negotiating teams would be working "in the coming days and weeks ahead" to reach agreement. He said that an FTA "done right" would be a "win-win" for both countries.

On December 4, 2010, President Obama announced that U.S. and South Korean negotiators had reached agreement on modifications to the KORUS FTA making the agreement a win for the United States and for "our ally and friend" South Korea.

In South Korea, there is an ongoing debate over whether or not to have the National Assembly vote on the KORUS FTA before the agreement is submitted to Congress. South Korea's President Lee Myung-bak has said he hopes to have the South Korean National Assembly pass the agreement soon. Lee's Grand National Party controls a majority in the unicameral National Assembly, and most observers believe the agreement has the votes to pass.

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[3] White House Office of the Press Secretary, "Background Readout by Senior Administration Officials to the Travel Pool on the President's Meeting with President Lee Of The Republic Of Korea," April 2, 2009.

[4] *International Trade Daily*. June 17, 2009.

[5] White House Press Release, "Remarks by President Barack Obama and President Lee Myung-Bak of Republic of Korea in Joint Press Conference," November 19, 2009.

[6] "TRANSCRIPT: Fox News Interviews President Obama," FOXNews.com, updated November 18, 2009.

The United States and South Korea entered into the KORUS FTA as a means to further solidify an already strong economic relationship by reducing barriers to trade and investment between them and to resolve long festering economic issues. The United States specifically sought increased access to South Korean markets for agricultural products, services, and foreign investment. For South Korean leaders, the KORUS FTA is a mechanism to promote reform in its own economy and also to gain a competitive advantage in the U.S. market for autos and other manufactured goods.

Supporters of the FTA in the United States argue that failure to approve the KORUS FTA would allow those opportunities to slip away, particularly if Seoul's strategy of negotiating a web of FTAs, with South Korea at the center, is successful. On October 6, 2010, South Korea signed its most prominent FTA yet with the European Union (EU).[7] However, some opponents of the KORUS FTA argued that the agreement as originally concluded in June 2007 failed to go far enough in addressing South Korean trade barriers and would be a lost opportunity if approved in its current form. A congressionally mandated study by the United States International Trade Commission (USITC) concluded that investment and trade between the United States and South Korea would increase modestly as a result of the KORUS FTA.[8] This result is in line with other similar studies. In general and in the short-to-medium term, the KORUS FTA's largest commercial effects are expected to be microeconomic in nature. The U.S. services and agriculture industries, for instance, are expected to reap significant benefits if the agreement is implemented.

Many observers have argued that in addition to its economic implications, the KORUS FTA would have diplomatic and security implications. For example, they have suggested that it would help to deepen the U.S.-South Korean alliance. The United States and South Korea have been allies since the United States intervened on the Korean Peninsula in 1950 and fought to repel a North Korean takeover of South Korea. Over 33,000 U.S. troops were killed and over 100,000 were wounded during the three-year conflict.[9] South Korea subsequently has assisted U.S. deployments in other conflicts, most recently by deploying over 3,000 troops to play a non-combat role in Iraq. However, some counter this by positing that the KORUS FTA need not be seen as a necessary, let alone sufficient, condition for enhancing the U.S.-ROK alliance. Mutual interests on critical issues pertaining to North Korea and the rest of the region will continue to require close cooperation between the two countries in the national security sphere. Indeed, in many respects, the KORUS FTA's fate may have more profound implications for U.S. trade policy and East Asia policy than for U.S.-South Korean relations.

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

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[7] The Korea-EU FTA is expected to enter into force on July 1, 2011, after the two countries have completed their respective ratification processes.

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

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

The KORUS FTA in a Nutshell

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

Agriculture

Under the KORUS FTA's agricultural provisions, South Korea immediately would grant duty-free status to almost two-thirds of current U.S. agricultural exports. Tariffs and import quotas on most other agricultural goods would be phased out within 10 years, with a few commodities and food products subject to provisions that phase out such protection by year 23. However, because of their sensitivity, access for several U.S. products would slowly expand in perpetuity but remain subject to Korean import quotas.

Much effort went into negotiating provisions covering three agricultural commodities of export interest to the United States. Under the KORUS FTA, South Korea agreed to eliminate its 40% tariff on beef muscle meats imported from the United States over a 15 year period. However, negotiators did not reach a breakthrough by the end of the talks on the separate but parallel issue of how to resolve differences on the terms of access for all U.S. beef in a way that would address Korea's human health concerns arising from the 2003 discovery of mad cow disease in the U.S. cattle herd. Though sales of U.S. boneless beef from cattle aged less than 30 months did resume in April 2007 under the terms of a separate agreement reached in early 2006, sales of bone-in beef (e.g., ribs) only began in July 2008 after the conclusion of a difficult series of negotiations—accompanied by widespread public protests in Korea—on a more comprehensive agreement. This requires the removal of specified risk materials known to transmit mad cow disease from cattle that are less than 30 months old when slaughtered. Both countries view this "voluntary private-sector" arrangement as a transitional step intended to improve Korean consumer confidence in U.S. beef. (See **Appendix A** for additional information.)

Negotiations on access for U.S. rice and oranges into the Korean market also were contentious. Rice was a "make-or-break" issue for Seoul, and excluded at Korea's insistence out of U.S. recognition that if pushed, the talks would likely have collapsed. Special treatment for U.S. oranges was struck at the last moment, when negotiators compromised on a multi-part solution expected to increase U.S. navel orange exports over time. Korea secured an extension in the tariff phase-out for U.S. frozen pork in the December 2010 supplemental agreement in return for the changes made in the agreement's auto and other provisions. Also, Members of Congress from dairy producing states have asked USTR to take steps to ensure that market access for U.S. cheeses in the South Korean market would not be undercut by provisions in the EU-Korea (KOREU) FTA.

Automobiles

Trade in autos and auto parts proved to be among the most difficult issues tackled by U.S. and South Korean negotiators. In December 2010, the U.S. and South Korea made several significant changes to the 2007 agreement.[10] These changes included revisions to the automotive provisions, which would alter the original tariff elimination schedule for passenger cars and trucks. A special vehicle safeguard was added. The revised agreement also increased the exemption for U.S. car manufacturers from South Korean standards so long as they meet U.S. federal safety standards. These adjustments, among others, were deemed necessary before all three U.S. automakers would support the KORUS FTA. Increasingly, U.S. car makers find themselves challenged by South Korean motor vehicle manufacturers who are seeking to increase their market share through imports and increased car production in the United States and other major automotive markets like the European Union. In negotiating the KORUS FTA, U.S. industry argued that South Korea should eliminate policies and practices that seemingly discriminate against U.S. auto imports. Another apparent objective was to safeguard the U.S. market from a possible surge in South Korea auto imports. A detailed discussion of the auto-specific provisions is provided later in this report. A few of the most important provisions are highlighted below:

- The December 2010 agreement adjusts the tariff elimination schedule for passenger cars and trucks. A longer phase-out period was a key priority for Ford Motor Company and the United Auto Workers (UAW). The United States and South Korea agreed to delay the full elimination of their respective tariffs on passenger cars of 2.5% and 8% until year five after KORUS FTA implementation, rather than remove the tariffs immediately as agreed in 2007. South Korea would reduce its passenger car tariff to 4% immediately upon entry into force of the FTA. A notable exception is the acceleration of the phase-out of tariff rates on electric cars and hybrid vehicles, a possible new market for U.S. and South Korean automakers. Electric car tariffs would be phased out over five years instead of 10 years as negotiated in the 2007 KORUS FTA.[11] The United States would keep its 25% truck tariff in place for a longer period than under the 2007 agreement. It would remain for seven years and would be phased out completely by year 10. South Korea kept its commitment to immediately eliminate its 10% duty on U.S. trucks. The snapback provision would allow the U.S. to reapply the 2.5% passenger car tariff once the tariffs have been phased out under the FTA if U.S. automakers claim that South Korea is in violation of the KORUS FTA agreement. The snapback does not extend to the 25% truck tariff. Snapback would be extended to violations of new standards. South Korean commitments regarding a specified group of new and already proposed regulations on automobile fuel economy and greenhouse gas emissions do not seem to be enforceable under the dispute settlement provisions of the KORUS FTA; presumably snapback would not apply to these regulations.[12]
- Several other significant auto-specific changes were also part of the revised 2010 agreement. For the first time, both sides agreed to a special motor vehicle safeguard. It would allow the United States to take action if there are "any harmful surges in Korean auto imports due to the agreement." As a remedy under

[10] In the December 2010 press release, USTR refers to the 2010 amendments as a "supplemental agreement." Some international trade observers note that by referring to the revisions as a "supplemental agreement" it might fall outside the original 2007 agreement which has been changed by the 2010 pact.

[11] In the original 2007 agreement the United States and South Korea had agreed to phase out their respective electric car tariffs of 2.5% and 8%, respectively, over 10 years.

[12] For more information see pp. 2-4 of CRS Report R-41544, *Trade Promotion Authority and the U.S.-South Korea Free Trade Agreement*, by Emily Barbour.

> the auto-specific safeguard, the U.S. would be able to reimpose the 2.5% passenger vehicle tariff which would be eliminated under the KORUS FTA. South Korean auto manufacturers have substantially increased their production in the United States since 2005, so it seems unlikely that there would be a surge in automobile imports from South Korea. U.S. vehicle production at South Korean auto manufacturers' U.S. plants in Alabama and Georgia was approximately 450,000 in 2010, an increase from just over 210,000 in 2009.[13] The 2010 agreement also substantially increased the threshold in the number of automobiles U.S. automakers could export to South Korea if they meet U.S. federal safety standards. The exemption was raised from a ceiling of 6,500 per U.S. automaker per year to as many as 25,000 cars per U.S. automaker per year, which would include foreign-owned automakers with U.S.-based production such as BMW, Mercedes-Benz, or Nissan if they export directly from the United States to South Korea and meet the KORUS FTA domestic content provisions. The revised agreement also gives U.S. automakers some flexibility to be considered in compliance with new South Korean fuel economy and greenhouse gas emissions standards.

Other Key Provisions

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

Trade remedies were a critical issue for South Korea and a sensitive issue for the United States. The FTA allows for the United States to exempt imports from South Korea from a "global" escape clause (section 201) measure if they are not a major cause of serious injury or a threat of serious injury to the U.S. domestic industry. The FTA would also provide for a binational consultative committee to review trade remedy decisions involving one another.[14]

In addition, South Korea and the United States agreed to establish an independent body, a Medicines and Medical Devices Committee, to review recommendations and determinations regarding South Korean pricing and government reimbursement for *pharmaceuticals and medical devices* and to improve transparency in the process for making those determinations.

Furthermore, one year after the KORUS FTA enters into force, a binational committee would be formed to study the possibility of eventually including products from "Outward Processing Zones," such as the *Kaesong Industrial Complex,* that use North Korean labor.

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[13] Automotive News, "*North America Light Vehicle Production by Assembly Plant*," January 10, 2011, http://www.autonews.com

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

Estimates of the Overall Economic Effects of a KORUS FTA

Economists have released several studies estimating the potential effects of the KORUS FTA. As required by the TPA statute, the USITC conducted a study in 2007 of the KORUS FTA at the request of the President.[15] The USITC study concludes that U.S. GDP would increase by $10.1 billion to $11.9 billion (approximately 0.1%) if the KORUS FTA is fully implemented, a negligible amount given the size of the U.S. economy. The USITC based this estimate primarily on the removal of tariffs and tariff-rate-quotas, that is, barriers that can be relatively easily quantified. The study concludes that U.S. exports of goods would likely increase by $9.7 billion to $10.9 billion, primarily in agricultural products, machinery, electronics, transportation equipment, including passenger vehicles and parts. U.S. imports would increase $6.4 billion to $6.9 billion, primarily in textiles, apparel, leather products, footwear, machinery, electronics, and passenger vehicles and parts.[16]

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

The study estimates that changes in aggregate U.S. employment would be negligible given the much larger size of the U.S. economy compared to the South Korean economy. However, while some sectors, such as livestock producers, would experience increases in employment, others such as textile, wearing apparel, and electronic equipment manufacturers would be expected to experience declines in employment.[17]

Other studies draw the same basic conclusions, although the magnitudes differ because they employ different models from the USITC study. For example, a University of Michigan analysis commissioned by the Korea Economic Institute estimates that U.S. GDP would increase by $25.12 billion (0.14% of U.S. GDP). This is larger than the USITC estimate, but in part this is because its authors quantified the effects of liberalization in services trade.[18] The authors also analyzed the impact of a KORUS FTA before the final text had been released and assumed, among other things, that rice trade would be liberalized, which, in the end, was not the case.

In December 2005, the Korea Institute for International Economic Policy (KIEP) published a study measuring the potential economic impact of a U.S.-South Korean FTA on South Korea

[15] Section 2104(f) Trade of 2002. P.L. 107-210. United States International Trade Commission (USITC). *U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects*. Investigation No. TA-2104-24. USITC Publication 3949. September 2007. (Hereafter referred to as USITC (2007).) In March 2011, the USITC released a study updating its analysis of the KORUS FTA's impact on the U.S. passenger vehicle market as a result of the December 2010 modifications, *U.S.-Korea Free Trade Agreement: Passenger Vehicle Sector Update,* Investigation No. 332-523, USITC Publication 4220, March 2011.

[16] USITC (2007). pp. xvii-xviii.

[17] USITC (2007). p. xix.

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

alone. The study estimated some of the dynamic, or long-run, economic effects in addition to the static, or one-time, effects of the FTA on South Korea. The KIEP study estimated that the FTA would eventually lead to a 0.42% to 0.59% increase in South Korea's GDP according to a static analysis, and 1.99% to 2.27% according to a dynamic analysis.[19]

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

South Korea is a major economic partner for the United States. In 2010, two-way trade between the two countries totaled $86.9 billion, making South Korea the United States' seventh-largest trading partner. (See **Table 1**.) South Korea is among the United States' largest markets for agricultural products. Major U.S. exports to South Korea include semiconductors, machinery (particularly semiconductor production machinery), aircraft, and agricultural products.

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

(billions of U.S. dollars)

Year	U.S. Exports	U.S. Imports	Trade balance	Total trade
1990	14.4	18.5	-4.1	32.9
1995	25.4	24.2	1.2	49.6
2000	26.3	39.8	-13.5	66.1
2003	22.5	36.9	-14.4	59.5
2004	25.0	45.1	-20.1	70.1
2005	26.2	43.2	-17.0	69.4
2006	30.8	44.7	-13.9	75.5
2007	33.0	45.4	-12.4	78.4
2008	33.1	46.7	-13.6	79.8
2009	27.0	38.7	-11.7	65.7
2010	38.0	48.9	-10.9	86.9
Major U.S. Export Items	Industrial machinery; chemicals; semiconductor circuits; corn & wheat; specialized instruments.			
Major U.S. Import Items	Cell phones; semiconductor circuits; cars & car parts; iron & steel.			

Sources: 1990 and 1995 data from Global Trade Information Services. 2000-2008 data from U.S. International Trade Commission. The 2000-2010 U.S. export data are for U.S. domestic exports and the data for U.S. imports are for imports on a consumption basis.

South Korea is far more dependent economically on the United States than the United States is on South Korea. In 2010, the United States was South Korea's third-largest trading partner, second-largest export market, and the third-largest source of imports. It was among South Korea's largest

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

suppliers of foreign direct investment (FDI). In 2003, China for the first time displaced the United States from its perennial place as South Korea's number one trading partner. In 2005 Japan overtook the United States to become South Korea's second-largest trade partner.

Table 2. Asymmetrical Economic Interdependence (2010)

	Total Trade	Export Market	Source of Imports	Source of FDI
For the U.S., South Korea ranks	# 7	# 8	# 7	# 16 (2008)
For South Korea, U.S. ranks	# 3	# 2	# 3	# 2 (2007)

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

Increased economic interaction between the United States and South Korea has been accompanied by numerous disagreements over trade policies. In general, U.S. exporters and trade negotiators identify the lack of transparency of South Korea's trading and regulatory systems as the most significant barriers to trade with South Korea in almost every major product sector. Many U.S. government officials also complain that Seoul continues to use government regulations and standard-setting powers to discriminate against foreign firms in politically sensitive industries, such as automobiles and telecommunications. Another major cross-sectoral complaint is that rigidities in the South Korean labor market, such as mandatory severance pay, raise the cost of investing and doing business. Finally, the United States and other countries have pressed South Korea to open further its agricultural market, which is considered one of the most closed among members of the Organization for Economic Co-operation and Development (OECD).[20] Many of these issues arose during the KORUS FTA negotiations.

The intensity of these disputes has diminished considerably since the late 1980s and early 1990s, in part because South Korea enacted a set of sweeping market-oriented reforms as a *quid pro quo* for receiving a U.S.-led $58 billion package from the International Monetary Fund (IMF) following the near collapse of the South Korean economy in 1997. In particular, as a result of the reforms, South Korea opened its doors to foreign investors, ushering in billions of dollars of foreign portfolio and foreign direct investment (FDI). The result is that foreign companies, including U.S. firms, now are significant shareholders in many prominent industrial conglomerates (*chaebol*); at one point earlier in the decade, foreign firms owned about one-third of the South Korean banking industry and an estimated 40% of the value of the shares traded on South Korea's stock exchange. Since the 1997 crisis, FDI commitments by U.S. companies have totaled over $25 billion.[21]

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

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

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

U.S. and South Korean Objectives in an FTA

U.S. and South Korean policymakers shared certain goals in launching and completing the negotiations on the KORUS FTA. Both governments saw in the FTA a logical extension of an already important economic relationship that would provide a means by which the two trading partners could address and resolve fundamental issues and, thereby, raise the relationship to a higher level. For the United States these issues have included the high tariffs and other restrictions on agricultural imports. For South Korea, these difficult issues have included perceived U.S. discrimination toward South Korean imports in the application of trade remedies and treatment of products made at the Kaesong Industrial Complex in North Korea.

While sharing some broad objectives, U.S. and South Korean leaders also approached the KORUS FTA from different perspectives that were reflected in the conduct and outcome of the negotiations. A primary objective of the United States was to gain access to South Korean markets in agricultural products, pharmaceuticals and medical equipment, some other high-technology manufactured goods, and services, particularly financial and professional services—areas in which U.S. producers are internationally competitive but for which South Korean barriers seemed to be high.

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

Launching the FTA negotiations was largely at the initiative of South Korea. Its main objective in securing an FTA with the United States was much broader than gaining reciprocal access to the U.S. market. Entering an FTA with the United States meshed with a number of former South Korean President Roh Moo-hyun's long-term economic and strategic goals. Roh made an FTA the top economic priority for the remainder of his tenure, which expired in February 2008.[22] Soon after his election in 2002, Roh committed himself to raising South Korea's per capita gross domestic product (GDP) to $20,000 by the end of the decade and to transforming South Korea into a major "economic hub" in Northeast Asia by expanding the economic reforms begun by his predecessor following the 1997 Asian financial crisis. Ongoing competitive pressure from Japanese firms, increased competition from Chinese enterprises, and the rapid ageing of the South Korean workforce has heightened the sense of urgency about boosting national competitiveness. Continuing along this line of argument, ex-Prime Minister Han Duk-soo has said that a failure to adopt significant economic changes will mean that "Korea's long term growth potential is likely to deteriorate."[23] Lee Myung-bak, who was elected President in December 2007, made the

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

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

economy the centerpiece of his campaign and has supported the KORUS FTA as part of a larger program to promote South Korean economic growth.

During the negotiations, South Korean officials and other South Korean proponents of the KORUS FTA tended not to focus on the increased access to the U.S. market. Rather, they emphasized the medium and long-term gains that would stem from increased allocative efficiency of the South Korean economy, particularly in the services industries. This would presumably be brought about by an influx of U.S. investment and technology into South Korea and by the spur of increased competition with U.S. firms.[24] Senior officials in particular emphasized the need to boost the competitiveness of South Korean service industries. An FTA with the United States, they argued, will help address South Korea's increased economic polarization by spurring job creation in fields such as medical, legal, education, and accounting services in a free trade agreement.[25] Some, however, say an FTA will worsen South Korea's income gap.[26] Also, during the talks, there were continuous and often large scale anti-FTA protests, generally led by South Korean farmers and trade unionists.

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

Sector-Specific Issues and the KORUS FTA

Under the KORUS FTA, U.S. and South Korean negotiators addressed a number of sector-specific issues. Some issues, such as elimination of tariffs on most manufactured goods, were not very controversial and were dealt with in early stages of the negotiations. Other issues, such as trade in agricultural products and in autos, were the most difficult and were not completed until the final hours of the 2007 negotiations. The two sides signed the agreement on June 30, 2007. In December 2010, U.S. and South Korean negotiators agreed to modifications to the KORUS FTA, pertaining largely to the auto trade, in order to assuage concerns raised by some members of the auto sector and Members of Congress.

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

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

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

Agriculture and Sanitary and Phytosanitary Issues

Overview

Attaining comprehensive market access for U.S. agricultural products to South Korea's large market and finding a way to resolve Korea's continued restrictions on U.S. beef purchases (imposed to protect human health following the late 2003 discovery of mad cow disease in the U.S. cattle herd) were the two primary objectives pursued by U.S. agricultural negotiators. Though South Korea ranks among the leading agricultural importing countries in the world, its farm sector is highly protected with high tariffs and quotas.[27] This reflects its farmers' long-standing political influence (particularly that of rice producers) and its urban population's deep ties to its rural roots.

In concluding the KORUS FTA on April 1, 2007, the United States secured nearly complete access for all U.S. agricultural commodities and food products into Korea's market. However, a breakthrough on the beef issue (technically not part of the FTA talks but nevertheless the subject of high-level discussions) did not occur until June 2008. This reflected the then newly elected Korean President Lee's view that an agreement spelling out the rules that apply to beef imports from the United States had to be in place before President Bush would consider sending this agreement to Capitol Hill. Several Members of Congress had for months stated that South Korea must agree to fully reopen its market to U.S. beef under scientifically based international rules and in commercially significant quantities before Congress considers or approves the agreement. U.S. agricultural groups, well aware of this deal's potential benefits for producers, had then also conditioned their support on the resumption of U.S. beef exports.

More recently, the late 2010 negotiations to address outstanding FTA issues did not result in the full opening of South Korea's market to U.S. beef as sought by the Obama Administration and some Members of Congress. The only change made to the agreement's agricultural provisions is a concession (among others) requested by South Korea in return for changes sought by USTR in the auto provisions. The United States accepted a two-year extension in the phasing out of Korea's tariff on the largest category of pork imports from the United States. Responding to the conclusion of these talks, the U.S. beef and pork sectors have expressed their support for the KORUS FTA, emphasizing that its approval as soon as possible is vital to realizing the gains negotiated before other countries' FTAs with South Korea take effect.

In 2010, South Korea was the fifth-largest market for U.S. agriculture, as export sales totaled $5.3 billion. Under the KORUS FTA's agricultural provisions, South Korea immediately would grant duty-free status to almost two-thirds of current U.S. agricultural exports. Tariffs and tariff-rate quotas (TRQs)[28] on most other agricultural goods would be phased out within 10 years, with a few commodities and food products subject to provisions that phase out such protection by year

[27] South Korea's average applied agricultural tariff in 2009 was almost 49%, compared to 4.7% for the United States, from WTO, "Country Profiles" for South Korea and the United States, October 2010, available at http://stat.wto.org/CountryProfiles/KR_e.htm and http://stat.wto.org/CountryProfiles/US_e.htm.

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

23. Seven U.S. products (skim and whole milk powders, evaporated milk, in-season oranges, potatoes for table use, honey, and identity-preserved soybeans for food use) would be subject to Korean import quotas that slowly expand in perpetuity. However, the agreement does not give U.S. rice and rice products additional access to South Korea's market (see below).[29]

With the immediate elimination or phase-out of most of South Korea's relatively high agricultural trade barriers under the KORUS FTA, the U.S. agricultural and food processing sectors would noticeably benefit from additional exports. The USITC estimates that the increase in U.S. exports of agricultural commodities and processed foods would account for up to one-third of the entire projected increase in total U.S. exports to South Korea's market once the KORUS FTA's provisions are fully implemented. Sale of agricultural products would be from $1.9 billion to $3.8 billion (44% to 89%) higher than exports under a no-agreement scenario. Almost half of this export increase would accrue to the U.S. beef sector, based on the USITC's assumption that U.S. beef exports recover to the level before South Korea imposed its import restrictions in late 2003. (For information on the mid-2008 agreement on Korean rules that now apply to U.S. beef imports, see **Appendix A**.) About 20% of the export increase would benefit U.S. producers and exporters of pork, poultry and other meat products.[30] In another analysis, the American Farm Bureau Federation (AFBF) projects that U.S. agricultural exports by the end of the transition period (2027) would be more than $1.5 billion (45%) higher under the KORUS FTA than would be the case otherwise. Sales of beef, poultry, and pork would account for $644 million (or 42%) of this increase.[31]

Because South Korean agricultural exports to the United States are small ($298 million in 2010) and largely complementary, there was no controversy in negotiating access to the U.S. market. The United States agreed to phase out tariffs and quotas on all agricultural imports from South Korea under seven phase-out periods ranging up to 15 years. One 10-year TRQ would apply to imports of fluid milk and cream, among other specified dairy products. The USITC projects that imports of agricultural products (primarily processed food products) from South Korea under the KORUS FTA would be from $52 million to $78 million (12% to 18%) higher than such imports under a no-agreement scenario.

Beef

Under the KORUS FTA, South Korea agreed to eliminate its 40% tariff on beef muscle meats imported from the United States over a 15-year period. Also, South Korea would have the right to impose safeguard tariffs on a temporary basis in response to any potential surge in imports of

[29] Summaries of commodity-specific market access provisions (tariff reduction schedules, transition periods, TRQ amounts and growth rates, and safeguards) are found in the USDA fact sheets "U.S. - Korea Trade Agreement," December 2010, available at http://www.fas.usda.gov/itp/KORUS%20One-Page%20Fact%20Sheet.pdf, and "U.S. Korea Trade Agreement - Benefits for Agriculture," December 2010, available at http://www.fas.usda.gov/itp/KORUS%20Detailed%20Fact%20Sheet%202010.pdf. Detailed fact sheets on the agreement's commodity provisions and prospective impacts for agriculture in 45 states are available at http://www.fas.usda.gov/info/factsheets/Korea/us-koreatafactsheets.asp.

[30] Derived by CRS from Table 2.2 in USITC, *U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects,* Publication 3948, September 2007, pp. 2-8 and 2-9.

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

U.S. beef meats above specified levels. The trigger for this additional tariff would be 270,000 metric tons (MT) in year 1, which would increase 2% annually; in year 15, the trigger would be 354,000 MT.[32] In year 16, this protective mechanism would no longer apply. The 18% tariff on imports of beef offals (tongues, livers, tails, and feet), and tariffs ranging from 22.5% to 72% on other beef products, would also be eliminated in 15 years.

Assuming that South Korea fully lifts its restrictions on U.S. beef and bilateral beef trade returns to normal, the USITC estimates that the phase-out of South Korea's beef tariff and safeguard could increase U.S. beef exports from about $600 million to almost $1.8 billion (58% to 165%) above what would be the case otherwise. Under the KORUS FTA, the AFBF projects that U.S. beef sales would be $265 million higher as the United States recaptures its historic share of the South Korean market. However, its analysis notes that the market share of U.S. beef likely will not increase over time. That is because South Korean tastes have developed a preference for grass-fed Australian beef, according to the AFBF, and will continue to be competitive in price against U.S. beef even with the current 40% tariff removed.

On June 21, 2008, U.S. and South Korean negotiators reached agreement on the requirements that now apply to Korean imports of U.S. beef and beef products. Imports of boneless and in-bone beef, and other beef products, from cattle less than 30 months of age are allowed entry, but are subject to various conditions that U.S. beef exporters and the U.S. government must meet. This agreement occurred against the backdrop of mounting public protests in Korea against an earlier agreement, calls by opposition parties that the initial terms be renegotiated, and the Korean President's apologies for how his government mishandled this matter. The Korean government secured these additional changes in order to allay public concerns about the safety of U.S. beef. Since mid-July 2008, U.S. beef sales have resumed and increased on a year-over-year basis. Future U.S. beef exports will depend the pace at which Korean consumers resume purchases in light of the controversy that swirled around this issue, and on the extent that the U.S. dollar remains weak against the currencies of other beef exporting countries (e.g., Australia). (See **Appendix A** for additional details.)

Rice

South Korean negotiators succeeded in excluding the entry of U.S. rice on preferential terms—its prime objective in negotiating agriculture in the KORUS FTA. This reflects Korea's efforts to maintain its stated policy of self-sufficiency in rice production, the national sentiment that preserving rice production is inseparable from the country's identity, and the political reality that rice farming preserves the basis for economic activity in the countryside. That rice was a make-or-break issue for Seoul is seen in the comment made by a top U.S. trade official, Deputy United States Trade Representative Karan Bhatia, the day after the talks concluded: "Ultimately, the question that confronted us was whether to accept a very, very good albeit less perfect agreement or to lose the entire agreement because South Korea refused to move on rice."[33] On rice, the KORUS FTA would only require South Korea to continue to abide by its multilateral trade commitments to increase rice imports.

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

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

At present, U.S. rice exporters have access to the South Korean market under (1) a 24% share (50,076 MT) of the rice import quota established under that country's multilateral World Trade Organization (WTO) commitments in 1995, and (2) a separate quota available to all countries.[34] Rice entering under both quotas faces a 5% tariff. Entries above each quota are prohibited—a unique concession that South Korea received in the 1993 Uruguay Round of multilateral trade negotiations. U.S. rice exports against both quotas have fluctuated, but since 2005 have risen to reach $76 million (107,905 MT) in 2008. Future U.S. sales are expected to grow slowly in line with the expansion of the most recently established rice quota.

Though the U.S. rice industry expressed disappointment with the rice exclusion, the United States will have other opportunities to negotiate access for additional U.S. rice in Korea's market. A further opening of the South Korean rice market could occur in the process of concluding a multilateral agreement to further liberalize agricultural trade in the WTO's Doha Development Round. Also, the United States and other rice exporting countries could press for additional access when Korea's current multilateral rice access provisions expire in 2014.

Oranges

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

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

The cost of selling to what already is a leading U.S. export market for fresh oranges would be significantly reduced as Korea's high 50% tariff is phased out. In 2010, South Korea ranked second (after Canada), with U.S. orange sales totaling $114 million (118,945 MT). The U.S. Department of Agriculture (USDA) estimates that the value of the in-season 2,500 MT quota and tariff reductions on all orange exports in the first year that the agreement is in effect would be

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

almost $18 million. Over seven years, USDA estimates the cumulative value of savings associated with these orange access provisions at $208 million.[35]

Pork

As revised by the December 2010 supplemental agreement, the KORUS FTA would phase out South Korea's 25% tariff on 90% of the U.S. pork (primarily frozen product) now shipped to that market by January 1, 2016. This is two years longer than what both sides had agreed upon in the 2007 text (i.e., January 1, 2014). Korea's 22.5% tariff on other U.S. pork products (e.g., fresh pork bellies and miscellaneous fresh cuts) would be eliminated over 10 years. South Korea secured a safeguard to protect against import surges of these fresh pork products, which would expire at the end of 10 years.

In 2010, South Korea was the fourth-largest market for U.S. pork (fresh, chilled and frozen), with sales of almost 84,000 MT valued at $161 million. The National Pork Producers Council acknowledged that, even with the last minute concession on pork in order to resolve the auto issue, the KORUS FTA is "a good deal." It expects the agreement to "be one of the most lucrative for the U.S. pork industry," with a substantial increase projected in exports to South Korea, live hog prices, and direct jobs.[36]

Geographical Indications for Dairy Products

The U.S. dairy sector has expressed concern that the geographical indications (GI) provisions that apply to various EU cheeses in the KOREU FTA would undercut the potential benefits negotiated under the KORUS FTA for U.S. cheeses with identical names that sell into the Korean market. GIs (similar to a trademark) refer to marks that "identify a good as originating in the territory of a country, or a region or locality in that territory, where a given quality, reputation or other characteristic of the good is essentially attributable to its geographical origin."[37] To illustrate, "champagne" and "Idaho potatoes" are examples of GI designations. Products so designated are eligible for relief from acts of infringement and/or unfair competition under a country's trademark laws and regulations. Because GIs are commercially valuable in the international trade of agricultural products, wines, and spirits, the EU in negotiating its bilateral trade agreements has sought to secure additional protection for its GI-designated agricultural and beverage products in FTA-partner country markets beyond what multilateral trading rules currently provide.

More than 50 Members of the House requested the USTR to ensure that as South Korea develops regulations to implement the KOREU FTA's GI provisions, those rules "do not undercut the dairy market gains secured" in the KORUS FTA. They expressed concern that the U.S. dairy industry will not be able to increase cheese exports if (1) the United States does not "combat European efforts to carve out the sole right for their producers to use … cheese names most familiar to consumers around the world (e.g., feta, gorgonzola, muenster, parmesan, provolone)," and (2) act to safeguard against possible threats to the use of such generic terms as cheddar and mozzarella "that could arise as a result of recent EU legal precedents" to protect the names of some EU wines

[35] USDA, Foreign Agricultural Service, Fact Sheet "U.S.-Korea Free Trade Agreement—What's At Stake for Fresh Citrus and Orange Juice," September 2008.

[36] NPPC, "U.S.-South Korea FTA Remains A Good Deal For U.S. Pork Producers," December 3, 2010.

[37] Uruguay Round Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), Article 22.1.

and spirits. USTR has held talks on this matter separate from those that concluded in the supplemental agreement, and reportedly is still working on solutions to address the concerns.[38]

Sanitary and Phytosanitary Provisions

As found in most other U.S. FTAs, the KORUS FTA establishes a bilateral standing committee to address food safety and animal/plant life or health issues that frequently emerge in agricultural trade. However, there are no commodity-specific sanitary and phytosanitary (SPS) provisions to address outstanding issues, such as Korea's import health requirements on U.S. beef imports or Korean standards that have prevented sales of some U.S. horticultural products to that market. The Committee on SPS Matters would serve as a forum to implement the WTO's Agreement on the Application of SPS Measures, enhance mutual understanding of each country's SPS rules, resolve future bilateral SPS disputes that arise, coordinate technical assistance programs, and consult on issues and positions in the WTO and other international bodies where SPS issues are considered. The text of the SPS chapter specifically states that neither the United States nor South Korea has recourse to pursue dispute settlement to address any SPS issue that arises. Instead, any matter would be resolved using the formal process established under the WTO's SPS Agreement.

U.S. beef producers had argued until the 2008 bilateral agreement was reached that Korea's stance on U.S. beef imports must be scientifically based upon internationally recognized guidelines issued by the World Organization for Animal Health, also known as OIE by its French acronym.[39] Other agricultural groups also have raised concerns about Korea's implementation of SPS measures on food additives and those that have restricted U.S. fruit and vegetable exports. This new standing committee potentially could be used as the venue to attempt to resolve future SPS disputes, taking into account latest available scientific findings and knowledge.

Autos

The U.S. and South Korea revised parts of the 2007 KORUS FTA on trade in automobiles in December 2010. The Obama Administration claimed this was a necessary step in moving the agreement forward because "the [original] U.S.-Korea trade agreement did not go far enough to provide new market access to U.S. auto companies and to level the playing field for U.S. auto manufacturers and workers."[40]

The main automotive trade provisions, including the December 2010 revisions, may be summarized as follows:

- *Elimination of South Korean tariffs on U.S.-made motor vehicles.* South Korea would immediately reduce its 8% tariff on U.S.-built passenger cars, including electric vehicles and plug-in hybrids, to 4% and would immediately reduce its 10% tariff on trucks to zero.[41] In year five, tariffs on U.S.-made motor vehicles,

[38] Letter from Congressional Dairy Farmers Caucus to USTR Ron Kirk, September 27, 2010; World Trade Online, "Dairy GI Issue Related To Korea FTA Still Unresolved Despite Auto Deal," December 8, 2010.

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

[40] White House. "*Increasing U.S. Auto Exports and Growing U.S. Auto Jobs Through the U.S.-Korea Trade Agreement*," (December 3, 2010).

[41] Tariffs on trucks cover pickup trucks, panel vans, and commercial vehicles. Many light trucks (i.e., SUVs and (continued...)

including electric cars and plug-in hybrids, would be reduced to zero.[42] Tariffs would be immediately reduced to zero in each country for auto parts imported from the other.[43]

- *Elimination of U.S. tariffs on South Korean-made automobiles and a "snapback" clause.* The United States would keep its passenger vehicle tariff (which would also cover electric and plug-in hybrid vehicles) of 2.5% in place for five years. In the original agreement, the tariff would have been eliminated immediately on imports of South Korean cars with small gas engines. Tariffs on passenger vehicles with larger gas engines and diesel engines would be phased out over three years. The elimination of the 25% duty on trucks, a residual rate dating from an earlier trade dispute with Europe, would be delayed. It would stay in place for the first seven years after the agreement is ratified and would then be phased out in equal installments in years 8, 9, and 10 based on the 2010 revision.[44] The FTA, in Annex 22-A, also establishes a special bilateral dispute settlement panel, designed to resolve automotive issues within six months. If the panel finds a violation of an auto-related commitment or the nullification/impairment of expected benefits, the complaining Party may suspend its tariff concessions on passenger vehicles and assess duties at the prevailing MFN rate (i.e., 'snapback' any tariff reductions provided by the FTA)."[45] The renegotiated agreement does not extend the snapback to the higher 25% truck tariff.[46] It does appear the revisions would strengthen the snapback with the White House fact sheet stating "the 2010 supplemental agreement substantially increases Korea's obligations in a number of areas subject to this strong enforcement mechanism."
- *Reduction of alleged discriminatory effects of engine displacement taxes.* Automotive-specific taxes, which play an important role in determining the final price of a vehicle, are viewed by U.S. automakers as another barrier to foreign car sales in South Korea. The U.S. complaint centers on South Korea's steeply ascending vehicle tax schedule, with very high rates on vehicles with larger engine capacities such as might be exported by U.S. producers, makes U.S. imported cars more expensive than smaller South Korean cars. Moreover, the tax system has a "cascade" effect, so that subsequent taxation rates incorporate, for example, the 8% duty paid on an imported vehicle. Currently, 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 motor vehicles, and these taxes

(...continued)

minivans) are counted as cars.

[42] Tariffs for electric cars and plug-in hybrids would be phased out over five years, whereas passenger car tariffs would remain in place at 2.5% until year five.

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

[44] The 2007 agreement would have required the U.S. to begin phasing out its 25% tariff on light truck imports immediately until full elimination in year 10 following implementation of KORUS FTA.

[45] USTR, "Auto-Related Provisions," p. 1; USITC. *U.S.-Korea FTA*, p. 3-80 (Box 3-4). In the case of the United States the MFN tariff (HTS 8703) would be 2.5% and for South Korea it would be 8%.

[46] The truck tariff applies to "motor vehicles for the transport of goods (HTS 8704)" which would include trucks like the Ford F-150.

are often higher on vehicles with engines 2,000 cubic centimeters (cc) or larger.[47] In the renegotiated 2010 agreement, South Korea agreed to "additional transparency" on tax treatment of U.S. automobiles.[48]

- *Improved regulatory transparency for new automotive regulations*. South Korea also committed to an improvement in its regulatory process in two ways. U.S. auto companies would be given one year between the time a final regulation relating to autos is issued and when U.S. automakers must comply with the new regulation. South Korea also agreed to develop a new post-implementation review system within two years after the agreement takes effect to ensure that existing auto regulations are applied in the least burdensome manner possible.
- *Regulations on harmonization of automotive safety and environmental standards.* U.S. manufacturers complain that South Korea sets automotive safety and environmental regulations in a manner that is closed to outsiders and not transparent. This results in standards idiosyncratic to South Korea. South Korean-based producers, who hold the lion's share of the domestic market, can afford to operate one line for domestic production, and another for export. Foreign companies have difficulty affording the high unit cost of customizing a small number of vehicles for the South Korean market.[49] This problem is addressed in the KORUS FTA (Chapter 9—"Technical Barriers to Trade") and in an exchange of "confirmation letters" of June 30, 2007, between USTR Susan Schwab and South Korean Trade Minister Hyun Chung Kim. The revised 2010 agreement provides for self-certification to U.S. federal safety standards for a limited number of U.S.-exported vehicles raising the ceiling to 25,000 per automaker per year compared to no more than 6,500 per year per U.S. automotive manufacturer as agreed to in 2007. Under the revised 2010 KORUS FTA agreement, U.S. auto manufacturers would be given some flexibility in meeting new higher South Korean environmental standards.[50] U.S. automakers would be considered in compliance with new South Korean fuel economy or greenhouse gas emissions standards if "they meet a target level that is 19% more lenient than the relevant target level provided in the regulation that would otherwise be applicable to that

[47] One measurement of car engines is displacement. An engine 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 1,400 cc and a 1.8 liter 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.

[48] White House. "*Increasing U.S. Auto Exports and Growing U.S. Auto Jobs Through the U.S.-Korea Trade Agreement*," (December 3, 2010).

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

[50] South Korea's new environmental regulations will become more stringent over the next five years. These new regulations, which are still being developed, are set to take effect in 2012 and are expected to remain in place until 2015. South Korea will raise the average fuel economy of automobiles seating 10 or fewer passengers to 17 kilometers per liter and will lower the standard for carbon dioxide emissions to 140 grams per kilometer by 2015. Automobile importers would be able to choose either standard to satisfy the requirement.

manufacturer."[51] This provision applies to U.S. carmakers that sold fewer than 4,500 cars in South Korea in calendar year 2009.

- *Creation of an "Automotive Working Group."* Under terms of Annex 9-B, the two parties agreed to create an Automotive Working Group, which would meet at least annually, and would review and resolve "issues with respect to developing, implementing and enforcing relevant standards, technical regulations and conformity assessment procedures."[52]
- *Inclusion of a Special Motor Vehicle Safeguard*. The original KORUS FTA text signed in June 2007, did not include a safeguard specific to the U.S. automotive industry, whereas under the 2010 KORUS revisions South Korea committed to add a special safeguard for motor vehicles to ensure that the U.S. auto industry is not hurt as a result of any "harmful surges" in South Korea auto imports as a result of the trade agreement. The new auto-specific safeguard provision would allow the United States to impose extra duties if there is an unexpected import surge for up to two years. Any higher tariff that might be imposed could be applied for four years, instead of three under the general safeguard. The auto safeguard would continue for 10 years after the full elimination of tariffs. Thus, the safeguard could be in place until at least 2031 in case of truck tariffs. Another feature of the safeguard is that it could be applied to a particular auto product more than once in the event of a recurring surge that causes serious injury to U.S. production of that product. The White House fact sheet also notes that "fewer procedural steps are required to speed up the application of the safeguard when workers need faster relief."[53] This would seem to make it easier for the United States to roll back parts of the agreement if there are complaints.

Under the 2010 modification, U.S. tariffs on imports of South Korean cars will fall more slowly than agreed in 2007 and could be raised in case of an import surge, while South Korean tariffs will fall more quickly, albeit not as fast as in the original agreement. The new auto-specific provisions would protect the U.S. auto industry for a longer period of time possibly stemming the number of South Korean cars coming into the United States.

Neither the original nor the revised KORUS FTA would affect domestic production of South Korean cars. South Korean manufacturers now make hundreds of thousands of cars in the United States and they are poised to grow their local production capacity. Thus, a surge in automobile imports from South Korea seems unlikely in the next few years. GM Daewoo, the South Korean arm of U.S. automaker GM, manufactured over 100,000 cars in South Korea every year since 2005. See **Appendix B** for an overview of South Korea's motor vehicle manufacturing industry.

[51] USTR. *Agreed Minutes*, February 10, 2011, http://www.ustr.gov/webfm_send/2555

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

[53] White House. "*Increasing U.S. Auto Exports and Growing U.S. Auto Jobs Through the U.S.-Korea Trade Agreement*," December 3, 2010, http://www.whitehouse.gov/sites/default/files/fact_sheet_increasing_us_auto_exports_us_korea_free_trade_agreement.pdf

Expected Impact and Industry Reaction

The USITC simulation model of the KORUS FTA estimates that while U.S. automotive exports to South Korea would increase by a range of 45% to 59%, this would only amount to about $300 million-$400 million because of the low current baseline.[54] It states that tariff elimination "would likely have a positive effect on U.S. exports ... further, the overall tax burden on the South Korean consumer who purchases an imported vehicle would be reduced, more or less equalizing the total taxes paid on imported and domestic vehicles."[55] It particularly emphasizes the potential gain for U.S.-exported hybrid vehicles to South Korea. Whether this will eventually happen remains uncertain. Most hybrids in the U.S. market today are imported from Japan.[56] The Japanese automaker Toyota, with its Prius, accounted for over half, or 140,900, of all hybrid electric vehicles sold in the United States in 2010.[57] The Detroit-based U.S. manufacturers have increased their hybrid electric vehicle sales in recent years, rising from zero in 2003 to over 40,000 in 2010. It is possible, however, that Japanese manufacturers of hybrid electric vehicles could use the United States as an export platform to South Korea and other overseas markets. More competition could also come from South Korean automakers who are also planning to enter the hybrid segment of the U.S. market. Hyundai's entrant is the Sonata hybrid, which will be the first South Korean hybrid sold in the United States.[58]

With respect to automotive imports from South Korea into the United States, the USITC simulation estimates an "increase by $1.3-1.7 billion (9-12%)." However, it also finds that "approximately 55-57% [would be] represented by diverted imports from other trade partners."[59] Jeffrey Schott of the Peterson Institute for International Economics states that South Korea gave a "priority to eliminating the small U.S. tariff primarily because of Japanese competition. Hyundai and Kia seem to be considering the development of pickup trucks that could be sold in the U.S. market, although whether they will be produced, and where (in the United States or South Korea), in the near future remains unclear.[60] Hyundai and Kia do already produce small pickup-type vehicles in South Korea, but they would not appear to be suitable in design or style for the United States.[61]

[54] Ibid., Table 2.2.

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

[56] Ibid.

[57] Energy Efficiency and Renewable Energy, U.S. Department of Energy, *Alternative Fuels & Advanced Vehicles Data Center*, HEV Sales by Model, 1999-2010, http://www.afdc.energy.gov/afdc/data/vehicles.html.

[58] Hyundai, "2011 Sonata Hybrid Delivers the Best Highway Fuel Economy of any Mid-size Sedan on the Market," press release, 2010, http://www.hyundainews.com/Media_Kits/2011_Models/Sonata_Hybrid/Press_Release.asp.

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

[60] Mike Levine, Hyundai Rumored to be Considering Full-Size Pickup Truck, May 8, 2010, http://news.pickuptrucks.com/2010/05/hyundai-rumored-to-be-considering-fullsize-pickup-truck.html

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

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

- The Detroit Three were split on the 2007 KORUS FTA. Ford and Chrysler were opposed to the original agreement, while General Motors (GM) was neutral. Ford changed its position based on the amended 2010 agreement stating it "provides Ford greater confidence that we will be able to better serve our Korean customers."[62] Ford was also concerned about competition from South Korean automakers in the U.S. market and the revised agreement would keep U.S. tariffs in place for a longer period of time than originally proposed. In particular, the truck tariff phase-out would be delayed for eight years before being eliminated in year 10 following the implementation of the agreement.
- Automotive parts suppliers have been supportive of the 2007 agreement because of their strong export-based business with Korean customers.
- Broader-based industry organizations hold favorable views of the 2007 agreement and have also weighed in positively on the 2010 revised agreement.
- Labor groups are split. The United Auto Workers (UAW)[63] announced they would support the agreement, while others like the AFL-CIO,[64] United Steelworkers (USW),[65] and the International Association of Machinists and Aerospace Workers (IAM)[66] remain opposed.
- Until the 2010 changes to the auto provisions were announced, both the management side and the labor side of the domestically owned U.S. automotive industry used the word "unbalanced" to describe the benefits that could flow from the implementation of the KORUS FTA. This may seem odd, given that the agreement has many provisions in various chapters dealing with specific South Korean policies and practices, and virtually none on the U.S. side, beyond the elimination of tariffs. Their views could be colored by the global competitive problems currently affecting the unionized, domestically owned sector of the U.S. motor vehicle industry which go well beyond the scope of the KORUS FTA to solve.[67] Indeed, given major differences in the profiles of the U.S. and South Korean motor vehicle markets, it remains to be seen whether the Detroit Three (GM, Ford, and Chrysler), which tend to specialize domestically in the production of larger vehicles, would ever gain more than a fractional position in the South Korean market through exports from the United States. Unlike Ford and Chrysler, GM has secured a solid investment position in South Korea that it is integrating into its global strategy, which helps explain its neutral position.

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[62] White House, Statements of Support for the U.S-Korea Trade Agreement, December 3, 2010, http://www.whitehouse.gov/the-press-office/2010/12/03/statements-support-us-korea-trade-agreement

[63] UAW, "UAW Statement on the Proposed U.S.-Korea Free Trade Agreement," press release, December 6, 2010, http://www.uaw.org/articles/uaw-statement-proposed-us-korea-free-trade-agreement.

[64] AFL-CIO, "Statement by AFL-CIO President Richard Trumka on Korea Trade Deal," press release, December 9, 2010, http://www.aflcio.org/mediacenter/prsptm/pr12092010b.cfm

[65] United Steelworkers, "USW Opposes Passage of Revised U.S.-Korea Trade Agreement," press release, December 9, 2010, http://www.usw.org/media_center/releases_advisories?id=0344.

[66] International Association of Machinists and Aerospace Workers, "IAM Statement regarding Proposed U.S.-South Korea Free Trade Agreement," press release, December 9, 2010, http://www.goiam.org/publications/pdfs/12_09_2010_Machinists_Union_Strongly_Opposes_Korea_Trade_Deal.pdf.

- The original views were reflected in the September 2009 statements submitted to the Interagency Trade Policy Staff Committee on the US-Korea Free Trade Agreement. In the April 2007 report of the Industry Trade Advisory Committee on Automotive and Capital Goods (ITAC 2) to USTR, the chair noted that, "Generally, the manufacturers of capital goods see [the FTA] as an important milestone in providing market access to a country and region historically protectionist.... However, in terms of U.S. automotive equipment manufacturers, the outcome is mixed."[68]

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

Some of the earlier opposition to the agreement by some Members of Congress seems to have abated. For example, Representative Sander Levin, who has long opposed the auto provisions as negotiated in the 2007 agreement, said, "the changes announced in the U.S.-Korea Free Trade Agreement (FTA), today are a dramatic step toward changing the one-way street to a two-way street for trade between the U.S. and South Korea."[69] Similar views were expressed by the United Auto Workers (UAW) union, which until the December 2010 announcement was one of the main opponents to the FTA.[70] The renegotiated auto provisions were also positively viewed by Ways and Means Ranking Members Dave Camp and the Trade Subcommittee Ranking Member Kevin Brady. However, some Members remain opposed to the renegotiated agreement, most notably Representative Michael Michaud, chairman of the House Trade Working Group, an informal working group in the House of Representatives who are pushing for a fair trade agenda, who stated,

> I had hoped for more from this White House, which campaigned on the need to change the way we negotiate trade agreements so that they truly benefit American workers and businesses. The deal reached today, while beneficial to the auto industry, falls far short of that goal.[71]

In November 2010, the House Trade Working Group wrote to President Obama listing changes they viewed as critical before they would endorse the KORUS FTA, including protection of worker's rights, promotion of U.S. manufacturing through reciprocity, and increased export opportunities for small and medium manufacturers.[72] The AFL-CIO has come out against the revised trade agreement with South Korea, citing major concerns over provisions that the union believes would encourage the offshoring of U.S. jobs.[73]

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[68] ITAC 2 report, p. 1.

[69] Chairman Levin Statement on U.S.-South Korea Free Trade Agreement, December 3, 2010, http://www.house.gov/apps/list/press/mi12_levin/PR1232010.shtml

[70] UAW statement on the proposed U.S.-Korea Free Trade Agreement, December 6, 2010, http://www.uaw.org/articles/uaw-statement-proposed-us-korea-free-trade-agreement

[71] Michaud Responds to Deal on Korea-US Trade Agreement, December 3, 2010, http://www.michaud.house.gov/index.php?option=com_content&task=view&id=1163&Itemid=1

[72] Congressman Mike Michaud, "House Members Meet with Obama on a New Way Forward on Korea FTA," November 18, 2010, http://www.michaud.house.gov/index.php?option=com_content&task=view&id=1155&Itemid=1

[73]AFL-CIO, "Statement by AFL-CIO President Richard Trumka on Korea Trade Deal," press release, December 9, (continued...)

The revised agreement did not include earlier demands by some for managed trade. In 2007, 15 Members of Congress, including Representative Charles Rangel, then chair of the House Ways and Means Committee, proposed a "performance metric" approach, which was also suggested by ITAC 2. Their proposal would have delayed full elimination of the U.S. import tariff cut for at least 15 years, while U.S. representatives assessed South Korea's performance in opening its market for U.S. exports. A formula would be used each year to determine the number of South Korean-produced vehicles that would receive duty-free treatment in return. Such an approach would have created a one-for-one linkage in which the U.S. tariff would be lowered on one South Korean car whenever one U.S. car was sold in South Korea.

Textiles and Apparel

Textiles and apparel are a small and dwindling portion of U.S. manufactured imports from South Korea. In 2010, textiles accounted for 1.4% of total U.S. imports from South Korea and apparel accounted for less than 1%.[74] South Korea's shares of the U.S. market for textiles and apparel has shrunk in relative and absolute terms over the years. In 1990, for example, South Korea was the third-largest source of U.S. imports of apparel with an 13.0% share, but by 2010, it had dropped to the 27th-largest source with a 0.4% share. This decrease came largely as the result of the surge in China's share of U.S. apparel imports, which grew from 13.7% in 1990, to 40.9% in 2010. In 1990, South Korea was the third-largest source of U.S. textiles and fabric imports with a 9.8% share, which dropped to 7.9% in 2010.[75] The United States exports small volumes of apparel to South Korea—$112 million of apparel in 2010.[76]

The KORUS FTA would eliminate U.S. tariffs immediately on 52% (in terms of value) U.S. imports of South Korean textiles and apparel, and would phase out U.S. tariffs on 21% over five years and on the remaining 27% over 10 years.[77] Currently, the average U.S. MFN tariff on textiles is 7.9% with a maximum applied tariff of 34.0% and with 16.1% of textiles categories already entering the United States duty free. The average applied U.S. MFN tariff on apparel imports is 11.5% with a maximum tariff of 32%, and 3.3% of the tariff lines entering duty free.[78]

The average South Korean applied tariff on textiles is 9.2% with a maximum of 13% and 0.3% of tariff lines entering duty free. The average South Korean tariff on apparel is 12.6% with none entering duty free and with a maximum tariff of 13%.[79] The KORUS FTA, would eliminate South Korean tariffs immediately on 77% (by value) of U.S. exports of textiles and apparel and would phase out tariffs on 13% over three years and the remaining 10% over five years.[80]

(...continued)

2010, http://www.aflcio.org/mediacenter/prsptm/pr12092010b.cfm.

[74] The textile and apparel statistics are based on three NAICS codes (NAICS 313: Textiles & Fabrics; NAICS 314: Textile Mill Products; and, NAICS 315: Apparel Manufacturing) and were compiled using the International Trade Administration's Trade Stats Express, http://tse.export.gov/TSE/TSEhome.aspx.

[75] These statistics are based on NAICS 313: Textiles & Fabrics.

[76] These statistics are based on NAICS 315: Apparel Manufacturing.

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

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

[79] Ibid.

[80] USITC. pp. 3-52.

The KORUS FTA, with some exceptions, would use the yarn-forward rule of origin for apparel imports; that is, apparel made from yarn or fabric originating in either the United States or South Korea would be eligible for duty-free treatment under the FTA. The FTA also includes a special safeguard provision whereby, if imports of textiles or wearing apparel to one KORUS FTA partner country from the other increases at such a rate as to cause or threaten to cause serious injury to the domestic industry of the importing country, the importing country can suspend further reduction of tariffs, or it can increase the duty on the imported product to (the lesser of) the MFN rate applicable at the time the action was taken or the MFN duty that was in force when the FTA went into effect. The safeguard action can be in place for two years with a possible extension of two years but no more than a total of four years. However, the importing country will have to compensate the exporting country by making additional trade liberalizing concessions equivalent in value to the additional duties expected to result from the safeguard action. The concessions would be limited to textiles and apparel unless the two countries agree otherwise.

The USITC has estimated that, if implemented, the KORUS FTA would over time lead to an increase in U.S. imports of South Korean textiles of $1.7 billion to $1.8 billion and of apparel of $1.0 billion to $1.2 billion, with the major portion of the increase being diverted from other countries. The USITC also has estimated that the KORUS FTA would lead to an increase in U.S. exports of textiles of $130 million to $140 million and of apparel of $39 million to $45 million to South Korea.[81]

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

The textile and apparel industry appears split on their views of the KORUS FTA according to the Industry Trade Advisory Committee on Textiles and Clothing (ITAC-13).[82] Some representatives of the textile producers support the yarn-forward rule as benefitting their industry and also conforming to provisions in other U.S. FTAs but also argue that it should be broader by including sewing thread, narrow fabrics and pocketing fabrics, which are excluded from the rule. Others, including some textile representatives and representatives from the apparel industry with supply chains in other countries, have criticized the yarn-forward rule as being restrictive and limiting trade opportunities.

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

[81] Ibid. pp. 3-53.

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

FTA. Producers of both categories strongly support the FTA and how their products would be treated.[83]

Other Manufactured Goods

The provisions of the KORUS FTA affect a wide range of other industries beyond the automotive sector and textiles and apparel. Cross-sectoral trade associations that represent broad ranges of U.S. manufacturers have indicated their support for the agreement, not only because of the general elimination of South Korean tariffs on U.S. exports, but also because of such provisions as those promising to increase cooperation in the reduction of technical barriers to trade and the improvement in South Korea of the protection of U.S. companies' intellectual property rights.[84] Similarly, most sectoral trade associations expressed support, although some noted reservations with specific provisions.[85] The steel industry in particular was a notable dissenter.

Capital Goods Machinery and Equipment

U.S. machinery exports could be the largest single sectoral gainer from the FTA with South Korea. According to the USITC's simulation analysis, the sector stands to gain nearly $3 billion in exports if the agreement is approved.[86] The tariffs on U.S. machinery and equipment imported into South Korea range from 3% to 13%, but U.S. products are already competitive in many cases, and already account for 15%-20% of total South Korean imports. (A specific example is U.S.-made computer-numerically controlled machine tools.) Most machinery tariffs would be immediately eliminated; others would be phased out over three to 10 years.[87] As noted in the previous section on autos, the capital goods machinery industry representatives in ITAC 2 split with the motor vehicle industry representatives and supported the agreement. The ITAC report specifically cited, "U.S. manufacturers of electrical equipment [who] will benefit substantially by South Korean tariff reductions and eliminations, where the sector has already returned to running a trade surplus with South Korea."[88] The USITC report further noted the export potential of electrical-power generating equipment, for which South Korean duties range up to 8% currently. U.S. exporters are nonetheless already leading suppliers of turbines, generators and nuclear reactors to South Korea.[89] The National Electrical Manufacturers Association (NEA) stated that U.S. exports to South Korea had risen steadily, by a total of 62%, since 2002, and that there was a U.S. surplus in bilateral trade. It calls for:

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[83] Ibid.

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

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

[86] Ibid., Table 2.2.

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

[88] ITAC 2, p. 1.

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

> legislators in both countries to ratify the Agreement as soon as possible. While the U.S. electrical equipment industry still has concerns relating to non-tariff barriers and intellectual property protection in South Korea, the overall FTA package would improve conditions for selling there by featuring the elimination—most of it immediate—of remaining tariffs on goods in NEA's product scope.[90]

Another major capital goods item in which the United States has a strong bilateral trade position is aircraft. Total 2010 aircraft and parts exports to South Korea were $2.6 billion.[91] However, civilian aircraft imports are already duty-free in South Korea.[92]

Electronic Products and Components

Both South Korean and U.S. tariffs on most electronics products, such as semiconductors, telecommunications equipment, and computers, are already zero, as they are included in the multilateral Information Technology Agreement eliminating tariffs among more than 70 countries. In 2010, the United States posted a trade deficit in computer and electronic products with South Korea of $11.1 billion, compared to $9.7 billion in 2009. The U.S. trade deficit with South Korea in semiconductors and other electronic components with South Korea reached a record high of $3 billion in 2010.[93]

Sectoral organizations representing these industries supported the KORUS FTA. It was argued the FTA would extend tariff-free treatment to consumer electronics products and could guarantee improvements for U.S. products in South Korea with respect to intellectual property protection, technical barriers, government procurement, and competition policy.[94]

Steel

The American steel industry registered a strongly negative position on the KORUS FTA through its industry advisory body to USTR, ITAC 12 (Steel). Its report noted that the agreement "does not provide for changes in U.S. AD-CVD statutes" and that each party retains its full rights under World Trade Organization rules. However, ITAC 12 objected to "changes to the related legal processes" in the KORUS FTA chapter on trade remedies with respect to three "key areas:"

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

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

91 The aerospace products and parts statistics are based on NAICS code (NAICS 3364: aerospace products and parts) and were compiled using the International Trade Administration's Trade Stats Express, http://tse.export.gov/TSE/TSEhome.aspx

92 USITC. *U.S.-Korea FTA*, p. 3-68 and Table 3.13.

93 These statistics are based on NAICS codes for computers and electronic products (NAICS 334) and semiconductors and other electronic components (NAICS 3344), http://tse.export.gov/TSE/TSEHome.aspx.

94 Ibid., pp. 3-68 through 3-73.

- In Article 10.4, either party must afford to the other an adequate opportunity for, and due consideration of, price undertakings by respondent companies, "which, if accepted may result in suspension of an investigation" without imposition of penalty duties. The steel industry is concerned that the provision "would encourage the use of suspension agreements and the injection of foreign governments into the trade law process."
- The steel industry opposes the provision to establish a bilateral Commission on Trade Remedies (Article 10.8) as "unprecedented, unnecessary and would provide yet more opportunities for South Korea to weaken U.S. trade law enforcement."[95]

The specific details of the trade remedies chapter are discussed elsewhere in this report. Beyond these specific issues ITAC 12 also made a number of other critical points. It argued that the rules of origin provisions did not follow earlier precedents and there were concerns with products eventually being produced in the Kaesong Industrial Complex of North Korea. (See the section on the "Kaesong Industrial Complex.") It objected to the proposed KORUS FTA's ignoring currency manipulation issues. They also supported their U.S. automotive customers' view that the FTA failed to insure adequately access to the South Korean market for U.S.-made motor vehicles. On these grounds, "especially with regard to the proposed AD-CVD provisions, ITAC 12 cannot conclude at this time that the KORUS FTA promotes the economic interests of the United States and provides for equity and reciprocity within the steel sector."[96]

Pharmaceuticals and Medical Devices

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

South Korea is among the world's top 12 largest markets for pharmaceuticals, accounting for about $8 billion in sales annually.[97] The South Korean market for medical devices accounts for roughly $2.5 billion in sales annually and is expected to grow 10%-15% each year in the next several years, in part due to the rapid aging of the population.[98] While potentially lucrative, South Korea is a market in which U.S. P&M manufactures claim government regulations have limited their ability to penetrate that market.

In 2010, the United States exported $538 million in medical equipment and supplies to South Korea, accounting for 2.1% of total U.S. exports of those products and 1.7% of total U.S. manufactured exports to South Korea. In 2010, the United States exported $825 million in pharmaceuticals and medicines to South Korea accounting for 1.7% of total U.S. exports of

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

[96] Ibid., p. 2.

[97] USITC. p. 3-64.

[98] Ibid. p. 3-91.

pharmaceuticals and 2.1% of total U.S. merchandise exports to South Korea.[99] In the same year South Korea exported $197.3 million in medical equipment and supplies and $80.9 million in pharmaceuticals to the United States.

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

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

In response, South Korea agreed in the KORUS FTA to allow U.S. pharmaceutical makers to apply for increased reimbursement levels based on safety and efficacy. South Korea also agreed to publish proposed laws, regulations, and procedures that apply to the pricing, reimbursement, and regulation of pharmaceuticals and medical devices in a nationally available publication and to allow time for comment. In addition, South Korea agreed to establish a process for U.S. manufacturers to comment on proposed changes in laws and regulations and for them to obtain a review of administrative determinations that adversely affect them.

Intellectual property rights protection in South Korea has been a critical issue for U.S. pharmaceutical manufacturers. Specifically, the failure of the South Korean government to protect from competitors proprietary data that manufacturers must submit for market approval. In addition, the South Korean government has, in some cases, approved marketing of some pharmaceuticals before it has determined that the applicant is the rightful owner of the patent and trademark.[100]

In response, under the KORUS FTA's data exclusivity provisions, South Korea would not allow a third company, such as a generic drug manufacturer, from marketing a new pharmaceutical using the safety and efficacy data, supplied by an original U.S. manufacturer as part of the market approval process, without the permission of the original U.S. maker for five years from the date of marketing approval for the original product. In addition, if a third party submits safety or

[99] The pharmaceuticals and medicines statistics are based on NAICS 3254 and medical equipment and supplies NAICS 3391 were compiled using the International Trade Administration's Trade Stats Express, http://tse.export.gov/TSE/TSEhome.aspx

[100] Primosch, William. *Testimony of Senior Director, International Business Policy, National Association of Manufacturers on the Proposed United States-Korea Free Trade Agreement for the Trade Policy Staff Committee, Office of the U.S. Trade Representative.* March 14, 2006. p. 6.

efficacy information for a product that an FTA partner government had already approved, the government is to notify the original patent holder of the identity of the third party and is to prevent the marketing of the third party's product on its territory if permission had not been granted by the original patent holder. In a side letter, the United States and South Korea agreed to not invoke the data exclusivity provision until the FTA has been in effect 18 months. Furthermore, South Korea agreed to a patent-linkage system; that is, neither government is to approve the marketing of a generic drug while the original patent is still in effect. Another provision, known as patent-term extension, would require each FTA government to adjust the length of the effective period for patents on pharmaceuticals to take into account delays incurred in receiving patent approval and marketing approval. The KORUS FTA states that no provision would prevent either government from taking measures to protect the public health of its residents from HIV/AID, tuberculosis, malaria, and other epidemics, by ensuring access to medicines. The FTA would reaffirm each country's commitment to the WTO TRIPS/health Declaration.

Reactions within the pharmaceutical and medical devices industries were somewhat split on the KORUS FTA. Makers of innovative products supported the provisions that are designed to preserve the rights of patent holders and provisions that are designed to make the South Korean regulatory, pricing, and reimbursement process more transparent and open to comments and procedural reviews. At the same time, industry representatives remain critical of South Korea's new reimbursement procedures and argue that the new system does not take into account the benefits of innovative drugs that cause drug prices to be higher. Generic drug manufacturers argue that the KORUS FTA does not contain provisions guaranteeing the availability of affordable drugs.[101]

Financial and Other Services

U.S. service providers exported $15.5 billion in services to South Korea in 2010. Among them were South Koreans' travel to the United States ($2.6 billion); other transportation, such as freight services ($3.3 billion); royalties and license fees ($4.0 billion); and other private services, such as professional services, business services, banking, insurance, and other financial services ($5.9 billion).[102] However, this amount probably undervalues the total volume of U.S. sales of services to South Korea as services are also sold through three other modes of delivery: by U.S. companies with a long-term presence in South Korea, by U.S. providers to South Korean residents located temporarily in the United States, and by U.S. providers temporarily located in South Korea.

In 2010, the United States imported $10.4 billion in services, including other transportation ($3.0 billion), U.S. travel to South Korea ($2.0 billion), expenditures by U.S. military ($2.7 billion), and other travel ($1.6 billion).[103] This figure does not include services sold to U.S. residents by South Korean firms through the other modes of delivery.

U.S.-South Korean trade in services cuts across several chapters of the KORUS FTA—Chapter 12 (cross-border trade in services); chapter 13 (financial services); and Chapter 15

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

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

[103] Ibid.

(telecommunications); chapter 11 (foreign investment); among others. A major U.S. objective in the KORUS FTA negotiations was to obtain South Korean commitments to reduce barriers to trade and investment in its services sector, especially in professional, financial, and telecommunications services.

In general the two countries would commit to:

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

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

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

Regarding *financial services*, under the KORUS FTA, if a domestic provider in one partner country develops and sells a new financial service in its home market, providers from the FTA partner country would be able to sell a like service in that market. The agreement would allow an FTA partner government to impose restrictions on the sale of financial services by providers from the other partner country for prudential reasons, for example, to protect investors, depositors, policy holders, or persons to whom a fiduciary duty is owed. The FTA would also permit either partner government to restrict monetary transfers in order to ensure the soundness of financial institutions.

The South Korean *insurance* market is the seventh-largest in the world. The USITC estimates, therefore, that U.S. insurers would be poised to obtain sizeable gains in a liberalized South Korean services market.[104] U.S. insurance companies have been concerned that the state-owned Korea Post and the cooperative insurance providers—the National Agricultural Cooperative Federation and the National Federation of Fisheries Cooperative—are not regulated by the Korean Financial Supervisory Commission or by the Financial Supervisory Service, while both private-sector foreign and domestic providers are so regulated.[105] Under the KORUS FTA, South Korea agreed that those entities would be subject to an independent state regulator as opposed to being self-regulated.[106] In addition, Korea Post would not be allowed to offer new insurance products. The two countries would allow a partner country financial services provider to transfer electronically information from its territory as necessary in the course of doing business.[107] This is a provision that the U.S. industry highlighted as being particularly important.

In *telecommunications services*, South Korea would reduce government restrictions on foreign ownership of South Korean telecommunications companies. Two years after the KORUS FTA enters into force, U.S. companies would be able to own up to 100% of voting shares in domestic South Korean telecommunications companies, and those companies would be able to own up to 100% of a facilities-based licensee.[108] These provisions do not apply to KT Corporation nor to SK Telecom Co for which a 49% foreign ownership limit would remain. In addition, each KORUS FTA partner would ensure that telecommunications providers from the other would have access to and use of its public telecommunications network for purposes of interconnection under non-discriminatory conditions and would guarantee dialing portability among other conditions.[109]

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

> We commend Ambassador Schwab and the team of negotiators who secured significant benefits for U.S. services providers in this agreement.... Korea is a key market for U.S. service companies, and this is a very high-quality agreement that merits swift passage by the Congress because it creates new commercial opportunities that will support new jobs.[110]

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[104] USITC. p. 4-8.

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

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

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

[108] Annex -I (Korea).

[109] KORUS FTA Chapter 14 Telecommunications.

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

Visas

For years, a priority for South Korea has been to convince the United States to ease restrictions on the issuance of visas for South Korean business representatives. The visa issue—along with South Korea's request to be added to the Visa Waiver program (VWP), which allows visa free travel for short-term visitors—was addressed in discussions outside of the KORUS FTA negotiations. On October 17, 2008, President Bush announced that South Korea was one of seven countries that would be admitted into the program in 4-6 weeks.[111] With this step, the VWP is likely to no longer be an issue in bilateral relations. South Korea is one of the United States' largest sources of foreign visitors. In FY2007 there were 811,251 short-term visitors for business or pleasure from South Korea.[112]

On a separate track, as part of the package of modifications agreed to on December 3, 2010, the United States agreed to extend the initial validity period of L-1A visas. These visas are used by foreigners entering the United States to work at U.S.-subsidiary of a foreign company. One group of these visas are used for foreigners coming to establish a U.S. subsidiary and the initial validity period was extended from one to five years. A second group is used for foreigners coming to work at an already established subsidiary and the initial validity period was extended from three to five years.[113]

General Provisions

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

Trade Remedies[114]

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

The three most commonly used trade remedies are *antidumping* (AD), *countervailing duty* (CVD), and *safeguard* actions. Antidumping (19 U.S.C. § 1673 *et seq.*) actions provide relief from the adverse impact of imports sold at prices shown to be less than fair market value, and countervailing duty (19 U.S.C. § 1671 *et seq.*) actions provide similar relief from goods that have been subsidized by a foreign government or other public entity. Safeguard actions (19 U.S.C. § 2251 *et seq.*) are designed to give domestic industries an opportunity to adjust to new competition

[111] White House Office of the Press Secretary, "President Bush Discusses the Visa Waiver Program," October 17, 2008. South Korea's path to entry into the VWP was made possible by reforms of the VWP that were embodied in H.R. 1 (P.L. 110-53), the Implementing the 9/11 Commission Recommendations Act of 2007. For more on the U.S. Visa Waiver Program, see CRS Report RL32221, *Visa Waiver Program*, by Alison Siskin.

[112] Department of Homeland Security, Temporary Admissions in *Yearbook of Immigration Statistics: 2007* Table 28.

[113] *Inside U.S. Trade*, December 10, 2010.

[114] This section on trade remedies was written by Vivian C. Jones, Specialist in International Trade and Finance, Foreign Affairs, Defense, and Trade Division, CRS.

and are triggered by import surges of fairly traded goods. The relief provided in a safeguard case is a temporary import duty, temporary import quota, or a combination of both, while the relief in an antidumping or countervailing duty action is an additional duty placed on the dumped or subsidized imports. These actions are authorized by the WTO as long as they are consistent with the rights and obligations of Article XIX of the General Agreement on Tariffs and Trade (GATT) 1994, the WTO Agreement on Safeguards and Countervailing Measures (Subsidies Agreement), and the WTO Agreement on Implementation of Article VI of the GATT 1994 (Antidumping Agreement).[115]

Many Members of Congress have expressed support for maintaining and strengthening U.S. trade remedy laws in the face of growing import competition. As a result, the preservation of U.S. authority to "enforce rigorously its trade laws" was a principal negotiating objective included in presidential Trade Promotion Authority (TPA) in the 107th Congress.[116]

According to news reports, the "single most important South Korean demand" in the bilateral talks was changes to U.S. antidumping rules.[117] This may be due, in part, to the significant number of U.S. trade remedy cases brought by U.S. industries on South Korean goods. As of February 12, 2010, antidumping duties were being collected on 12 South Korean imports (mostly on stainless steel specialty products such wire rod and pipe fittings), and countervailing duties were being assessed on 3 South Korean products, while South Korea had no trade remedy measures in place against U.S. products.[118] The U.S. global safeguard cases imposed on steel in February 2000 (line pipe) and March 2002 (many steel products) also significantly reduced South Korean steel imports to the United States.[119] Of the 14 WTO dispute resolution complainant cases South Korea has brought to date, eight have been disputes against U.S. trade remedy actions.[120] South Korea is also a member "Friends of Antidumping" group in the WTO Doha Round that insists on implementing changes to the Antidumping and Subsidies Agreements in any new multilateral agreement.

In the bilateral negotiations between the United States and South Korea, talks broke down in early December 2006 when South Korea presented the United States with a list of specific changes to U.S. antidumping laws on a "basically" take-it-or-leave-it basis,[121] but in mid-January 2007, South Korean officials softened their stance after accepting the assurances of U.S. negotiators that

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

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

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

[118] USITC. "Antidumping and Countervailing Duty Orders In Place As of September 10, 2008, by Country." Available at http://www.usitc.gov. Korea Trade Commission, TR Measures, available at http://www.ktc.go.kr/en/kboard_child/list.jsp?bm=86&pg=1.

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

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

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

Trade Promotion Authority had granted the Bush Administration only limited flexibility to make concessions on trade remedy issues.[122]

The KORUS FTA, just as in earlier FTAs the United States has entered into, proposes that each party to the agreement would retain all rights and obligations under the WTO agreements—meaning that the trading partners would be permitted to include each other in global safeguard actions (although, as in other FTAs, it does extend a possible exemption from global safeguard measures to either party if its imports are not a substantial cause of serious injury) and to implement AD and CVD actions against each other. Additionally, as in earlier FTAs, the trade remedies article would also authorize either party to the agreement to apply a transitional safeguard measure against imports of the other party if, as the result of the reduction or elimination of a duty mandated by the agreement, a product is being imported in increased quantities as to be a substantial cause of serious injury to a domestic industry that produces a like or directly competitive good.[123]

In the case of a safeguard, the party imposing it must provide a mutually agreed-upon amount of compensation. If the parties do not agree, the other party may suspend concessions on imports of the other party in an amount that has trade effects substantially equivalent to the safeguard measure.[124]

As such, the agreement does not seem to require any changes to U.S. AD, CVD, or global safeguard laws, or substantially change administrative procedures required to implement these actions.[125] However, in an apparent departure from previous FTAs, the KORUS FTA seems to require a few additional administrative steps prior to initiation of a trade remedy investigation involving goods from the other party. First, each party would have to notify the other if an antidumping petition is received regarding the other party's imports, as well as provide an opportunity for a meeting between the parties before an investigation is initiated.[126] Additionally, the party initiating an AD or CVD investigation would be required to provide written information regarding its procedures for negotiating a price or quantity undertaking (known in U.S. law as a suspension agreement),[127] and, after a preliminary affirmative determination is reached, "provide due consideration and adequate opportunity for consultations regarding proposed price undertakings" which could result in suspension of the investigation without imposition of duties provided a mutually agreeable undertaking is reached.[128]

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

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

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

[124] Article 10.4, Compensation.

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

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

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

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

remedy laws and practices, overseeing the implementation of the trade remedies chapter of the agreement, improving cooperation between the parties, developing educational programs on trade remedy laws, and providing a forum for exchange of information on trade remedies and other topics of mutual interest.[129]

As discussed earlier, the Industry Trade Advisory Committee on Steel (ITAC 12) believes that the procedural concessions made on trade remedies could politicize trade remedy actions, thus possibly weakening U.S. trade laws. In particular, the ITAC 12 stated that the U.S. AD-CVD investigative process is already transparent and that the pre-initiation notification and consultation requirements would delay and politicize the process.[130] It also objected to the "undertakings" provisions, saying that these provisions would encourage the use of suspension agreements and introduce actions of foreign governments into trade remedy procedures.[131] (For more information on the steel industry's reaction, see discussion in section on "Other Manufactured Goods.")

The ITAC 12 also opposes the establishment of a Committee on Trade Remedies, saying that it such a forum would give South Korea an opportunity to attempt to further try to weaken U.S. trade remedy laws.[132] Speaking in April 2007, Assistant U.S. Trade Representative for Korea, Japan, and APEC Wendy Cutler, the chief U.S. negotiator, implied that the consultative committee would focus on information sharing and "will not provide a forum to discuss specific cases."[133] She also mentioned that the committee could be a benefit to the United States by providing a platform for discussing certain industrial subsidies that the South Korean government may be supplying to manufacturing firms, and that negotiators worked out an "accommodation" that was beneficial to both sides' needs on a very contentious part of the negotiations.[134]

Kaesong Industrial Complex[135]

A consistent and significant goal for South Korea in the FTA talks was securing preferential treatment for products made in the Kaesong Industrial Complex (KIC) in North Korea, a position the United States adamantly opposed throughout most of the negotiations. Located near the North Korean city of Kaesong (also spelled "Gaesong"), 40 miles north of Seoul, the KIC is designed for South Korean companies to employ North Korean workers. As of the end of 2010, over 120 medium-sized South Korean companies were employing over 47,000 North Korean workers to manufacture products in Kaesong. The facility, which in 2010 produced $323 million in output, has the land and infrastructure to house two to three times as many firms and workers. Products vary widely, and include clothing and textiles (71 firms), kitchen utensils (4 firms), auto parts (4 firms), semiconductor parts (2 firms), and toner cartridges (1 firm).

The KIC has generated controversy because it provides an ongoing revenue stream to the Kim Jong-il regime in Pyongyang, by virtue of the share the government takes from the salaries paid

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

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

[131] Ibid., p. 4

[132] Ibid.

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

[134] Ibid.

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

to North Korean workers. South Korean and U.S. officials estimate this revenue stream to be around $20 million per year. On the other hand, the KIC arguably helps maintain stability on the Peninsula and provides a possible beachhead for market reforms in the DPRK that could eventually spill over to areas outside the park and expose tens of thousands of North Koreans to outside influences, market-oriented businesses, and incentives.

In the final KORUS FTA agreement, the two sides reached a compromise on the KIC. One year after the KORUS FTA enters into force, a binational committee will be formed to study the possibility of eventually including products from "Outward Processing Zones" (OPZs) using North Korean labor sometime in the future.[136] The agreement identifies three general categories for which the committee is to develop more detailed criteria: progress in the denuclearization of North Korea, developments in intra-Korean relations; and wages, the environment, and labor standards. For the third category of issues, the committee is to consider relevant international norms as well as the "situation prevailing elsewhere on the Peninsula." After the committee has developed criteria, the OPZ provisions in the FTA lay out a three step process by which products made in the KIC could be incorporated into the FTA. First, the committee must deem that an outward processing zone meets the criteria it has established. Second, the two governments must agree that the FTA should be amended accordingly. Third, each government must seek "legislative approval for any amendments to the Agreement with respect to outward processing zones." The agreement does not lay out the size or composition of the committee, or how committee members will be chosen, or the procedures by which the committee is to arrive at decisions.[137]

For years, neither the Bush nor Obama Administrations specified what form "legislative approval" for OPZ-related amendments to the KORUS FTA would take. In March 2011, the office of the United States Trade Representative (USTR) issued a statement that Congress "would need to pass, and the President would need to sign, a law to extend any KORUS FTA tariff benefits to products made in Kaesong or any OPZ."[138]

Some observers, particularly many opponents of the KORUS FTA, argue that the agreement could lead to increased U.S. imports of goods or components made in North Korea. The scenario they suggest involves South Korean firms obtaining low-cost Kaesong-made goods or components, incorporating the latter into finished products such as electronics or automobiles, and then reshipping the goods to the United States with "Made in [South] Korea" labels. If the KORUS FTA were in effect, the argument runs, these goods might receive preferential treatment. However, a close analysis of the agreement and the nature of trade flows reveals that unless the KIC is brought into the KORUS FTA, the FTA would likely have only a marginal impact on whether the United States imports North Korean finished products or goods that contain North Korean components. Instead, the extent of the problem of North Korea imports will be largely determined by the degree to which North Korean producers become integrated into the global economy.

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

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

[138] March 2011 document issued by the Office Of The United States Trade Representative, "Outward Processing Zones, Kaesong, and the U.S.-Korea Trade Agreement Frequently Asked Questions"; Deputy United States Trade Representative reiterated this point in April 7, 2011, testimony before the House Ways and Means Trade Subcommittee.

Another criticism of the KORUS FTA has been that it could constrain the United States' ability to restrict imports of North Korean goods or components, for instance, by invoking the agreement's dispute settlement procedures to challenge a U.S. decision to prohibit the entry of a South Korean product that contains North Korean components. However, provisions in the KORUS-FTA would appear to allow either the United States or South Korea to impose or maintain trade restrictions against the goods of a third country (such as North Korea); thus the agreement would accord each Party the right to restrict trade with the other Party in implementing any such embargo.

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

Foreign Investment

Foreign investment is becoming an increasingly significant element in the U.S.-South Korean bilateral economic relationship. Over the past decade, the stock of U.S.-South Korean foreign direct investment (FDI), valued on an historical cost basis, has increased substantially, due in no small part to the market-oriented reforms South Korea undertook after its 1997 financial crisis. In 1997, the value of stock of U.S. FDI in South Korea was $6.5 billion and had increased to $26.9 billion by the end of 2009 (latest data available). In 2009, 41% of U.S. FDI in South Korea was in manufacturing, especially in computers and electronic products, chemicals, and other manufacturing facilities. The remainder of the FDI was in services, with U.S. FDI in banking and other financial services accounting for much of this investment. South Korean FDI in the United States has also increased substantially in the last 11 years, albeit from a much lower base. In 1997, the stock of South Korean FDI in the United States was valued at $0.6 billion and had increased to $12.0 billion by the end of 2009 (latest data available).[139]

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

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

The FTA sets down general principals for the treatment by South Korea and the United States of investors and investments from one partner in the territory of the other.[140] The principle of national treatment—that one party to the agreement will treat covered investments and investors from the other party no-less favorably than it treats domestic investors and investments—is paramount. The FTA allows each party to make exceptions to the national treatment principle, but those exceptions must be specified in the relevant annexes to the agreement.[141] A second fundamental principal is most-favored-nation treatment (MFN)—the two parties agree to treat investors and investments from the other no less favorably than it treats investors and investments from third, non-party countries. A third principle is minimum standard of treatment, that is, each party shall accord to all covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security.

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

Similar to other U.S. FTAs, the KORUS FTA would establish procedures for the settlement of investor-state disputes involving investments covered under the agreement where the investor from one partner-country alleges that the government of the other partner-country is violating his rights under the FTA. The FTA stipulates that the two parties should try to first resolve the dispute through consultations and negotiations. But, if that does not work, the agreement would provide for arbitration procedures and the establishment of tribunals as provided under the “Convention on the Settlement of Investment Disputes Between States and Nationals of Other States.”

The USITC concluded that U.S. investors, especially investors in financial services, would likely gain from the KORUS FTA.[142] (See section on “Financial and Other Services.”) The United States has been the predominate partner in terms of foreign investment and stands to gain the most from the protections provided by the KORUS FTA. However, South Korean investments in the United States are increasing, and therefore, South Korea could benefit as well.

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

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

[142] USITC. p. 6-5.

Intellectual Property Rights

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

- require each government to extend national treatment to IPR holders from the other country;[143]
- require transparency through the publication of regulations and laws regarding intellectual property rights;
- facilitate the registration of and protection of trademarks and established limitations on the use of geographical indications;
- ensure the right of authors, performers, producers of recordings to determine use of copyrighted products;
- require copyright protection for no less than 70 years; thus, South Korea agrees to extend its copyright protection term, an objective of U.S. copyright holders;
- protect copyrighted material against piracy and provide penalties for those who abet piracy including the seizure and destruction of pirated and counterfeit products;
- protect copyrighted performances on the internet; and
- protect encrypted programming over satellites and cable signals.

Labor Rights and Conditions

On May 10, 2007, a bipartisan group of congressional leaders and the Bush Administration released a statement that provided language to be included in pending FTAs, including KORUS FTA. Among other things, the statement, or framework, called "The New Trade Policy for America," requires U.S. FTA partners to commit to enforcing the five basic international labor standards and would require that the commitment be enforceable under the FTA.[144] Neither

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

[144] The FTA would require each Party to adopt and maintain five internationally accepted labor rights that are contained in the ILO Declaration on Fundamental Principles and Rights at Work and Its Follow-Up (1998) (ILO Declaration) Article 19:2 specifies these rights as the freedom of association, the effective recognition of the right to collective bargaining, the elimination of all forms of compulsory or forced labor, the effective abolition of child labor and the elimination of discrimination in respect of employment and occupation. The framework also requires FTAs to adhere to seven major multilateral environmental agreements and for this commitment to be enforceable under the FTA. "The Trade Policy for America" was completed after President Bush notified Congress on April 1, 2007 of his intention to (continued...)

country is to waive or otherwise derogate from its labor statutes that reflect the five labor rights in a manner that affects trade or investment between the two FTA countries. Each country is to ensure that those affected by their respective labor laws have access to tribunals that enforce their rights under those laws. During his nomination process, USTR Ron Kirk stated the Obama Administration's position that the KORUS FTA appropriately incorporates the May 10th understanding.[145]

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

To many outside observers, South Korea's labor rights regime is generally considered to be strong for regular workers. South Korea ranks in the top third of the OECD's thirty members in terms of employment protection for regular workers.[146] Indeed, for years, a major complaint of U.S. multinationals is that restrictions in the South Korean labor market, such as mandatory severance pay, significantly raise the cost of investing and doing business in Korea. In contrast, U.S. union representatives argue that recent changes to make South Korean labor markets more flexible are reducing the rights of South Korean workers.[147] Korea's unions have earned a reputation for activism; the number of working days lost to strikes is regularly among the highest in the OECD. Hyundai Motors, for instance, has experienced a strike every year since 1994. Moreover, strikes in South Korea are notable in that they are sometimes accompanied by violence and the occupation of workplaces and public spaces (such as highways), to which the government often responds with police action. In its comments on the KORUS FTA, the Labor Advisory Committee for Trade Negotiations and Trade Policy (LAC), criticized South Korea for the imprisonment of around 200 unionists who were "exercising basic labor rights" and for mobilizing riot police against union activity.[148]

Korea's labor pool is divided into two segments: (1) South Korean "salarymen" (salaried workers, overwhelmingly men, in large corporations) comprise less than one-third of the workforce. Over half of this segment of the workforce is represented by powerful unions. (2) The remainder of the

(...continued)

sign the KORUS FTA but prior to the signing on June 30. At first, South Korean officials balked at opening negotiations to add the language but eventually agreed to do so. After, the two sides held negotiations, they included the language in the final text that was signed on June 30, 2007.

[145] In Questions for the Record posed by members of the Senate Finance Committee, USTR Kirk was asked "Do you think that the labor and environment provisions of the U.S.-Korea FTA are appropriate?" He responded that "the U.S.-Korea FTA incorporates the May 10th Agreement, which established a strong foundation for bipartisan progress on trade." United States Senate Committee on Finance, "Finance Committee Questions For The Record. Hearing on Confirmation of Mr. Ronald Kirk to be United States Trade Representative," March 9, 2009.

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

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

[148] *Ibid.*

workforce is comprised of employees in small-scale firms plus the country's temporary and day laborers. Few of these workers are unionized. The proportion of temporary workers has grown markedly, to nearly one-third of the workforce, one of the highest rates in the industrialized world.[149] These workers tend to receive low wages and receive limited coverage by the social safety net, points highlighted by the LAC. Labor markets are notoriously rigid.

Government Procurement

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

The KORUS FTA reaffirms the GPA as a baseline for government procurement but would expand the criteria to include more contracts. The GPA applies to contracts valued at around $193,000 and above. The KORUS FTA would apply agreement to contracts valued at $100,000 and above, potentially increasing the value of bilateral government-procurement trade. The GPA applies only to contracts tendered by 79 U.S. federal government agencies and by 42 South Korean central and subcentral agencies listed in the annex. Under the KORUS FTA, South Korea would add nine more agencies to be covered.

Environment Protection

In keeping with the May 10, 2007 understanding on labor and the environment between the Bush Administration and congressional leaders, under the KORUS FTA, the United States and South Korea would commit to enforce a list of seven multilateral environmental agreements to which both are parties and to add to the list when other agreements enter into force. (See the "Labor Rights and Conditions" section above.)[150] In addition, the FTA would prevent the two countries from easing environmental standards in order to allow firms on their territory from gaining a competitive trade advantage. Furthermore, violations of the environmental provisions are to be handled in the same manner as commercial provisions through the dispute settlement mechanism of the KORUS FTA and subject to trade sanctions, unprecedented for U.S. FTAs. As mentioned earlier, the Obama Administration has indicated that the May 2007 agreement is incorporated into the KORUS FTA.[151]

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[149] OECD, *Economic Survey—Korea 2007*, pp. 128-40.

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

[151] United States Senate Committee on Finance, "Finance Committee Questions For The Record. Hearing on (continued...)

Transparency

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

Institutional Provisions and Dispute Settlement

The KORUS FTA would provide several options for the United States and South Korea to resolve disputes arising under the agreement, in addition to the special dispute settlement provisions under the foreign investment chapter and other chapters. KORUS FTA would require the two countries to establish a joint committee chaired by the USTR and the Minister of Foreign Trade or their designees to supervise the implementation of the agreement. The committee would establish a panel to adjudicate disputes between the two countries under the agreement, if consultations do not lead to a resolution of the dispute. Annex 22A of the KORUS FTA contains provisions for the settlement of disputes regarding motor vehicles, specifically the snap-back provision. (See discussion in section on "Autos.") Annex 22-B provides for eventual discussion of the inclusion of products made in outward processing zones in North Korea. (For more information, see discussion in "Kaesong Industrial Complex" section.)

Other Technical Provisions

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

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

(...continued)

Confirmation of Mr. Ronald Kirk to be United States Trade Representative," March 9, 2009.

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

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

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

Next Steps, Implications, and the Emerging Debate

The United States concluded and entered into (signed) the KORUS FTA within the parameters of the Trade Promotion Authority (TPA) under the Bipartisan Trade Promotion Act of 2002. (P.L. 107-210). Therefore, any implementing legislation would be subjected to expedited procedures, that is mandatory congressional consideration, limited debate, no amendments, and an up-or-down vote. TPA does not impose a deadline on the President to submit the draft implementing bill. It is generally assumed that the President would do so only when he expects to have sufficient support in Congress to pass it, although he could submit the bill without that assurance and risk the bill's failure. President Bush did not send implementing legislation for the KORUS FTA to the 110th Congress before his term ended largely because of differences between his Administration and the Democratic leadership of the 110th Congress over the potential effectiveness of the agreement in addressing South Korean barriers to U.S. exports of manufactured goods, particularly autos, and South Korea's remaining restrictions on imports of U.S. beef.

During the first two years of his Administration, President Obama expressed support for the KORUS FTA but indicated that the outstanding issues regarding autos and beef needed to be resolved before he could send the agreement and implementing legislation to Congress for approval. With the announcement of the modifications to the agreement on December 3, 2010, it appears clear the Obama Administration intends to move ahead with the approval process. USTR Ron Kirk has indicated that the Obama Administration is now working on the timing of sending draft implementing legislation to Congress, as well as draft implementing legislation for the Colombia and Panama FTAs.[152]

[152] Office of the USTR. Remarks by Ambassador Ron Kirk to the Washington International Trade Association, April 28, 2011.

Implications for South Korea and the U.S.-ROK Alliance

In South Korea, the KORUS FTA must be approved by a majority vote in the unicameral National Assembly to take effect. The Assembly is controlled by President Lee Myung Bak's Grand National Party, which officially supports the agreement. Unlike in the United States, trade agreements are not subject to any fast-track time lines. President Lee Myung Bak, who was elected in December 2007, has made passage of the KORUS FTA a priority for his government. Most opinion polls generally have shown a majority of South Koreans in favor of the agreement, though opposition has been intense from the opposition parties and rural interests, among others. Furthermore, most polls of South Korean legislators show broad support for the agreement within the National Assembly. The KORUS FTA was not a significant issue in either the 2007 presidential election campaign, despite the fact that one of the major candidates opposed the agreement, or in the April 2008 parliamentary elections.

For South Korea, entering an FTA with the United States meshes with a number of Lee's economic and strategic goals. Ongoing competitive pressure from Japanese firms, increased competition from Chinese enterprises, and the rapid aging of the South Korean workforce has heightened the sense of urgency to boost national long-term competitiveness, particularly in the services industries, where South Korean productivity typically lags compared to other industrialized countries. Indeed, former President Roh and other South Korean officials have argued that the KORUS FTA is essential for South Korea's economic survival.[153] Similarly, if less grandiosely, President Lee has argued that passage of the KORUS FTA will help revitalize South Korea's economy. To accelerate Korea's reform efforts—and also to avoid being left out from other FTAs being created globally and in Asia—Presidents Roh and Lee have pursued an aggressive effort to negotiate FTAs. South Korea has entered into FTAs with Chile, Singapore, the European Free Trade Association (EFTA), the Association of Southeast Asian Nations (ASEAN), and India. It has signed an agreement with the European Union and is negotiating FTAs with other countries, including Canada, Mexico, and Australia.[154]

The United States and South Korea negotiated the KORUS FTA in part as a means to restore the health of a critical foreign policy and national security alliance.[155] While the talks were ongoing, the KORUS FTA sometimes was discussed as a possible counterweight to the bilateral friction that was occurring over issues such as how to manage relations with North Korea and the repositioning of U.S. troops in South Korea. These tensions decreased markedly in 2007, following the Bush Administration's decision to place greater emphasis on engagement and negotiations with North Korea. The election of Lee, who has stressed the importance of rebuilding U.S.-South Korean ties has improved relations further. Thus, with the alliance apparently on firmer ground, the KORUS FTA no longer appears as an exceptional area of bilateral cooperation.

Although the FTA's utility as an acute salve for the alliance has been reduced, some argue it could help to boost the alliance, over the medium and longer term, by deepening bilateral economic and

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[153] Korea Broadcast System, March 31, 2006 Broadcast in Korean, summarized by the Open Source Center, "ROK TV Carries Economic Minister's Comments on ROK-US FTA," April 10, 2006, FEA20060410021900. (Han was Finance Minister when he made these remarks.) South Korean Blue House, "Address to the Nation," April 2, 2007.

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

[155] For more, see CRS Report RL33567, *Korea-U.S. Relations: Issues for Congress*, by Larry A. Niksch.

political ties. Entering into an FTA, some argue, is a way to help reorient the alliance to adapt to the changes on the Korean Peninsula and in East Asia. However, in concrete terms, it is difficult to see how the KORUS FTA would make a significant difference in the strategic relationship, as it is unlikely to alter either country's fundamental interests on the Peninsula or in Northeast Asia.

In contrast, while the *passage* of the KORUS FTA is unlikely to have a major substantive impact on the strategic relationship, a *collapse* of the KORUS FTA would probably have a profound symbolic effect, particularly upon the way South Koreans view the alliance. If the KORUS FTA is rejected or subjected to a prolonged delay by the United States, it would be a psychological blow to many South Korean policymakers, many of whom would likely see it as a betrayal. This would be particularly true since, in their eyes, they made politically costly concessions on autos, beef, labor, and the environment to help ensure the agreement would be more favorably received in the U.S. Congress. The KORUS FTA's failure in the United States, according to some Korean politicians and policymakers, would lend credence to arguments in South Korea that the U.S. commitment to Korea and Northeast Asia is declining. If these perceptions take hold, it would increase the political costs of South Korean leaders' taking unpopular decisions on behalf of the alliance, such as increasing South Korean payments for relocating U.S. troops on the Peninsula. If the KORUS FTA is rejected or delayed in the United States, U.S. policymakers could attempt to somewhat ameliorate the negative symbolic effects in South Korea by taking high profile steps to expand U.S.-ROK strategic, rather than economic, relations.

President Obama's moves to prioritize the KORUS FTA have occurred as strategic relations between the United States and South Korea have become deeper and broader. Cooperation between the two allies over North Korea policy, already at a high point, has grown even closer since the March 2010 sinking of a South Korean naval vessel, the *Cheonan*, in waters disputed by North and South Korea has dominated the news. A multinational investigation team led by South Korea determined that the ship was sunk by a North Korean submarine. The growing affinity between the Obama and Lee Administrations also has been illustrated by U.S. backing for South Korea's successful bids to host the G-20 summit that took place in Seoul in November 2010 and the second international Nuclear Security Summit scheduled to take place in 2012

Implications for U.S. Trade Policy and U.S. Asia Policy

On the KORUS FTA and other trade-related issues, President Obama faces competing pressures. On one side, are those, including business community representatives and pro-trade Members of Congress, who view the KORUS FTA as an important opportunity for the United States to increase trade and investment with an important East Asian market and ally. They also are concerned about U.S. manufacturers and investors losing out to the their EU competitors if the EU-Korea FTA enters into force before the KORUS FTA. On another side, are those who have argued that the KORUS FTA does not sufficiently address South Korean barriers to imports of manufactured goods, particularly cars and some appliances, and these deficiencies would have to be fixed before a bill could pass Congress. The Obama Administration, including the President himself, has expressed such views and has indicated that they are in the process of seeking solutions.

The KORUS FTA faces even deeper opposition from those who are skeptical about the benefits of FTAs, in general, at least as pursued under current trade policy. Much of this opposition comes within the Democratic Party in Congress and is manifested in legislation, the TRADE Act of 2009, (H.R. 3012 (Michaud), S. 2821 (S. Brown)) introduced in the 111th Congress. At this writing, the House bill has 136 co-sponsors and the Senate bill has 6 co-sponsors. Each bill calls for a review of KORUS FTA and the other two pending agreements to ensure that U.S. interests are served and also calls for review of some FTAs already in force, and would subject them to possible renegotiation if they are deemed failing to serve U.S. interests.

But as of early December, the modifications appear to have accomplished their primary objective. They have shifted the politics surrounding the KORUS FTA debate in the United States, where the original agreement was encountering strong resistance and without fundamentally altering the politics in South Korea, where the agreement has broad support. Shortly after the announcement, a number of U.S. groups and individuals who had previously opposed the agreement, including several Members of Congress, announced their support. In South Korea, the modifications do not appear to have shifted the terms of political debate over the FTA, which generally has been expected to be approved by the National Assembly. Most South Korean media commentators have observed that the balance of concessions in the December deal were in the United States' favor, a dynamic that the agreement's opponents have seized upon as another reason to criticize the FTA. In contrast, South Korean supporters of the agreement appear to accept the concessions as regrettable but tolerable.

The fate of the KORUS FTA could affect U.S. efforts to institutionalize its economic presence in East Asia, a goal the Bush Administration pursued in part through FTAs. In addition to the KORUS FTA, the United States has an FTA with Singapore. The Bush Administration initiated FTA negotiations with Malaysia and Thailand, but they ultimately stalled. In November 2009, President Obama announced the United States would enter into negotiations on a Trans-Pacific Partnership (TPP) trade agreement, a trade liberalization negotiation among Australia, Brunei Darussalam, Chile, New Zealand, Peru, Singapore and Vietnam. Some observers worry that the TPP negotiations, which began in March 2010, could assume a higher priority for the Administration than the economically more significant KORUS FTA.[156]

Since the early 2000s, U.S. use of FTAs in Asia also has been a proposed response to the plethora of bilateral and multilateral FTAs that are being negotiated in the region. None of the actual or proposed multilateral agreements include the United States. Failure of the KORUS FTA could be viewed as a serious blow to the U.S. "competitive liberalization" strategy. With FTAs throughout East Asia proliferating, a failure of the KORUS FTA to be implemented would also likely mean that the United States would be shut out of regional economic groupings in East Asia. In contrast, the implementation of the KORUS FTA could spark interest of other East Asian countries, such as Japan, to negotiate FTAs with the United States in order not to lose their share of the huge U.S. market to South Korea. Thus, if the proponents of the "competitive liberalization" argument are correct, the fate of the KORUS FTA could play an important role in accelerating or decelerating the move to open market regionalism in East Asia.

Similarly, the fate of the KORUS FTA is likely to be seen as a bellwether for broader U.S. trade policy, which is now in a period of reevaluation. In addition to the KORUS FTA, U.S. FTAs with Colombia and Panama are pending. The Doha Development Agenda round in the WTO is, for all intent and purposes, on life support. This raises questions in the minds of U.S. policymakers and other experts, regarding the future role of the WTO and multilateral negotiations in shaping the international trading framework. The KORUS FTA will likely play a role in this reassessment.

[156] "Lack of Movement on Korea Auto Fix May Mean No FTA Vote in Near Term," *Inside US Trade*, January 15, 2010.

For better or worse, its rejection or indefinite delay might call into question the viability of FTAs as a serious U.S. tool to strengthen economic ties with major trading partners

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

On April 18, 2008, U.S. and South Korean negotiators reached agreement on the sanitary rules that Korea will apply to beef imports from the United States. It allows for imports of all cuts of U.S. boneless and bone-in beef and other beef products from cattle, irrespective of age, as long as specified risk materials known to transmit mad cow disease are removed and other conditions are met. However, to address subsequent Korean concerns, both sides revised this deal on June 21, 2008, to limit sales of U.S. beef from cattle less than 30 months old.

South Korea quickly published rules to put this agreement into effect, and began to inspect U.S. beef shipments. The U.S. Department of Agriculture similarly began to implement a new program to verify that the beef sold is processed from cattle under 30 months old. U.S. beef exporters have since worked to recapture a key overseas market.

In 2003, South Korea was the third-largest market for U.S. beef exports, prior to the ban imposed after the first U.S. cow infected with mad cow disease, or BSE (*bovine spongiform encephalopathy*), was discovered. Korea's commercial significance is reflected in the position taken by some Members of Congress, who have stated that congressional consideration of, and support for, the KORUS FTA depends upon South Korea fully opening its market to U.S. beef.

While the U.S. beef industry and U.S. policymakers welcomed the initial April deal, Korean TV coverage of the issue and Internet-spread rumors that questioned the safety of U.S. beef resulted in escalating protests and calls for the beef agreement to be renegotiated or scrapped. U.S. officials countered that measures already in place to prevent the introduction of BSE in U.S. cattle herds meet international scientific standards. To address mounting public pressure, the Korean government twice pursued talks with the United States to find ways to defuse public concerns without "renegotiating" the beef agreement. In late June 2008, both governments confirmed a "voluntary private sector" arrangement that allows Korean firms to import U.S. beef produced only from cattle less than 30 months old. Both viewed this as a transitional step until Korean consumers regain confidence in the safety of U.S. beef.

Under this arrangement, exports of U.S. beef (including bone-in cuts) to South Korea resumed in mid 2008, and by year-end reached almost $300 million, more than one-third of the record 2003 sales level. In 2009, with the drop off in beef sales worldwide due to the economic recession, U.S. beef sales to Korea fell to $216 million. For 2010, sales more than doubled over the previous year to reach $518million.[157] Though Australia is the main competitor, U.S. beef exporters have gained noticeable market share since the Korean market reopened. The U.S. share (in quantity terms) rose from 15% in 2008, 26% in 2009, to 32% in 2010 (compared to 69% in 2003). Promotional efforts to rebuild consumer confidence in U.S. beef, aggressive marketing efforts by large store chains, and much lower retail prices for foreign than for Korean beef, account for the continued growth in U.S. beef sales in Korea.[158]

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[157] National Cattlemen's Beef Association, "Statement from NCBA Chief Economist Gregg Doud on US, Korea Trade Deal," December 3, 2010.

[158] For more information, see CRS Report RL34528, *U.S.-South Korea Beef Dispute: Issues and Status*, by Remy Jurenas and Mark E. Manyin.

Obama Administration officials, following the President's June 26, 2010, announcement of his decision to present the KORUS FTA to Congress, stated their intent was to resolve the beef and auto issues with South Korea by November 2010 once consultations with Congress and stakeholders were complete. In the negotiations concluded on December 3, 2010, the beef issue reportedly received little discussion as both sides focused on revising the auto provisions. President Obama, in discussing the supplemental agreement, indicated that the United States will continue to work toward "ensuring full access for U.S. beef to the Korean market."[159]

Congressional reaction on the outcome of the beef issue was mixed. Senator Baucus (chairman of the Senate Finance Committee), who has advocated for full access for U.S. beef irrespective of the age of cattle in accordance with international scientific standards, expressed "deep disappointment" that the supplemental deal "fails to address Korea's significant barriers to American beef exports." He stated his commitment to right "this wrong" and to work with the Administration to ensure that ranchers "are not left behind." More recently, Baucus said he will not support the KORUS FTA until South Korea opens up its beef market. A few other Senators, though concerned with the lack of progress on beef, viewed the deal positively and welcomed the prospect for considering the KORUS FTA in 2011.[160] Meat industry groups expressed support for this trade agreement that they expect over time will significantly increase their exports to South Korea, and urged Congress to move quickly to ratify it. Beef interests, also supportive, called for continued efforts to secure full market access.[161]

Memories of the size and intensity of the 2008 anti-beef agreement protests in South Korea appear to have directly influenced the position taken on the beef issue by Korean negotiators. Reflecting this political sensitivity, they reportedly rejected any discussion on this matter in the negotiations held in early November leading up to the summit between Presidents Obama and Lee and in the final talks leading to the supplemental agreement. Their position was that this issue "did not fall under" the FTA concluded in 2007. Since then, South Korea's trade minister has confirmed that there will be no more discussions on ending the age limits of U.S. cattle slaughtered for beef. This stance was more recently affirmed by its ambassador to Washington in late January 2011.[162] The outcome appears to have been successful in that it has not altered the political debate expected to occur in South Korea on the KORUS FTA. However, if changes had been made to the terms of current U.S. beef access, opponents would have been given an opening to shift the debate on the agreement.

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[159] White House, Office of the Secretary, "Remarks by the President at the Announcement of a U.S.-Korea Free Trade Agreement," December 4, 2010.

[160] Senate Finance Committee, "Baucus Deeply Disappointed With Announcement on Korea Trade Deal, Commits to Keep Fighting for American Ranchers," December 3, 2010; Senate Agriculture Committee, "Sen. Chambliss Statement on U.S.-South Korea Free Trade Agreement," December 3, 2010; Senator Grassley, "Conference Call with Farm Broadcasters," December 7, 2010; *Washington Post*, "Senator's objection may slow trade pact," February 3, 2011, p. A4.

[161] Meatingplace.com, "U.S.-Korea FTA deal leaves beef unchanged, phases out tariffs," December 6, 2010; Ibid., National Cattlemen's Beef Association; American Meat Institute, "AMI Statement on Finalized U.S. Free Trade Agreement with South Korea," December 3, 2010.

[162] *Inside U.S. Trade*, "Korean Negotiators Refused To Engage On Beef Issue In Seoul," November 19, 2010; *Washington Trade Daily*, "The KorUS Supplemental Agreement," December 6, 2010, p. 3; Washington Post, Political Economy Blog, "Obama, Lee outlined U.S.-Korea trade deal in Seoul, official says," December 6, 2010; Bloomberg, "South Korea's Kim Rules Out Negotiations on U.S. Beef Imports," December 6, 2010; *Inside U.S. Trade*, "Baucus to Oppose Korea FTA Unless More Progress Made on Beef Issue," December 10, 2010, p. 3; International Trade Daily, "Korea Has No Plans to Discuss Beef Prior to Action on FTA, Ambassador Says," February 1, 2011.

Appendix B. South Korean Motor Vehicle Manufacturing

South Korea came late to the table of major motor vehicle manufacturing nations. Government attempts to foster a domestic automobile industry began in 1962 when the South Korean government enacted the Automobile Industry Protection Law, with assembly line production of automobiles in Korea beginning that year using complete knock down kits imported from Japan.[163] The 1980 edition of the *Automotive News Market Data Book*, an authoritative industry source, listed no South Korean company among the top 50 global producers. By 1988, according to the same publication's 1990 edition, total South Korean car and truck production exceeded one million units. By 2010, according to the International Organization of Motor Vehicle Manufacturers, total South Korean production of cars and commercial vehicles was given as 4.3 million units, which ranks South Korea as the global number four national producer, behind, in order, China, Japan, and Germany.[164] Yet, South Korea remains only a mid-level consumer of motor vehicles, with domestic sales of 1.5 million. Exports account for nearly 65% of Korea's motor vehicle production volume, a figure that is matched by no other major motor vehicle producing country.[165]

South Korea has aggressively developed and protected its automotive manufacturing base. Motor vehicle imports were prohibited in South Korea until 1987, and imports from Japan were banned until 1999.[166] Originally the South Korean government promoted the development of a fleet of domestically owned producers, but this strategy failed. In the shakeout after South Korea's economic crisis of 1997-98, only one major South Korean-owned company was left, Hyundai, which also took control of the number-two producer by volume, Kia. Others were marginalized, out of the business altogether, or controlled by foreign companies. Korea's third producer, and their only other major manufacturer left in the business, Daewoo, is now controlled by General Motors.[167] The lone major South Korean-owned producer, the Hyundai-Kia combination, in 2009 produced 4.2 million vehicles worldwide, ranking it fifth globally.[168]

Hyundai is a world-class global competitor, with current and planned assembly operations in the United States, the European Union, and other countries. The export orientation of the South Korean motor vehicle industry, the quality of South Korean cars, and the relatively low U.S. tariff on all imported motor vehicles, except trucks, has made the United States a good market of opportunity for South Korean automobile exports. Currently, the United States imposes a 2.5% duty on imported passenger vehicles and a 25% duty on trucks. South Korean auto makers

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[163] Andrew Green, "South Korea's Automobile Industry: Development and Prospects," *Asian Survey*, vol. 32, no. 5 (May 1992), pp. 413-414.

[164] International Organization of Motor Vehicle Manufacturers, *World Motor Vehicle Production*, World Ranking of Manufacturers, 2010 Provisional Production Statistics, http://oica.net/category/production-statistics/

[165] American Automotive Policy Council, "*Statistical Overview of the Korean Automotive Industry/Market & U.S. Trade Relationship, 1990-2010*," http://www.aapc.us/industry-facts?page=1

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

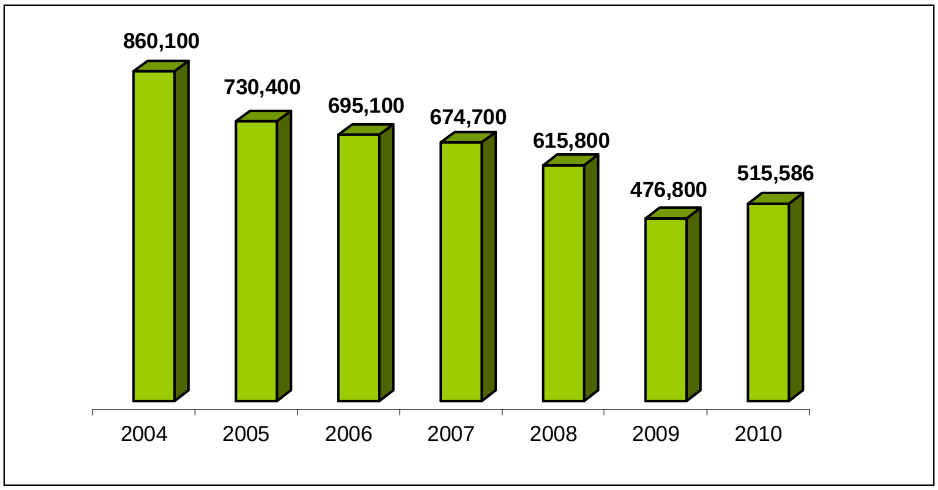
[167] Ibid., pp. 60-61; Graeme P. Maxton and John Wormald, *Time for a Model Change*: *Re-Engineering the Global Automotive Industry.* Cambridge, U.K.: Cambridge University Press, 2004. pp. 101-2; CRS Report RL32883, *U.S. Automotive Industry: Recent History and Issues*, pp. 75-76.

[168] International Organization of Motor Vehicle Manufacturers, *World Motor Vehicle Production*, World Ranking of Manufacturers, Year 2009, 2008, http://oica.net/wp-content/uploads/ranking-2009.pdf

exported many more cars to the United States than U.S. car manufacturers export to South Korea. Total South Korean motor vehicle exports to the United States peaked at more than 860,000 units in 2004, according to U.S. Commerce Department data, and have dropped every year through 2009, but increased to nearly 516,000 passenger vehicles and light trucks in 2010 (see **Figure 1**). U.S.-based automobile exporters, which could include South Korean and other foreign-owned manufacturers, shipped more than 15,600 passenger cars and light trucks to South Korea in 2010 , which was more than double the 7,663 cars and light trucks in 2010.[169]

Figure 1. South Korean Passenger Vehicle and Light Truck Exports to the United States

2004-2010



Source: U.S. Department of Commerce, Office of Transportation and Machinery.

Another important development affecting automotive exports and imports are the investments South Korean automakers have made in the U.S. market since the mid-2000s. Hyundai and Kia have established production facilities in the United States. Thus, Hyundai's Montgomery, AL, plant and Kia's West Point, GA, facilities allow them to substitute for some imports. In 2010, Hyundai sold over 894,000 cars in the United States, of which over 40%, or 381,505 units, were produced in the United States.[170] Kia has also begun to assemble automobiles in the United States from U.S. and globally sourced parts. At the end of 2009, the first U.S.-built Kia vehicle rolled off its production line.[171] By the end of 2010, 130,000 Kia Sorento's and 17,000 Hyundai Santa Fe's were produced at the Georgia manufacturing facility.[172] At full capacity, the Georgia Kia plant will be able to produce 300,000 vehicles. Meanwhile, GM Daewoo Auto & Technology (GMDAT), which is the South Korean arm of U.S. automaker GM, builds and sells cars in South

[169] U.S. Dept. of Commerce. International Trade Administration. Office of Aerospace and Automotive Industries (Commerce Dept. OAAI). *U.S. Motor Vehicle Industry Domestic and International Trade Quick-Facts* (yearend 2010 data and earlier years).

[170] "*U.S. Light Vehicle Sales by Nameplate, December & YTD*," Automotive News, January 4, 2011, http://www.autonews.com

[171] Ihlwan, Moon, "Korea's Kia Opens Auto Plant in U.S.," *Business Week*, November 17, 2009. http://www.businessweek.com/globalbiz/blog/eyeonasia/archives/2009/11/koreas_kia_open.html

[172] "*North American Light Vehicle Production by Assembly Plant*," Automotive News, January 10, 2011, http://www.autonews.com.

Korea. In 2010, GMDAT sold 125,730 domestically built cars.[173] Since these vehicles are not exported they are not covered by the free trade agreement.

The total value of South Korean automotive exports to the United States, including parts, was $11.4 billion in 2010, compared to U.S. exports of similar products to South Korea of $873 million. Thus, the bilateral trade deficit in autos totaled $10.6 billion in 2010. This compares to trade deficits earlier in the decade of $11.7 billion in 2006, $11.2 billion in 2007, $10,6 billion in 2008, and $7.9 billion in 2009, but up over the long term from a deficit of $5.5 billion in 2000, and $1.5 billion in 1990.[174] One analyst who examined the effects of the proposed FTA, found in simulation models of projected market changes, South Korea would always gain relative to the United States from bilateral liberalization, "because Korea has a comparative advantage over the United States in the automobile sector; in other words, Korea has been much more successful in accessing the U.S. market than the United States has been in accessing the Korean market."[175]

Through aggressive and successful marketing, Hyundai and Kia together have significantly increased U.S. market share between 2009 and 2010. Both brands saw a jump in their U.S. sales (for Hyundai sales of both their domestic and imported vehicles increased by 27% from 2009 to 2010 and Kia's car and light truck sales were up by 19% during the same time period). Overall sales of U.S. light vehicles were also up, but did not grow as fast increasing by 11% in 2010 compared to 2009. South Korean automakers share of the U.S. market jumped from 5.1% in 2008 to 7.0% in 2009 and 7.7% in 2010. By comparison, sales of Chevrolet's Aveo model, which is imported from South Korea, grew by 26% between 2009 and 2010.[176] Stronger U.S. sales growth have been recorded in 2010 for all major automakers, including Hyundai-Kia, which combined increased their U.S. sales in 2010 by 22% compared to the same period in 2009, with sales of over 894,000 cars in the United States.[177]

South Korean policies that allegedly restrict imports of foreign-made motor vehicles have been a major target of U.S. trade policy. In 1995 and 1998, the USTR negotiated memoranda of understanding (MOUs) with South Korea, aimed at reducing formal and informal South Korean policies that were said to discriminate against imports of U.S.-made vehicles and other foreign imports. U.S. policy primarily focused on motor vehicle taxation policies and South Korean motor vehicle standards, which supposedly did not conform to international standards, or those widely used in major markets.[178] The import share of the domestic market in South Korea has increased since the MOUs were signed. According to data from the Korea Automobile Manufacturers Association and the Korea Automobile Importers and Dealers Association, total imports grew from a low of less than 1% of the market (4,400 units) in 2000 to almost a 5% market share by 2010 (90,562 units). Together, European manufacturers accounted for 65% of imported cars in the South Korean market in 2010 and Japanese manufacturers combined comprised another 26%. U.S.-headquartered automakers made up the remainder with a 8% share

[173] American Automotive Policy Council, *Facts About the Korean Auto Industry and Economy*, http://www.aapc.us/industry-facts?page=1.

[174] 2000, 2007, 2008, 2009, and 2010 data from Commerce Dept. OAAI. Data for 1990 quoted from CRS Report RL32883, *U.S. Automotive Industry: Recent History and Issues*, Appendix 5.

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

[176] *Automotive News* data base, "U.S. Light-Vehicle Sales by Nameplate, December & YTD," January 11, 2010.

[177] *Automotive News*, "*U.S. Light-Vehicle Sales by Nameplate, December & 12 months 2010*," January 11, 2011.

[178] CRS Report RL32883, *U.S. Automotive Industry: Recent History and Issues*, p. 60.

of new imported cars sold in South Korea (i.e., Ford at 4,018, Chrysler at 2,638, and GM at 749).[179]

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[179] To complete the picture, General Motors has sold over 100,000 cars annually since 2005 through its South Korean subsidiary, the GM Daewoo operations. The rest of its production, which totaled nearly 882,000 vehicles, were shipped abroad. General Motors Corporation and Korea's Daewoo Motor Company launched the GM Daewoo Auto & Technology Company in 2002. GM holds a 72% stake in the Korean car maker, with the rest of the company controlled by the state run Korea Development Bank. GM Daewoo operates five manufacturing facilities in Korea and one assembly plant in Vietnam.