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

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Summary

President Obama signed the legislation implementing the U.S.-South Korea Free Trade Agreement (KORUS FTA) on October 21, 2011 (P.L. 112-41), and the Korean National Assembly passed the agreement on November 22, 2011. The KORUS FTA entered into force on March 15, 2012.

With the KORUS FTA now in force for over two years, focus has shifted from the debate over its passage to its implementation, economic impact, and effect on future U.S. FTAs. Some U.S. companies have argued that certain aspects of the KORUS agreement are not being implemented appropriately, citing issues related to rules of origin verification, express delivery shipments, data transfers, and pending auto regulations. In addition, a widening trade deficit with South Korea since the implementation of the agreement has led some observers to argue the agreement has not benefitted the U.S. economy, but it is difficult to distinguish the KORUS FTA's impact on U.S.-South Korea trade patterns from the impact of other economic variables. As the largest of the recently passed U.S. FTA's, perceptions of the KORUS FTA's economic impact and concerns over its implementation may influence congressional debate in the new FTAs now under negotiation, specifically the Trans-Pacific Partnership (TPP), which South Korea has signaled an interest in joining, and the Transatlantic Trade and Investment Partnership (T-TIP) between the United States and the European Union.

The KORUS FTA is the second-largest U.S. FTA (next to NAFTA). In goods trade in 2013, South Korea was the sixth-largest trading partner of the United States, and the United States was South Korea's second-largest trading partner. The KORUS FTA covers a wide range of trade and investment issues and, therefore, could have significant economic implications for both the United States and South Korea.

Congress approved the KORUS FTA implementing legislation using expedited procedures authorized by Trade Promotion Authority (TPA). Under TPA, which expired in 2007, the President had the discretion on when to submit the implementing legislation to Congress. The KORUS FTA was negotiated and signed on June 30, 2007, by President George W. Bush. However, President Bush did not submit the legislation because of differences with the Democratic leadership over treatment of autos and beef, among other issues. On December 3, 2010, after a series of negotiations, President Obama and South Korean President Lee announced that they had reached an agreement on addressing the outstanding issues related to the KORUS FTA. As a result, the final implementing legislation modified certain provisions of the 2007 agreement, primarily focused on trade in agriculture and autos.

A broad swath of the U.S. business community supported the KORUS FTA. With the modifications in the commitments reached in December 2010, the three Detroit-based auto manufacturers and the United Auto Workers (UAW) union changed their positions and backed the agreement. Other labor unions and some nongovernmental organizations opposed the agreement. Many U.S. supporters viewed the KORUS FTA as important to secure new opportunities in the South Korean market, while opponents claimed that the KORUS FTA did not go far enough to break down South Korean trade barriers or that it would benefit U.S. corporations without producing gains for U.S. workers. Other observers suggested 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.

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Introduction

The U.S.-South Korea Free Trade Agreement (KORUS FTA) entered into force on March 15, 2012. It includes provisions to reduce and eliminate bilateral tariff and non-tariff barriers and enhance the rules and disciplines governing the bilateral trade and investment relationship, including issues such as: trade in manufactured goods, agricultural products, and services; foreign investment; government procurement; intellectual property rights; and worker rights and the environment, among other issues. While most of the agreement's provisions went into effect immediately, some are being phased in over the next several years.

The United States and South Korea entered into the KORUS FTA as a means to further solidify an already strong bilateral economic relationship. The United States specifically sought increased access to South Korean markets for agricultural products, manufactured goods, services, and foreign investment. The United States likely also sought to maintain its competitiveness in South Korea in the face of Seoul's FTA negotiations with other major trading partners, including the European Union. For South Korean leaders, the KORUS FTA was a mechanism to promote reform in its own economy and also to gain greater access to the U.S. market for autos and other manufactured goods.

In general and in the short- to medium-term, the KORUS FTA's largest commercial effects are expected to be microeconomic in nature. In other words, from the perspective of specific industries, the agreement may have a noticeable impact even if its economy-wide effects are modest. However, the increase in the U.S. trade deficit with South Korea since the agreement's entry into force has caused some observers to question the benefits of the agreement, although other factors—including a decrease in South Korea's rate of economic growth—may have been the main drivers of evolving trade patterns.

As discussed in the "Implementation Issues" section below, some U.S. companies have argued that certain aspects of the KORUS agreement are not being implemented appropriately. For instance, U.S. exporters have claimed the agreement's effectiveness has been diminished by South Korean customs authorities requiring allegedly excessive documentation to certify rules of origin of imports of U.S. products. U.S. manufacturers also have raised concerns that a proposed South Korean tax credit/tax penalty program for car purchases may discriminate against imports of U.S.-made cars. South Korean and U.S. officials are reportedly working to resolve these issues.

Perceptions about the KORUS FTA and its provisions may influence other U.S. trade negotiations, as well as congressional debate over their potential implementation. The most prominent of these is the Trans-Pacific Partnership (TPP), a 12-nation FTA negotiation that now includes Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam, and in which South Korea has signaled an interest in participating.[1] Views on the relative benefits of KORUS may also affect the ongoing Transatlantic Trade and Investment Partnership (T-TIP) negotiations between the United States and the European Union.

[1] For more information on the TPP negotiations, see CRS Report R42694, *The Trans-Pacific Partnership (TPP) Negotiations and Issues for Congress*, coordinated by Ian F. Fergusson and CRS Report R42344, *Trans-Pacific Partnership (TPP) Countries: Comparative Trade and Economic Analysis*, by Brock R. Williams.

Many observers have argued that in addition to its economic implications, the KORUS FTA has diplomatic and security implications. For example, they have suggested that it will deepen the U.S.-South Korean alliance by strengthening the bilateral economic relationship. 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.[2]

This report examines the provisions of the KORUS FTA and issues related to its implementation in the context of the overall U.S.-South Korean economic relationship, U.S. objectives, and South Korean objectives. It also examines recent trade patterns.

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 granted duty-free status to almost two-thirds of current U.S. agricultural exports. Tariffs and import quotas on most other agricultural goods will 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, duty-free access for several U.S. products will slowly expand in perpetuity but remain subject to South Korean import quotas.

Much effort went into negotiating provisions covering four 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. It was only following the conclusion one year later of a difficult series of negotiations on a separate bilateral understanding on the terms of U.S. beef access to the South Korean market—accompanied by widespread public protests in Korea—that shipments resumed in July 2008.

Negotiations on access for U.S. rice and oranges into the South Korean market also were contentious. Rice was a "make-or-break" issue for Seoul, and excluded at South Korea's insistence out of U.S. recognition that if pushed, the talks would likely have collapsed. Special treatment for U.S. oranges was agreed to at the last moment, when negotiators compromised on a multi-part solution expected to increase U.S. navel orange exports over time. In the December 2010 changes to the initial agreement, Korea secured a two-year extension in the tariff phase-out for one commercially important line of U.S. frozen pork product in return for changes the United States sought in its commitments under the auto and other provisions. In June 2011, South

[2] For more on the U.S.-South Korean alliance, see CRS Report R41481, *U.S.-South Korea Relations*, coordinated by Mark E. Manyin.

Korea's trade minister clarified that the use of certain generic names by U.S. cheese exporters selling to that market will not be restricted by provisions in the EU-Korea (KOREU) FTA.

Automobiles

Trade in autos and auto parts proved to be among the most contentious areas tackled by U.S. and South Korean negotiators. In recent years, South Korean auto manufacturers have increased their market share through imports and expanded car production in the United States and other major automotive markets like the European Union. U.S. industry argued that South Korea should eliminate policies and practices that seemingly discriminate against U.S. auto imports. In December 2010, the United States and South Korea reached a joint understanding on automotive trade.[3] Due to these modifications, all three U.S. automakers ultimately supported the KORUS FTA. A detailed discussion of the auto-specific provisions is provided later in this report. A few of the most important provisions are discussed below.

- The United States will eliminate its tariff of 2.5% on passenger cars, including electric and hybrid vehicles, as of 2016. South Korea cut its passenger car tariff to 4% upon implementation of the KORUS FTA and will remove the remaining tariff in 2016.[4] For trucks, South Korea dropped its 10% duty upon implementation, while the U.S. tariff of 25% will remain in place for seven years and then be phased out entirely by 2021.[5] The KORUS FTA also includes a "snapback provision" that allows the United States to reinstate its 2.5% passenger car tariff, once the duties are completely eliminated, if U.S. automakers claim and the dispute settlement panel finds that South Korea is in violation of the agreement. The snapback could also be imposed due to violations regarding imports of trucks. 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 the snapback will not apply to these commitments.[6]
- A special motor vehicle safeguard allows the United States to take action if there are "any harmful surges in South Korean auto imports due to the agreement." A safeguard can be initiated by the United Auto Workers union, the domestic auto industry, or the U.S. government. The remedy for finding injury is a snapback to the original tariff levels in place prior to the implementation of the FTA. This remedy can be used more than once and is available for a period of up to 10 years after the concerned tariffs are eliminated. As a remedy under the auto-specific

[3] The December 2010 commitment modifications adjusted the tariff elimination schedule for passenger cars and trucks, allowing for a longer phase-out period, which was a key priority for Ford Motor Company and the United Auto Workers (UAW). A special vehicle safeguard was added to protect the U.S. market from a possible surge in South Korean auto imports exempting U.S. car manufacturers that export 25,000 or fewer autos and trucks to South Korea from South Korean safety standards if they meet U.S. federal safety standards.

[4] In the initial 2007 agreement the United States and South Korea had agreed to phase out their respective electric and hybrid car tariffs of 2.5% and 8%, over ten years.

[5] The U.S. Department of Commerce's FTA tariff tool shows the tariff elimination schedule for specific industrial goods, http://export.gov/fta/ftatarifftool/TariffSearch.aspx.

[6] For more information see pp. 2-4 of CRS Report R41544, *Trade Promotion Authority and the U.S.-South Korea Free Trade Agreement*, by Emily Barbour.

> safeguard, the United States will be able to re-impose the 2.5% passenger vehicle tariff. South Korean assembly production in the United States rose to almost 770,000 cars and light trucks in 2013. At more than 750,000 units, nearly an equal number of passenger vehicles and light trucks were imported from South Korea in 2013, up 28% from two years earlier.[7] If U.S.-based producers—including foreign-owned automakers such as BMW or Toyota—meet U.S. federal safety standards, each manufacturer can export as many as 25,000 cars directly to South Korea from the United States without complying with South Korean safety standards. Additionally, they must satisfy KORUS FTA domestic content provisions. U.S. automakers also have some flexibility to be considered in compliance with new South Korean fuel economy and greenhouse gas emissions standards. The Koreans made some concessions on issues that were seen as non-tariff barriers to auto trade involving safety and environmental (e.g., fuel economy and emissions) standards.

Trade data show that exports of U.S. autos to South Korea have risen in recent years measured by dollar value and number of units. Sales of "Detroit 3" cars in Korea grew 20% to more than 11,600 cars in 2013, a difference of almost 2,000 cars from 2012, with Ford vehicles representing the majority. However, it is too early to make any conclusive observations about the benefits or disadvantages of the KORUS FTA for the auto industry. A two-year snapshot can be misleading, especially since tariffs are still being phased out. Some U.S.-based automakers continue to raise concerns about non-tariff barriers that impede their exports to South Korea.

Other Key Provisions

The KORUS FTA covers a broad range of other areas. According to the Office of the United States Trade Representative (USTR), 95% of U.S.-South Korean trade in *consumer and industrial products* will become duty-free by 2016 and virtually all remaining tariffs will be lifted by 2021. 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* became duty-free immediately, and the KORUS FTA will 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 (§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 also provided for a binational consultative committee for information sharing on trade remedy matters.[8]

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.

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[7] "*North America Vehicle Production by Model, 2009-2013*," WardsAuto, February 25, 2014, http://www.wardsauto.com and *Statistical Overview of the Korea Automotive Industry/Market & U.S. Trade Relationship, 1990-2013,* provided to CRS by the American Automotive Policy Council.

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

Furthermore, one year after the KORUS FTA entered into force, a binational committee was to be formed to study the possibility of eventually expanding the agreement's coverage to products from "Outward Processing Zones," including the Kaesong Industrial Complex and/or other future zones located in North Korea. The committee met in November 2013 to discuss the issue and will continue to meet annually.[9]

Background on Legislation and Objectives

Legislative Action

The KORUS FTA 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 had the discretion on when to submit the implementing legislation to Congress. Despite signing the KORUS FTA in 2007, President Bush did not submit the implementing legislation to Congress because of differences, primarily with the Democratic leadership, over treatment of autos and beef, among other issues.

On December 3, 2010, U.S. and South Korean leaders announced that they had reached agreement on addressing the outstanding issues related to the KORUS FTA. As a result, U.S. and South Korean negotiators agreed to modifications to some of the commitments made in the 2007 agreement. These modifications, which were signed on February 10, 2011, are in the form of an "exchange of letters" and two "agreed minutes." They pertained mostly to the auto provisions and included changes in phase-out periods for tariffs on autos and pork, a new safeguard provision on autos, and concessions by South Korea to allow 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.

On October 3, 2011, President Obama submitted draft implementing legislation (H.R. 3080 /S. 1642) to both houses of Congress. On October 6, the House Ways and Means Committee reported out H.R. 3080 (H.Rept. 112-239). The Senate Finance Committee reported out S. 1642 (without written report). On October 12, the House passed H.R. 3080 (278-151) and sent it to the Senate which passed it (83-15). The President signed the legislation on October 21, 2011 (P.L. 112-41).

From 2006-2012, the negotiation and ratification of the KORUS FTA was a major issue in South Korean politics. On November 22, 2011, South Korea's National Assembly ratified the agreement by a vote of 151-7, with 12 abstentions. (The Assembly has 299 members.) The same day, the Assembly passed over a dozen implementing bills. The debate over the agreement's ratification was contentious and divisive, despite the fact that President Lee's party, the conservative Grand National Party (GNP)[10], controlled the National Assembly. Korea's largest opposition party, the left-of-center Democratic Party (DP)[11], strongly opposed the agreement. The final vote was held only after the GNP surprised the opposition by convening a special session for a snap vote.[12]

[9] "KORUS FTA Panel Holds 'Introductory' Talks on North Korean Factory Park," *Inside U.S. Trade*, November 8, 2013.

[10] In 2012, the GNP changed its name to the Saenuri (New Frontier) Party.

[11] In 2014, the DP became known as the New Politics Alliance for Democracy (NPAD).

[12] Reportedly, the GNP took this step after learning that the DP and its allies were planning to occupy the National Assembly's main chamber in order to block a vote on the KORUS FTA.

During parliamentary and presidential elections in 2012, several prominent DP candidates called for renegotiating parts or even all of the KORUS FTA. However, the issue appears to have faded since that time, in large part because the GNP's successor party retained control of both the presidency and the National Assembly in the 2012 elections.

U.S. and South Korean Objectives in an FTA

Economic Goals

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.

U.S. and South Korean leaders approached the KORUS FTA from different perspectives that were reflected in the conduct and outcome of the negotiations, despite some broad shared objectives. A primary objective of the United States was to gain greater access to South Korean markets in agricultural products, autos, 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. In addition, the United States sought to establish updated trade and investment disciplines in the dynamic and trade-oriented East-Asian region.

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. South Korean exporters already had a significant presence in areas in which they have proved to be competitive. Instead, entering an FTA with the United States meshed with a number of former South Korean President Roh Moo-hyun's long-term domestic economic and strategic goals. Roh made an FTA the top economic priority for the remainder of his tenure, which ended in February 2008.[13] 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. Former President Lee Myung-bak, who succeeded Roh in December 2007, made the economy the centerpiece of his campaign and 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

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

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.[14] Some, however, raised concerns that an FTA would worsen South Korea's income gap, and during the talks, there were continuous and often large scale anti-FTA protests, generally led by South Korean farmers and trade unionists.[15]

Foreign Policy Goals

The United States and South Korea negotiated the KORUS FTA in part as a means to strengthen and restore the health of a critical foreign policy and national security alliance.[16] While the talks were ongoing in 2006 and 2007, 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 December 2007 election of Lee, who stressed the importance of rebuilding U.S.-South Korean ties improved relations further. Thus, with the alliance on firmer ground, by 2009 the KORUS FTA no longer appeared to be an exceptional area of bilateral cooperation.

Although the FTA's utility as an acute salve for the alliance was reduced, some argue it will help to boost the alliance over the medium and longer term, by deepening bilateral economic and political ties. Entering into an FTA, some argue, was 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 has made or will make a significant difference in the strategic relationship, as it is not clear that it has altered either country's fundamental interests on the Peninsula or in Northeast Asia.

In contrast, while the *passage* of the KORUS FTA was unlikely to have a major substantive impact on the strategic relationship, a *collapse* of the KORUS FTA would probably have had a profound symbolic effect, particularly upon the way South Koreans view the alliance. If the KORUS FTA had been rejected or subjected to a prolonged delay by the United States, it would have been a psychological blow to many South Korean policymakers, many of whom would likely have seen 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 have lent credence to arguments in South Korea that the U.S. commitment to Korea and Northeast Asia was declining. If these perceptions had taken hold, it would increase the political costs of South Korean leaders' taking unpopular decisions on behalf of the alliance, such as increasing South Korea's share of the costs of maintaining U.S. troops on the Peninsula.

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[14] See, for instance, Junkyu Lee and Hongshik Lee, *Feasibility and Economic Effects of a Korea-U.S. FTA* (Seoul: Korea Institute for International Economic Policy, 2005), 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.

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

[16] For more, see CRS Report R41481, *U.S.-South Korea Relations*, coordinated by Mark E. Manyin.

U.S.-South Korean Economic Relations

South Korea is a major economic partner of the United States. In 2013, two-way goods trade between the two countries totaled $101.3 billion, making South Korea the United States' sixth-largest trading partner (**Table 1**). Major U.S. exports to South Korea include semiconductors, machinery (particularly semiconductor production machinery), aircraft, and agricultural products. Major U.S. imports from South Korea include autos and electrical machinery including cellular phones. Two-way services trade with South Korea totaled $31.7 billion in 2013. The U.S. consistently runs a goods trade deficit with South Korea ($23 billion in 2013) and a services trade surplus ($10.1 billion in 2013). In 2013, U.S. FDI into South Korea totaled $2.5 billion while South Korean FDI into the United States totaled $6.6 billion.

South Korea is more dependent economically on the United States than the United States is on South Korea. In 2013, the United States was South Korea's second-largest goods trading partner. In 2003, China for the first time displaced the United States from its perennial place as South Korea's number one trading partner. Since that time, Japan and the United States have fluctuated as South Korea's second-largest trading partner.

Table 1. U.S. Trade and Foreign Direct Investment with South Korea

(billions of U.S. dollars)

Year	U.S. Goods Exports	U.S. Goods Imports	Goods Trade Balance	U.S. Services Exports	U.S. Services Imports	Services Trade Balance	U.S. Outward FDI Flow	U.S. Inward FDI Flow
2004	24.8	45.1	-20.2	8.2	6.6	1.6	4.3	1.1
2005	26.1	43.2	-17.0	9.4	6.9	2.5	1.7	1.0
2006	30.6	44.7	-14.1	11.1	8.3	2.8	2.5	3.3
2007	32.7	45.3	-12.6	12.5	8.9	3.6	0.8	4.8
2008	32.9	46.7	-13.8	13.7	8.1	5.6	2.2	1.4
2009	27.0	38.8	-11.7	13.2	7.9	5.4	3.2	0.2
2010	36.8	47.9	-11.1	15.5	9.3	6.1	2.7	2.2
2011	41.3	56.0	-14.7	16.7	9.7	6.9	3.3	4.8
2012	40.0	57.9	-18.0	18.0	10.4	7.6	1.9	5.6
2013	39.2	62.1	-23.0	20.9	10.8	10.1	2.5	6.6

Sources: Goods data are from the U.S. Census Bureau and services and investment data are from the Bureau of Economic Analysis (BEA).

Notes: U.S. export data are for U.S. domestic exports and the data for U.S. imports are for imports on a consumption basis.

Historically, economic interaction between the United States and South Korea has been accompanied by numerous disagreements over specific trade issues. 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 raise concerns 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 issue of concern 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 Cooperation and Development (OECD).[17] The intensity of these disputes has diminished considerably in the past two decades, in part due to reforms enacted following the near collapse of the South Korea economy in 1997, and South Korea has become more open to foreign investors, such that many U.S. firms now have a significant presence in South Korea. In addition, many of these issues arose during the KORUS FTA negotiations and were addressed in the final agreement. The committees and working groups created as part of the FTA, such as the Automotive Working Group, provide further venues for the two nations to monitor trade issues including those related to the implementation of the agreement.[18]

Estimates of Economic Impact of a KORUS FTA

Prior to the KORUS FTA's entry into force, economists released several studies estimating the potential effects of the agreement. As required by U.S. Trade Promotion Authority (TPA), which expired in 2007, the USITC conducted a study in 2007 of the KORUS FTA at the request of the President.[19] The USITC study concluded that U.S. GDP would be higher by $10.1 billion to $11.9 billion (approximately 0.1%) when the KORUS FTA is fully implemented, a negligible amount given the size of the U.S. economy. The USITC based this estimate primarily on the removal of tariffs and tariff rate quotas, that is, barriers that can be relatively easily quantified. The study concluded that U.S. exports of goods would likely be higher 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.[20]

The estimates did not take into account the impact of the reduction of barriers to trade in services and foreign investment flows and changes in regulations as a result of the KORUS FTA. The study noted 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.[21]

The ITC study estimated 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, were estimated to experience increases in

[17] OECD, *Economic Surveys–Korea*, 2007.

[18] For more information see http://www.ustr.gov/countries-regions/japan-korea-apec/korea/korus-committees-and-working-groups.

[19] §2104(f) Trade Act 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.

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

[21] USITC (2007). p. xvii.

employment, others such as textile, wearing apparel, and electronic equipment manufacturers were expected to experience declines in employment.[22]

Other studies draw similar conclusions, although the magnitudes differ because they employ different models from the USITC study.[23] For example, a University of Michigan analysis commissioned by the Korea Economic Institute estimated that U.S. GDP will increase by $25.12 billion (0.14% of U.S. GDP). This is larger than the USITC estimate partly because it estimated the effects of liberalization in services trade.[24] 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 the KORUS FTA on South Korea alone. The study estimated some of the dynamic, or long-run, economic effects, in addition to the static, one-time effects. 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.[25]

The Economic Policy Institute estimated that the KORUS FTA would increase the U.S. trade deficit by $13.5 billion and eliminate approximately 159,000 jobs.[26] The study utilizes an unconventional approach in its estimation, using historical data on the changes in trade flows following other FTA agreements as a predictor of KORUS' economic impact.

Economic Impact: Two Years of the KORUS FTA

On entry into force of the KORUS FTA on March 15, 2012, 82% of U.S. tariff lines and 80% of South Korean tariff lines became duty free, whereas prior to the KORUS FTA, only 38% of U.S. tariff lines and 13% of South Korean tariff lines were duty free. By the tenth year of the agreement, the figures are estimated to be 99% and 98%, respectively, with tariff elimination occurring in stages and the most sensitive products, such as agricultural products, having the longest phase-out periods. Non-tariff barriers in goods trade and barriers in services trade and foreign investment also will be reduced or eliminated under the KORUS FTA.

Assessing the impact of the KORUS FTA on U.S.-South Korea trade flows and the U.S. economy is a difficult question to answer definitively for several reasons. First, assessing the impact of a policy change (the KORUS FTA) on an economic variable (trade flows) requires a careful analysis that takes into account other variables, which may also affect the outcome. Without a more dynamic modeling framework that accounts for these other variables, one may attribute a change in the trade balance to the KORUS FTA when a change in exchange rates or aggregate

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

[23] For more information, see CRS Report R41660, *U.S.-South Korea Free Trade Agreement and Potential Employment Effects: Analysis of Studies*, by Mary Jane Bolle and James K. Jackson.

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

[25] 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.

[26] Robert E. Scott, *Trade Policy and Job Loss: U.S. Trade Deals with Colombia and Korea Will Be Costly*, Economic Policy Institute, Working Paper 289, February 25, 2010, p. 9.

demand, for example, is actually responsible. In addition, the KORUS FTA has only been in effect for about two years, making it difficult to discern its long-term direct economic and trade effects on the United States. Tariffs on the most sensitive products will be phased out over several more years, and production and consumption patterns take time to adjust. Indeed, the benefits of trade agreements are generally long-term in nature, accruing gradually over time.

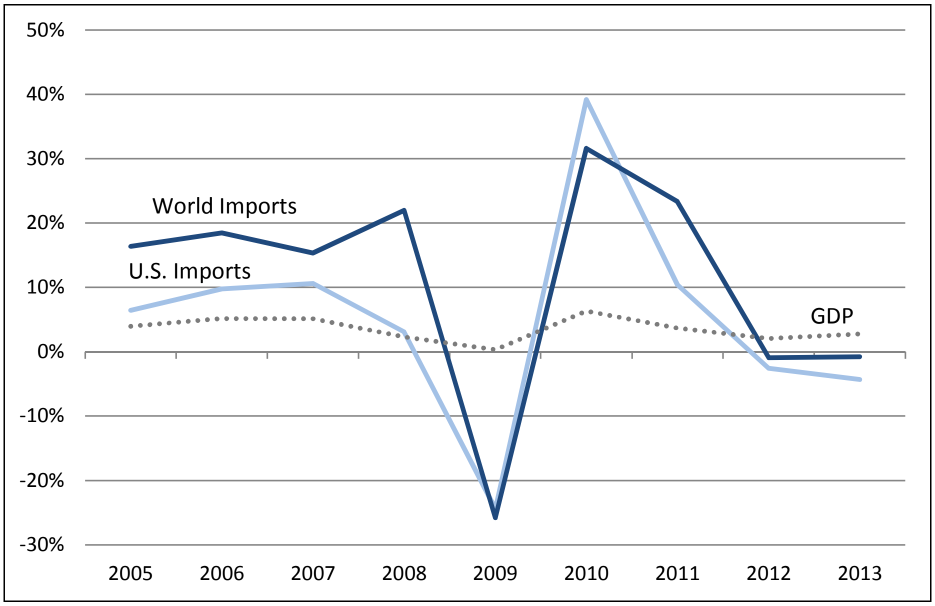
In addition, aggregate data on trade flows may not capture the full impact of the agreement. Any significant effects of the KORUS FTA are more likely to be evident on individual firms and industries rather than trade flows as a whole. Moreover, some of the potential benefits of freer trade, which include lower-priced and more diverse goods and services, as well as improved productivity among firms, cannot be easily measured by trade balances.

With these challenges in mind **Table 1** and the discussion that follows provides an examination of U.S. trade flows with South Korea since 2011, the last full year prior to the KORUS FTA's entry into force. From 2011 to 2013, U.S. goods exports to South Korea decreased from $41.3 billion to $39.2 billion (5% decrease), while imports increased from $56.0 billion to $62.1 billion (11% increase). This caused the U.S. goods trade balance with South Korea to decrease (become more negative) from $-14.7 billion to -$23.0 billion (56% decrease). During the same period, U.S. services exports increased from $16.7 billion to $20.9 billion (25% increase), while imports increased from $9.7 billion to $10.8 billion (10% increase), such that the U.S. services trade balance with South Korea increased from $6.9 billion to $10.1 billion (46% increase).

The increase in the U.S. goods trade deficit with South Korea since the implementation of the KORUS FTA has caused concern among some U.S. policymakers.[27] Some of the decrease in exports to South Korea, a contributor to the rising trade deficit, is likely due to fluctuations in the business cycle in South Korea during the same time period and is not unique to the United States. **Figure 1** charts the annual percent change of South Korea's imports from the world and the United States as well as its annual change in GDP. GDP growth slowed in South Korea in both 2011 and 2012, and South Korea's imports from the United States as well as the world at large fell in 2012 and 2013.

[27] "U.S.-Korea Trade Imbalance Up by More than Half as KORUS Turns Two," *Inside U.S. Trade*, March 13, 2014.

Figure 1. South Korean Imports and GDP
(annual percent change)



Source: Analysis by CRS. Trade data are from the International Monetary Fund (IMF) Direction of Trade Statistics. GDP data are from the IMF World Economic Outlook.

From 2011 to 2013, South Korea's goods imports from the world overall fell 1.7%, as did South Korea's imports from its top three import suppliers (**Table 2**). South Korea's imports from China fell by 3.9%, imports from Japan dropped by 12.1%, and imports from the United States shrank by 6.9%.

Table 2. South Korean Imports from Major Partners
(billions of U.S. dollars)

	Country	2011	2013	Percent Change
	-- World --	524.9	516.9	-1.68%
1	China	86.9	83.9	-3.90
2	Japan	68.9	60.9	-12.11
3	United States	45.9	42.9	-6.86
4	Saudi Arabia	37.9	38.9	1.86
5	Qatar	21.9	26.9	24.67
6	Australia	26.9	21.9	-21.04
7	Germany	17.9	19.9	14.01
8	Kuwait	17.9	19.9	10.42
9	United Arab Emirates	15.9	18.9	22.79
10	Taiwan	15.9	15.9	-0.41

Source: Analysis by CRS. Data are from Korean Customs Service and accessed through World Trade Atlas.

Notes: Trade data on South Korean trade with the United States provided by Korean Customs Service and may differ slightly from official U.S. trade statistics.

Table 3 provides additional information on the U.S.-South Korea import and export commodity categories that experienced the greatest increase or decrease in absolute terms between 2011 and 2013. Categories with large fluctuations include both those with and without large tariff changes as a result of the KORUS FTA, suggesting that other factors also affected the changing pattern of U.S.-South Korea trade flows. For example, U.S. imports of South Korean vehicles and vehicle parts increased by $4.5 billion, with imports of vehicles alone increasing by $3.3 billion, yet the U.S. import tariff on passenger vehicles (currently 2.5%) will not be reduced until 2016 and the U.S. truck tariff (currently 25%) will stay in place through 2018 and will be duty-free beginning in 2022.[28] Meanwhile, U.S. exports of cereals to South Korea, primarily corn, fell by more than $1.7 billion from 2011 to 2013. This had a large negative impact on the declining trade balance and resulted from the 2012 drought in the Midwest and Plain States—U.S. corn exports to the world were down over $7 billion during the same period. U.S. exports of pharmaceuticals increased by $374 million (60% increase) while the South Korean average import tariff on such products was reduced from 5% to 0%.[29]

Table 3. Top U.S.-South Korea Traded Commodity Categories by Change

(in millions of U.S. dollars)

U.S. Export Commodity Category	Change 2011-2013	U.S. Import Commodity Category	Change 2011-2013
Commodities with Largest Increase			
Aircraft, HS 88	$693	Vehicles and Parts, HS 87	$4,501
Machinery, HS 84	628	Ships, HS 89	718
Pharmaceutical Products, HS 30	374	Machinery, HS 84	499
Misc. Chemical Products, HS 38	234	Iron and Steel Products, HS 73	448
Edible Fruit and Nuts, HS 08	198	Plastic, HS 39	370
Commodities with Largest Decrease			
Cereals, HS 10	$-1,721	Electrical Machinery, HS 85	$-1,248
Mineral Fuels, Oil, etc., HS 27	-1,020	Organic Chemicals, HS 29	-460
Iron and Steel Products, HS 72	-495	Rubber, HS 40	-155
Organic Chemicals, HS 29	-404	Precious Stones /Metals, HS 71	-110
Electrical Machinery, HS 85	-382	Zinc and Articles Thereof, HS 79	-22

Source: Data from Census Bureau, accessed through World Trade Atlas.

Notes: Trade balance equals exports minus imports. Imports measured by imports for consumption and exports measured by domestic exports.

[28] Letter from Ron Kirk, USTR, to Jong-Hoon Kim, Korean Minister for Trade, February 10, 2011, http://www.ustr.gov/webfm_send/2557.

[29] Tariff average for HS category 30 from Commerce Department's FTA Tariff Tool, http://export.gov/FTA/ftatarifftool/FTASnapshot.aspx.

Implementation Issues

During the more than two years that the KORUS FTA has been in force, the United States has raised several issues regarding its implementation. Some of these issues are being addressed currently, while others are a matter of monitoring progress, and ongoing bilateral engagement. Several working groups and committees were established under the KORUS FTA and serve as the venues for monitoring implementation. Perceptions regarding how these issues are resolved and the adequacy of the KORUS FTA's mechanisms for their resolution may influence the negotiations and consideration for future FTAs including the TPP and T-TIP. Some issues U.S. officials and companies have raised include:

- **Origin verification**. The customs office of each trading partner applies procedures to determine whether an import from an FTA partner country meets the criteria under the rules of origin provisions of the FTA and therefore qualifies for the preferential treatment (i.e., the lower tariffs or duty free treatment). U.S. exporters have raised concerns that South Korean Customs Service (KCS) procedures require excessive documentation, unduly burdening importers of U.S. products and undermining the effectiveness of the FTA by eliminating the companies' tariff benefits. The U.S. government has questioned negative KCS rulings on imports of U.S.-origin products such as frozen orange juice concentrate, chemicals, cars, and other products.[30] USTR and CBP reportedly are working with KCS to resolve this issue, and recent positive rulings may suggest some improvements have been made.[31]
- **Express delivery packages**. U.S. officials have also raised concerns that South Korea may not be abiding by KORUS FTA requirements that express deliveries of packages of less than $200 in value be exempt from formal entry document requirements, thus slowing down shipments.[32]
- **Data transfers**. The KORUS FTA includes provisions allowing financial services companies operating in South Korea to process data off-shore and new regulations in South Korea allow for such activities. U.S. companies have raised concerns, however, with the discretion afforded regulators in determining whether or not data offshoring activities are permissible.[33] The South Korean government has agreed to review implementation quarterly of its commitments on data transfers.
- **Proposed automotive regulations**. The South Korean government has proposed a new regulation on auto sales intended to incentivize consumers to purchase cars with lower greenhouse gas emissions, generally closely correlated with engine size. U.S. automakers are particularly concerned about a potential tax penalty for consumers purchasing cars with a higher emissions profile, which they claim could effectively eliminate the tariff benefits they receive through the KORUS

[30] USTR, *2014 National Trade Estimate Report on Foreign Trade Barriers*, March 2014, p. 208.

[31] "Korea Moves to Resolve Issues Flagged by U.S. as Hurdles to TPP Entry," *Inside U.S. Trade*, July 31, 2014.

[32] Ibid., p. 213.

[33] American Chamber of Commerce in Korea, *KORUS Implementation Issue Paper*, July 2014.

FTA.[34] The South Korean government is reviewing the proposed regulation scheme, which was to be implemented in January 2015.

- **Pharmaceuticals and Medical Devices**. U.S. industry has raised concerns over a new pricing regime for pharmaceuticals in South Korea that they argue may undervalue new drugs.[35] U.S. business groups also claim that the South Korean government's proposed patent linkage system, which is required under the KORUS FTA, may be biased toward generic drug manufacturers.

U.S. industry has also suggested that factors not adequately covered in the KORUS FTA may be negatively impacting their ability to export to South Korea. For example, some groups, particularly U.S. automakers claim that South Korea has intervened in international currency markets in order to weaken the South Korean won relative to the U.S. dollar, thereby effectively raising the price of U.S. exports into the South Korean market.[36]

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

The KORUS FTA continues to have implications for U.S. trade policy and U.S. Asia policy. It is economically significant as South Korea is the sixth largest U.S. trade partner making the agreement the largest U.S. FTA after NAFTA. As more data becomes available, further analysis of the agreement's economic impact may influence debate over future trade agreements. Furthermore, as one of the most recent U.S. FTAs to be implemented the KORUS FTA reflects the most current U.S. trade and investment policy priorities of any existing FTA and its provisions likely serve as a starting point for current U.S. trade negotiations. The agreement also reflects both U.S. and South Korean use of bilateral trade agreements, alternative efforts to the WTO and the multilateral trading system, to achieve trade and investment liberalization. As such, the KORUS FTA may have an impact on the trade priorities of other nations as they consider participation in ongoing bilateral and regional trade liberalization talks.

The Asia-Pacific region is well known for its economic dynamism and the United States has sought to make the region a foreign policy priority. The entry into force of the KORUS FTA deepened the institutionalization of the United States' economic presence in the region. President Obama, Secretary of State Hillary Clinton, and other U.S. officials have said that the KORUS FTA, along with the TPP, are key parts of their move to "rebalance" U.S. strategic orientation toward the Asia-Pacific, in that they are designed to help shape the economic rules that will govern the region's economic activity in the coming decades.

Many Asia-Pacific countries are also pursuing non-U.S. led trade initiatives in the region, including bilateral and plurilateral FTAs. South Korea's decision to negotiate and implement a

[34] Ibid.

[35] Ibid.

[36] U.S. Congress, Senate Committee on Finance, Subcommittee on International Trade, Customs, and Global Competitiveness, *The U.S.-Korea Free Trade Agreement: Lessons Learned Two Years Later*, 113th Cong., 2nd sess., July 29, 2014, Testimony of Stephen E. Biegun, Ford Motor Company. For more information on currency and exchange rate policies, see CRS Report R43242, *Current Debates over Exchange Rates: Overview and Issues for Congress*, by Rebecca M. Nelson.

comprehensive FTA with the United States may also influence these other region-wide trade policies. As a participant in the Regional Comprehensive Economic Partnership (RCEP) negotiations, South Korea will help determine the structure and disciplines included in that potential regional FTA.[37] RCEP includes the 10 members of the Association of Southeast Asian Nations (ASEAN) as well as Australia, China, India, Japan, and New Zealand, and is the other major Asia-Pacific trade initiative in addition to the TPP.

Some observers note that the KORUS FTA may have sparked the interest of other Asia-Pacific countries to negotiate FTAs with the United States, such as Japan's entry, in July 2013, into the TPP negotiations. Japan and South Korea trade similar products with the United States, and despite generally low U.S. import tariffs, the KORUS FTA now provides South Korea with a competitive advantage in the U.S. market. Japan's entry into the TPP negotiations may likewise have prompted South Korea's interest in joining TPP. In the fall of 2013, South Korea announced its interest in participating in the TPP negotiations, despite existing trade agreements with a number of the TPP participants, including the United States. While the U.S. Administration has welcomed South Korea's interest, President Obama highlighted that full implementation of the KORUS FTA would help prepare South Korea to "meet the high standards of the Trans-Pacific Partnership," and the Administration also appears to wish to conclude an initial TPP agreement with current members before allowing new negotiating partners to participate.[38]

The KORUS FTA also highlights the pursuit of alternative routes to trade liberalization beyond the WTO Doha Round negotiations and multilateral trading system. Both the United States and South Korea are major global trading nations and both have made bilateral FTAs a key component of their trade policy. Challenges in implementation of the recent WTO trade facilitation agreement suggest that in the near term, bilateral, regional, and plurilateral initiatives among nations with similar trade policy priorities will continue to play a key role in international trade liberalization efforts.

Sector-Specific Issues and General Provisions of the KORUS FTA

Under the KORUS FTA, the market access provisions include the elimination of tariffs on most goods immediately and nearly all remaining tariffs will be removed within ten years.[39] This section provides additional information on the provisions related to some of the most sensitive traded products such as agricultural products, autos, and textiles and apparel. It also includes a

[37] The RCEP remains at an early stage of negotiations, but some observers do not expect the potential agreement to be as comprehensive in its product coverage or disciplines as the potential TPP.

[38] The White House, "Press Conference with President Obama and President Park of the Republic of Korea," press release, April 25, 2014, http://www.whitehouse.gov/the-press-office/2014/04/25/press-conference-president-obama-and-president-park-republic-korea.

[39] The KORUS FTA Tariff Schedule can be found in the USITC report, *Modifications to the Harmonized Tariff Schedule of the United States to Implement the United States-Korea Free Trade Agreement*, USITC Publication 4308, February 2012, http://www.usitc.gov/publications/tariff_affairs/USITCPub4308.pdf. Analysis of these tariff commitments, excluding the modifications made by the 2011 exchange of letters can be found in the USITC report, *U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects*, USITC Publication 3949, September 2007, pp. 1-7, http://www.usitc.gov/publications/docs/pubs/2104F/pub3949.pdf.

discussion of the general provisions of the FTA such as disciplines covering foreign investment, government procurement, and labor and environmental standards.

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 South 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.[40] 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 2013, South Korea was the fifth-largest market for U.S. agriculture, as export sales totaled $5.1 billion. With the KORUS FTA's agricultural provisions taking effect in March 2012, South Korea immediately granted duty-free status to almost two-thirds of current U.S. agricultural exports. Tariffs and tariff-rate quotas (TRQs)[41] on most other agricultural goods will be phased out within 10 years (i.e., 2021), with a few commodities and food products subject to provisions that phase out such protection in year 23 (i.e., 2034). 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) will be subject to Korean import quotas that slowly expand in perpetuity. However, the agreement did not give U.S. rice and rice products additional access to South Korea's market (see below).[42]

With the immediate elimination or phase-out of most of South Korea's relatively high agricultural trade barriers under the KORUS FTA, certain U.S. agricultural and food processing sectors are expected to noticeably benefit from additional exports. The USITC estimated that the increase in U.S. exports of agricultural commodities and processed foods will 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. It projected that the sale of agricultural products to South Korea would be $1.9 billion to $3.8 billion (44% to 89%) higher, compared to what exports

[40] South Korea's average applied agricultural tariff in 2011 was 48.6%, compared to 5.0% for the United States, from WTO, "Country Profiles" for South Korea and the United States, September 2012.

[41] 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 depending on the outcome of the negotiations. Imports above this quota are subject to a prohibitive tariff that in an FTA may or may not decline over time. At the end of a product's transition period to free trade under an FTA, both the quota and tariff usually no longer apply (unless specific exceptions are made), allowing for its unrestricted access to the partner's market.

[42] 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," March 2011, available at http://www.fas.usda.gov/sites/development/files/korus_one-page_fact_sheet_03-11.pdf, and "U.S. Korea Trade Agreement - Benefits for Agriculture," March 2011, available at http://www.fas.usda.gov/sites/development/files/korus_detailed_fact_sheet_03-11.pdf.

would be 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 import restrictions in late 2003. About 20% of the export increase would benefit U.S. producers and exporters of pork, poultry and other meat products.[43] In another analysis, the American Farm Bureau Federation (AFBF) projected that U.S. agricultural exports by the end of the transition period 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 the change in export value.[44]

Because South Korean agricultural exports to the United States are small 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 (i.e., 2026). One 10-year TRQ will apply to imports of fluid milk and cream, among other specified dairy products. The USITC projected that imports of agricultural products (primarily processed food products) from South Korea under the KORUS FTA would range from $52 million to $78 million (12% to 18%) higher than such imports would have been under a no-agreement scenario. In 2013, U.S. agricultural imports from South Korea totaled $242 million.

Beef

Market Access

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. South Korea, though, has the right to impose safeguard tariffs on a temporary basis in response to any potential surge in imports of U.S. beef meats above specified levels.[45] The trigger for this additional tariff was 270,000 metric tons (MT) in year 1 (2012), which will increase 2% annually; in year 15 (2026), the trigger is 354,000 MT.[46] In year 16 (2027), this protective mechanism will 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, are also 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 estimated 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%)

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43 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.

44 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.

45 A safeguard protects producers of an agricultural commodity against sudden import surges during the transition to free trade (e.g., as tariffs decline and/or quotas expand). Its use in the KORUS FTA is automatically activated when the quantity of a commodity that enters exceeds a specified amount (i.e., the trigger level), and is designed to give domestic producers additional time to adjust to increased import competition.

46 In 2003, South Korean imports of U.S. beef muscle meats totaled 224,037 MT. The safeguard level negotiated for year 1 (2012) allowed for duty-free access for 20% more U.S. beef than the 2003 level of actual U.S. beef imports. In 2013, South Korean imports of U.S. beef muscle cuts (92,145 MT) were one-third of that year's 276,000 MT trigger level.

above what would be sold if no trade agreement were in place. Under the KORUS FTA, the AFBF projected 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 noted 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. Australia in late 2013 also secured a 15-year tariff phase-out of Korea's 40% beef tariff in its FTA with South Korea. Assuming this FTA takes effect in 2015, the tariff on Australian beef will be almost 11% higher than on U.S. beef until eliminated. This differential, though, could be irrelevant if Australian beef continues to be preferred by Korean consumers, and/or if a more favorable exchange rate entices a Korean importer to purchase Australian rather than U.S. beef.

Sanitary Rules

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 was reflected in the position taken by some Members of Congress, who had stated that congressional consideration of, and support for, the KORUS FTA depended upon South Korea fully opening its market to U.S. beef.

On April 18, 2008, U.S. and South Korean negotiators agreed to a protocol on the sanitary rules that South 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 agreement 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.

While the U.S. beef industry and U.S. policymakers welcomed the initial April 2008 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 South 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 South 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. [47]

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

Subsequent Debate on Terms of U.S. Access to Korea's Beef Market

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."[48]

Congressional reaction on the outcome of the beef issue was mixed. Senator Baucus (chairman of the Senate Finance Committee), who had 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." At that time, Senator 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.[49] 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.[50]

Memories of the size and intensity of the 2008 anti-beef agreement protests in South Korea appeared to have directly influenced the position then 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 2010 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. Subsequently, South Korea's trade minister confirmed that there will be no more discussions on ending the age limits of U.S. cattle slaughtered for beef—a stance that was affirmed by its ambassador to Washington in late January 2011.[51] The outcome appeared to have been successful in that it did not alter the political debate expected to occur in South Korea on the KORUS FTA. However, if changes had

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

[49] 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.

[50] Meatingplace.com, "U.S.-Korea FTA deal leaves beef unchanged, phases out tariffs," December 6, 2010;National Cattlemen's Beef Association, "Statement from NCBA Chief Economist Gregg Doud on US, Korea Trade Deal," December 3, 2010; American Meat Institute, "AMI Statement on Finalized U.S. Free Trade Agreement with South Korea," December 3, 2010.

[51] *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.

been made to the terms of current U.S. beef access, opponents would have been given another opening to shift the debate on the agreement.

Seeking to move closer toward submitting the KORUS FTA to Congress for consideration, the USTR on May 4, 2011, announced two measures to be taken on the U.S. beef access issue. In a letter to Senator Baucus, the Administration committed to request consultations with South Korea on the "full implementation" (e.g., opening Korea's market "to all ages and all cuts of U.S. beef") of the protocol as soon as this trade agreement takes effect. The letter referenced one specific provision that stipulates bilateral consultations on the interpretation or application of the protocol's terms "shall be held within seven days" of a request. On the same day, the U.S. Department of Agriculture (USDA) announced a $1 million award to the U.S. Meat Export Federation (USMEF) to be used in FY2011 to promote U.S. beef sales in South Korea, and its intent to consider future funding requests from the USMEF to implement its planned five-year market beef promotion strategy in this key market. Senator Baucus welcomed both steps, stating he will support the KORUS FTA and work with the Administration on a package of trade measures that includes all three FTAs and renewing trade adjustment assistance and trade preference programs.[52] Since the KORUS FTA entered into force, the USTR has not had formal consultations with South Korea on the beef issue.

Impact of Resumed U.S. Beef Exports

Under the 2008 arrangement, exports of U.S. beef (including bone-in cuts) to South Korea quickly resumed, and reached $578 million in 2013. This represents 71% of the 2003 beef export level of $815 million. Though Australia still is the main competitor, U.S. beef exporters have gained noticeable market share since the South Korean market reopened (38% in 2013, compared to 76% in 2003 and 1% in 2005). 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.

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 then-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."[53] On rice, the KORUS FTA only requires South Korea to continue to abide by its multilateral trade commitments to increase rice imports.

[52] Senate Finance Committee, "Baucus Secures Administration's Commitment to Expand U.S. Beef Access in Korea," May 4, 2011, accessed at http://finance.senate.gov/newsroom/chairman/release/?id=514813d3-9192-4a38-8f5a-ea602675f442.

[53] *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 "global" quota available to all countries.[54] 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 much from year to year, and in 2011 peaked at $125 million (162,291MT).

With Korea's current WTO minimum market access agreement scheduled to expire at year-end 2014, South Korea has decided to eliminate its cap on the amount of rice allowed to enter each year. This means that beginning in 2015, rice above the currently-set 408,700 maximum quota will be allowed to enter, but will face an over-quota tariff of from 300 to 500%. With such prohibitive duties, U.S. rice exports likely will not increase much from recent year levels. Further, Korean preference for the flavor of Japonica rice not produced in the United States may limit sales.[55]

Oranges

Differences on how quickly to liberalize trade in fresh oranges were not resolved until just before the FTA negotiations concluded. The United States sought the complete elimination of South 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. Under its WTO commitments, 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 was created for "in-season" U.S. navel oranges (a variety that is not produced in Korea) that enter between September 1 and the end of February—a period that coincides with the Island's *unshu* (mandarin) orange harvest season. The initial 2,500 MT TRQ will increase at a compound 3% annual rate in perpetuity. Shipments in excess of the quota amount during this six-month period will continue to be subject to the 50% tariff. Second, in the first year (2012), this high tariff was reduced to 30% for "out-of-season" oranges that enter between March 1 and August 31, and will continue to be phased out in stages until eliminated in year 7 (2018). Third, South Korea's 144% tariff on other mandarin oranges will be phased out over 15 years.

The cost of selling to what already is a leading U.S. export market for fresh oranges will be significantly reduced as Korea's high 50% tariff is partly phased out. In 2013, South Korea continued to rank as the number 1 market, with U.S. orange exports totaling $96 million (73,448 MT). Though U.S. orange shipments declined from 2012's $216 million, they are higher than pre-KORUS levels.

[54] 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 separate global 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/topics/international-markets-trade/countries-regions/south-korea/policy.aspx.

[55] Reuters, "South Korea to scrap rice import caps, farmers stage protest," July 18, 2014.

Pork

According to the December 2010 modifications to the initial agreement, South Korea will phase out its 25% tariff on one tariff line of frozen pork cuts on January 1, 2016. This change will affect about 75% of all U.S. pork exports, as recorded by 2010 value. This is two years later than what both sides had agreed upon in the 2007 text (i.e., January 1, 2014). Korea's tariffs on most other U.S. pork products were phased out on January 1, 2014. On U.S. fresh/chilled pork, South Korea's 22.5% tariff will be phased out in stages over 10 years (2021). In the interim, a safeguard is available to protect against import surges of only this pork product category, which will expire in 2020.

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 expected 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.[56] U.S. pork exports to South Korea in 2013 totaled $234 million, higher than sales levels seen in the late 2000s.

Geographical Indications for Dairy Products

The U.S. dairy sector in late 2010 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."[57] 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 the United States (1) 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 and spirits.

A June 2011 exchange of letters between the USTR and Korea's trade ministry clarified that the use of generic terms used to identify types of cheeses (e.g., camembert, mozzarella, emmental, grana, parmesan, brie, cheddar) will not be restricted by the Korea-EU FTA. In other words, U.S.

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

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

exporters will be able to sell these cheeses into the important South Korean market. A U.S. trade official stated the United States is satisfied with the clarifications provided by South Korea's trade minister. U.S. milk and dairy product groups welcomed these assurances, noting that Korea already is one of the largest export markets for U.S. cheese.[58] Though U.S. cheese exports to South Korea have increased since the KORUS FTA took effect, U.S. exporters of certain cheeses listed as protected (i.e., only EU exporters can sell such-labeled cheeses) under the Korea-EU FTA GI annex (e.g., asiago, feta, gorgonzola) have been shut out of the Korean market.[59]

Sanitary and Phytosanitary Provisions

As found in most other U.S. FTAs, the KORUS FTA established a bilateral standing committee to address food safety and animal/plant life or health issues that frequently emerge in agricultural trade. However, the agreement did not include any 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 will 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 will 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.[60] 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 SPS 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.

Automobiles

The final KORUS FTA modified the initial commitments on trade in automobiles in December 2010 and subsequently in an exchange of legal texts on February 10, 2011.[61] The Obama

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[58] Letter from Korea's Trade Minister Jong-Hoon Kim to USTR Ron Kirk, June 20, 2011, available at http://www.ustr.gov/countries-regions/japan-korea-apec/korea/exchange-letters-between-ambassador-kirk-and-trade-minister; *Inside U.S. Trade*, South Korea Clarifies GI Provisions in EU-Korea FTA to USTR Satisfaction, June 24, 2011; U.S. Dairy Industry press release, "U.S. Rights to Export Variety of Cheeses to Korea Upheld," June 23, 2011, available at http://www.usdec.org/files/PressReleases/NMPFUSDECIDFA-U.S.RightstoExportVarietyofCheesestoKoreaUpheld.pdf.

[59] For background on why the use of geographic indications has become a contentious issue in free trade agreements, see CRS In Focus 16, *Geographical Indications in U.S.-EU Trade Negotiations*, by Renee Johnson.

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

[61] USTR, Legal Texts Reflecting December 3, 2010 Agreement, February 10, 2011, http://www.ustr.gov/trade-agreements/free-trade-agreements/korus-fta/legal-texts-reflecting-december-3-2010-agreement.

Administration claimed this was a necessary step in approval of the agreement 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."[62] The main components of the KORUS FTA specifically related to automotive trade include:

- *Elimination of South Korean tariffs on U.S.-made motor vehicles.* South Korea reduced its 8% tariff on U.S.-built passenger cars, including electric vehicles and plug-in hybrids, to 4% and removed its 10% tariff on trucks.[63] Tariffs on U.S.-made motor vehicles, including electric cars and plug-in hybrids, will be phased out entirely in 2016.[64] In addition, each country dropped its duties to zero on virtually all auto parts, which cover everything from gear boxes to seat belts, imported from the other in 2012.[65]
- *Elimination of U.S. tariffs on South Korean-made automobiles and a "snapback" clause*. The United States maintains its passenger vehicle rate of 2.5% until 2016. U.S. tariffs on electric and fuel cell vehicles will be reduced annually until duty free in 2016. The 25% duty on trucks, a residual rate dating from an earlier trade dispute with Europe, will stay in place through 2018 and will be duty-free beginning in 2022.[66] 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).[67] The final agreement does not extend the snapback to the higher 25% U.S. truck tariff, but measures affecting trucks could lead to the snapback of the 2.5% passenger car tariff.[68]
- *Reduction of alleged discriminatory effects of engine displacement taxes.* Automotive-specific taxes play an important role in determining the final price of a vehicle. U.S. automakers have complained that South Korea's steeply ascending vehicle tax schedule, with very high rates on vehicles with larger engine capacities that might be exported by U.S. producers, makes U.S. imported cars more expensive than smaller South Korean cars. Moreover, the tax system

[62] 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.

[63] Tariffs on trucks cover pickup trucks, panel vans, and commercial vehicles. Many light trucks such as SUVs and minivans are counted as cars.

[64] Tariffs for electric cars and plug-in hybrids are being phased out between 2012 and 2016, whereas passenger car tariffs will remain at 4% until 2016.

[65] U.S. Department of Commerce, International Trade Administration, *The U.S.-Korea Trade Agreement*, Opportunities for the U.S. Automotive Sector, April 2011, http://www.trade.gov/mas/ian/build/groups/public/@tg_ian/documents/webcontent/tg_ian_002590.pdf.

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

[67] 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 most-favored-nation (MFN) tariff (HTS 8703) would be 2.5% and for South Korea it would be 8%.

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

has a "cascade" effect, so that subsequent taxation rates also incorporate the duty paid on an imported vehicle. A special consumption tax, an educational tax, a value-added tax, a registration tax, and a subway bond are currently among the taxes that apply to motor vehicles. As part of the KORUS FTA, the South Korean government agreed to simplify and reduce the taxes imposed on each category of passenger vehicles. They also agreed to eliminate the discrepancy in the rates between imported and domestic vehicles by reducing the tax rate for vehicles in the largest engine-displacement-size categories.[69] U.S. automakers have raised concerns about a prospective Korean incentive/penalty regulation giving a consumer of a new car either a subsidy or a surcharge to the price of the car, at the point of sale, depending on the car's emission profile. They claim this new regulation is simply an engine displacement tax and such taxes are prohibited under KORUS.[70]

- *Improved regulatory transparency for new automotive regulations*. South Korea also committed to an improvement in its regulatory process. U.S. auto companies are provided one year between the time a final auto regulation is issued and when U.S. automakers must comply with the new regulation. In addition, South Korea 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. The Korean government would argue that it is meeting its regulatory obligations under KORUS. However, the U.S. auto industry has already identified a few proposed Korean automotive regulations that could impose additional burdens and costs on them, making it more difficult for them to sell cars in Korea.[71]
- *Regulations on harmonization of automotive safety and environmental standards.* U.S. manufacturers have long complained that South Korea sets automotive safety and environmental regulations in a closed and non-transparent manner, and that its standards remain idiosyncratic. As one remedy, the KORUS FTA 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.[72] Further, the agreement permits some flexibility in meeting new, higher South Korean environmental standards.[73] U.S. automakers will 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

[69] Displacement is one measurement of car engines. An engine in cubic centimeters shows the volumes displaced by the cylinders through one revolution. Typically, a higher number means a more powerful 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; examples of larger engines include the Ford Fusion at 2.5 liters and the Chevy Impala with an engine as large as 5.3 liters.

[70] American Chamber of Commerce in Korea, *Auto Industry: Key Issues and Recommendations*, March 4, 2014.

[71] USTR, *2014 Report on Technical Barriers to Trade*, April 2014, pp. 86-87.

[72] The 2007 agreement allowed no more than 6,500 vehicles per year per U.S. automotive manufacturer.

[73] South Korea's current emission standard took effect in 2012, raising the average fuel economy of automobiles seating 10 or fewer passengers to 17 kilometers per liter and lowering 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. Korea has proposed a new emission standard for 2016 and beyond, which may eliminate the current flexibility for low volume manufacturers (i.e., those with sales of less than 10,000 units).

manufacturer."[74] 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."* The KORUS FTA established an Automotive Working Group (AWG), which should meet at least annually, to address regulatory issues that may endure or new issues that could emerge with respect to developing, implementing, and enforcing relevant standards, technical regulations, and conformity assessment procedures. The AWG, which includes representatives from the Office of the U.S. Trade Representative and the Korean Ministry of Foreign Affairs, met once in June 2013, to discuss assorted issues, such as automotive safety, fuel economy, and greenhouse gas regulations. It expects to convene again sometime in 2014.[75]
- *Inclusion of a Special Motor Vehicle Safeguard*. The KORUS FTA includes a special safeguard for motor vehicles to ensure that the U.S. auto industry is not hurt owing to any "harmful surges" in South Korea auto imports. The new auto-specific safeguard provision allows the United States to impose extra duties if there is an import surge due to the trade agreement. Any higher tariff that might be imposed could be applied for four years. In the case of truck tariffs, the auto safeguard could be in place until 2031 as it is allowed to continue for 10 years after the full elimination of tariffs. Another feature of the safeguard is that it can 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. It appears easier to apply the safeguard if there are complaints because, as a White House fact sheet notes, "fewer procedural steps are required to speed up the application of the safeguard when workers need faster relief."[76]

The KORUS FTA will not affect the hundreds of thousands of cars assembled by South Korean automakers in the United States and their U.S. production capacity is poised to grow. Thus, a surge in automobile imports from South Korea seems unlikely in the next few years. GM Korea, the South Korean arm of U.S. automaker GM, has manufactured over 100,000 cars in South Korea every year since 2005. See **Appendix** for an overview of South Korea's motor vehicle manufacturing industry.

The USITC simulation model of the KORUS FTA estimates that while U.S. automotive exports to South Korea will increase by a range of 45% to 59%, this will only amount to about $300 million-$400 million because of the low current baseline.[77] 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."[78] It particularly emphasizes the potential gain for U.S.-exported hybrid vehicles to South Korea. Currently, most hybrids in the U.S. market are

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

[75] A list of KORUS Committees and Working Groups can be found at http://www.ustr.gov/countries-regions/japan-korea-apec/korea/korus-committees-and-working-groups.

[76] 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.

[77] Ibid. *U.S.-Korea FTA*, Table 2.2.

[78] Ibid. *U.S.-Korea FTA*, p. 3-78.

imported from Japan.[79] With sales at 222,140 in 2013, the Toyota Prius, including the Prius C and V, accounted for 45% of all hybrid electric vehicles sold in the United States. Hyundai's Sonata hybrid, the first South Korean hybrid sold in the United States, represented 4% of all such vehicles sold in 2013 to become one of the best-selling gas-electric cars in the United States. Combined, the Detroit-based U.S. manufacturers have increased their hybrid electric vehicle sales in recent years, rising from 0 in 2003 to nearly 100,000 in 2013.[80]

Alongside hybrids, 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), remains unclear.[81] Hyundai and Kia do already produce small pickup-type vehicles in South Korea, such as the Porter and Bongo, but they would not appear to be suitable in design or style for the United States.

Textiles and Apparel

Textiles and apparel are a small and decreasing portion of U.S. manufactured imports from South Korea. Their respective shares of the U.S. market have fallen in relative and absolute terms. South Korea provided 3% of textiles imported by the United States in 2013, compared with 9% in 1990. Purchases of garments by the United States from South Korea shrank to less than 1% of all apparel imports in 2013, down from 10% in 1990. This decrease is largely the result of the surge in U.S. apparel imports from China, which accounted for about 40% of all U.S. apparel imports in 2013, rising from 14% in 1990. The United States exports small volumes of textiles and apparel to South Korea—approximately $285 million and about $100 million in 2013, respectively.[82]

The KORUS FTA eliminated U.S. tariffs immediately on 52% (in terms of value) of U.S. imports of South Korean textiles and apparel, and will phase out U.S. tariffs on 19% by 2016 and on the remaining 21% by the end of 2021.[83] Currently, the average U.S. MFN tariff on textiles is 7.9% with a maximum applied tariff of 38%. The average applied U.S. MFN tariff on apparel imports is 11.6%, with a maximum tariff of 32%.[84]

The KORUS FTA eliminated South Korean tariffs on 77% (by value) of U.S. exports of textiles and apparel in 2012, then will phase out tariffs on 13% by 2015 and the remaining 10% by 2016.[85] The average South Korean applied tariff on textiles is 9.0% with a maximum of 13%. South Korean tariffs on apparel range from 8% to 13%.[86]

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[79] Ibid*. U.S.-Korea FTA.*

[80] Energy Efficiency and Renewable Energy, U.S. Department of Energy, *Alternative Fuels & Advanced Vehicles Data Center*, HEV Sales by Model, 1999-2013, updated April 2014, http://www.afdc.energy.gov/data/tab/vehicles/data_set/10301.

[81] Hans Greimel, *"Hyundai Exec: We're Studying Pickup for U.S.,"* Automotive News, April 1, 2013,

[82] Textile and apparel statistics are compiled from the Office of Textiles and Apparel (OTEXA) U.S, textiles and apparel trade balance report. Textiles comprise yarn, fabric, and made-up articles (e.g., sheets and towels), http://otexa.ita.doc.gov/.

[83] 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.

[84] World Trade Organization. *Tariff Profiles for South Korea and the United States*, 2013, http://www.wto.org/english/res_e/booksp_e/tariff_profiles13_e.pdf.

[85] USITC. pp. 3-52.

[86] OTEXA, South Korea, Market Reports, Textiles, Apparel, Footwear, and Travel Goods, http://web.ita.doc.gov/tacgi/ (continued...)

The KORUS FTA, with some exceptions, uses 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 is eligible for duty-free treatment under the FTA. Also included is a special safeguard provision whereby, if imports of textiles or garments 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 will be limited to textiles and apparel unless the two countries agree otherwise.

The USITC has estimated that the KORUS FTA will 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 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 will 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.[87]

The KORUS FTA allows 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. Absent is a cumulation-specific rule, which, in other trade preference programs and FTAs, allows preferential treatment for limited amounts of apparel woven from components outside the FTA area. A Committee on Textile and Apparel Trade Matters was established to raise concerns under the FTA regarding mutual trade in these products. The committee, which has met only once in November 2012, may be convened at the request of either party.

Other Manufactured Goods

Beyond the automotive sector and textiles and apparel, the KORUS FTA affects a wide range of other industries.

Capital Goods Machinery and Equipment

U.S. machinery exports could be the largest single sectoral gainer from the KORUS FTA. According to the USITC's simulation analysis, the sector stands to gain nearly $3 billion in exports of products such as U.S.-made computer-numerically controlled machine tools.[88] The tariffs on U.S. machinery and equipment imported into South Korea range from 3% to 13%, but U.S. products are often competitive and the United States runs an annual trade surplus in machinery products. Most machinery tariffs have been eliminated; others will be phased out

(...continued)

overseasnew.nsf/country/Korea-South.

[87] Ibid. *U.S.-Korea FTA*, pp. 3-53.

[88] Ibid., *U.S.-Korea FTA*, Table 2.2.

between 2014 and 2021.[89] Already duty-free before the implementation of the KORUS FTA, aircraft is another major capital goods item in which the United States has a strong bilateral trade position. U.S. exports to South Korea of aircraft products and parts totaled $3.5billion in 2013.[90] The U.S. Commercial Service reports that Korea is the tenth-largest market for U.S. aerospace exports. Recently, South Korea has embarked on making its aerospace sector more competitive. It intends to raise domestic aerospace production to $20 billion by 2020, with the aim of becoming the world's seventh-largest aerospace producer within a decade by among other ways supplying components to Boeing and EADS-Airbus. It also plans to provide maintenance of both commercial and military aircraft.[91]

Electronic Products and Components

Because they are parties to the multilateral Information Technology Agreement eliminating tariffs among more than 70 countries, South Korean and U.S. tariffs on most electronics products including semiconductors, telecommunications equipment, and computers were duty-free before the implementation of the KORUS FTA. The few remaining tariffs on U.S. electronics exports such as radio and television parts, certain static converters, and certain telecommunications apparatus—most of which were at 8% prior to March 15, 2012—were eliminated in 2014. In 2013, the United States ran a trade deficit in computer and electronic products with South Korea of $8.8 billion, compared with $6.5 billion in 2012. The U.S. trade deficit with South Korea in semiconductors and other electronic components totaled $1.2 billion in 2013, dropping from a record high of $3 billion in 2010.[92] Besides tariffs, the KORUS FTA provides improvements for U.S. products in South Korea with respect to intellectual property protection, technical barriers, government procurement, and competition policy.[93]

Steel

Steel products represent a significant share of trade between the United States and South Korea. In 2013, South Korea was the sixth-largest U.S. export partner in steel products and the fourth-largest source of overseas steel imports.[94] South Korea's steel industry is a global player and includes South Korean Pohang Iron and Steel Company (POSCO), the sixth-largest steel producer in the world, according to the World Steel Association.[95] The United States ran a steel products trade deficit with South Korea of $1.9 billion in 2013.

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

[90] Aerospace products and parts are classified under North American Industry Classification System (NAICS) code 3364. Data compiled from the International Trade Commission, Interactive Tariff and Trade Dataweb, (accessed July 11, 2014).

[91] U.S. Commercial Service, *Doing Business in Korea: 2013 Country Commercial Guide for U.S. Companies*, p. 27, 2013.

[92] Computers and electronic products are classified under NAICS 334 and semiconductors and other electronic components under NAICS 3344. Data compiled from the International Trade Commission, Interactive Tariff and Trade Dataweb, (accessed July 11, 2014).

[93] Ibid., *U.S.-Korea FTA*, pp. 3-68 through 3-73.

[94] Steel products include all iron and steel items listed with the two digit Harmonized Tariff Schedule (HTS) codes 72 and 73.

[95] World Steel Association, *Top Steel-Producing Companies 2013,* http://www.worldsteel.org/statistics/top-producers.html.

The American steel industry registered a strongly negative position on the KORUS FTA, raising various objections related to trade remedies, rules of origin provisions, the treatment of products being produced in the Kaesong Industrial Complex of North Korea, and concerns about currency manipulation issues. The specific details of the trade remedies chapter and Kaesong are discussed elsewhere in this report.

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. U.S. manufacturers also 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.

Overseas sales are critical to the U.S. pharmaceutical industry; some U.S. multinational firms generate revenues of 40% or higher in foreign markets.[96] The South Korean pharmaceutical market is one of the largest in Asia, with pharmaceutical sales at an estimated $18.6 billion in 2013, and is expected to reach $24.3 billion by 2020.[97] Although South Korea's pharmaceutical sector is a fast-growing developed country market, according to IMS Healthcare, it currently represents less than 2% of the global pharmaceutical market.[98]

South Korea is also an important market for U.S. medical equipment and device manufacturers valued at an estimated $4.9 billion in 2013[99] and could grow 10%-15% each year in the next several years, partly due to a rapidly aging population.[100] 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. Despite the implementation of KORUS, U.S. industry continues to express concern about transparency in the regulation of pricing and reimbursements of drugs and medical devices, which it claims impede their ability to sell in the Korean market.[101]

The United States sold $1.2 billion in pharmaceuticals and medicines to South Korea in 2013, representing around 2.4% of all U.S. exports of pharmaceuticals to South Korea.[102] Exports of medical equipment and supplies to South Korea totaled $497 million in 2013, accounting for less than 2% of total U.S. exports of medical equipment to South Korea. In the same year, the United States ran trade surpluses with South Korea in both pharmaceuticals and medical equipment and supplies.

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[96] International Trade Administration, *Pharmaceuticals Industry Profile 2010*, p. 8, July 2010.

[97] Global Data, *Country Focus: Healthcare, Regulatory and Reimbursement Landscape—South Korea*, April 2014.

[98] Jeong-Seok Lee, Industrial and Regulatory Perspectives on Pharmaceuticals in Korea, p. 6, November 2011.

[99] U.S. Commercial Service, *Doing Business In Korea: 2013 Country Commercial Guide for U.S. Companies*, pp. 51-53, 2013.

[100] USITC. *U.S.-Korea FTA*, p. 3-91.

[101] USTR, 2014 *National Trade Estimate Report on Foreign Trade Barriers*, Foreign Trade Barriers in Korea, March 31, 2014, p. 10, http://www.ustr.gov/sites/default/files/2014%20NTE%20Report%20on%20FTB%20Korea.pdf.

[102] Pharmaceuticals are classified under NAICS 3254 and medical equipment and supplies under NAICS 3391. Data compiled from the International Trade Commission, Interactive Tariff and Trade Dataweb, (accessed July 11, 2014).

Of major concern during the KORUS FTA negotiations 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 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 cited the South Korean government's policies on reimbursements for pharmaceuticals and medical devices under its single-payer health insurance program. U.S. manufacturers 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. U.S. manufacturers wanted the KORUS FTA to establish transparency as an important principal in South Korea's development and implementation of pricing and reimbursement policies, including an appeal process for decisions going against U.S. manufacturers.

The KORUS FTA provisions 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.[103]

In response, under the KORUS FTA's data exclusivity provisions, South Korea will not allow a third company, such as a generic drug manufacturer, from marketing a new pharmaceutical using the safety and efficacy data, supplied by an original U.S. manufacturer as part of the market approval process, without the permission of the original U.S. maker for five years from the date of marketing approval for the original product. In addition, if a third party submits safety or efficacy information for a product that an FTA partner government had already approved, the government is to notify the original patent holder of the identity of the third party and is to prevent the marketing of the third party's product on its territory if permission had not been granted by the original patent holder. In a side letter, the United States and South Korea originally agreed to not invoke the data exclusivity provision until the FTA had been in effect 18 months. Under the modifications to the commitments, the United States agreed to double to 36 months, or three years, the time South Korea will have to put in place a system of patent linkages for pharmaceuticals that is required under the FTA. Furthermore, South Korea agreed to a patent-

[103] 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.

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, requires the United States and South Korea 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 reaffirms each country's commitment to the WTO TRIPS/health Declaration.

Financial and Other Services

U.S. service providers exported $20.9 billion in services to South Korea in 2013. Among them were charges for the use of intellectual property ($7.3 billion); South Koreans' travel to the United States including passenger fares ($6.9 billion); other transportation, such as freight services ($2.2 billion); and financial and insurance services ($1.3 billion).[104] 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 2013, the United States imported $10.8 billion in private services, including transportation such as freight services ($5.4 billion), and U.S. travel to South Korea and passenger fares ($1.5 billion).[105] This figure does not include services sold to U.S. residents by South Korean firms through the other modes of delivery.

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

In general the two countries committed 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;

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

[105] Ibid.

- 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.

Under KORUS, the two countries agreed to the "negative list" approach in making commitments in services. That is, the KORUS FTA applies to all types of services unless specifically 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 allows U.S. law firms and U.S. licensed attorneys to provide advisory services on U.S. and international law. South Korea also permits 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, will allow U.S. law firms to form joint ventures with South Korean firms. However, South Korea will 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 will be able to sell a like service in that market. The agreement allows 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 will 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 will be poised to obtain sizeable gains in a liberalized South Korean services market.[106] 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.[107] Under KORUS, South Korea agreed that those entities will be subject to an independent state regulator as opposed to being self-regulated.[108] In addition, Korea Post will not be allowed to offer new insurance products. The two countries will

[106] USITC. p. 4-8.

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

[108] 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.

allow a partner country financial services provider to transfer electronically information from its territory as necessary in the course of doing business.[109] This is a provision that the U.S. industry highlighted as being particularly important.

In *telecommunications services*, South Korea will reduce government restrictions on foreign ownership of South Korean telecommunications companies. As of March 2014, U.S. companies can own up to 100% of voting shares in domestic South Korean telecommunications companies, and by March 2015 will be able to own 100% of program providers, network operators, and cable television-related system operators.[110] These provisions do not apply to KT Corporation nor to SK Telecom Co for which a 49% foreign ownership limit will remain. In addition, each KORUS FTA partner will 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 will guarantee dialing portability among other conditions.[111]

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.[112] 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 FY2012 there were 1.5 million short-term visitors for business or pleasure from South Korea.[113]

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 for South Korean nationals. 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 is 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.[114]

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

[110] Office of the United States Trade Representative. *2014 National Trade Estimates Report—Foreign Trade Barriers.* p. 214.

[111] KORUS FTA Chapter 14 Telecommunications.

[112] 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.

[113] Department of Homeland Security, *Nonimmigrant Admissions to the United States: 2012*, Table 2, http://www.dhs.gov/sites/default/files/publications/ois_ni_fr_2012.pdf*: 2012*.

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

General Provisions

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

Trade Remedies[115]

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

The three most commonly used trade remedies are *antidumping* (AD), *countervailing duty* (CVD), and *safeguard* actions. Antidumping (19 U.S.C. §1673 *et seq.*) actions provide relief from the adverse impact of imports sold at prices shown to be less than fair market value, and countervailing duty (19 U.S.C. §1671 *et seq.*) actions provide similar relief from goods that have been subsidized by a foreign government or other public entity. Safeguard actions (19 U.S.C. §2251 *et seq.*) are designed to give domestic industries an opportunity to adjust to new competition and are triggered by import surges of fairly traded goods. The relief provided in a safeguard case is a temporary import duty, temporary import quota, or a combination of both, while the relief in an antidumping or countervailing duty action is an additional duty placed on the dumped or subsidized imports. These actions are authorized by the WTO as long as they are consistent with the rights and obligations of Article XIX of the General Agreement on Tariffs and Trade (GATT) 1994, the WTO Agreement on Safeguards and Countervailing Measures (Subsidies Agreement), and the WTO Agreement on Implementation of Article VI of the GATT 1994 (Antidumping Agreement).[116]

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.[117]

According to news reports during the KORUS negotiations, the "single most important South Korean demand" in the bilateral talks was changes to U.S. antidumping rules.[118] 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 May 29, 2014, 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.[119] The U.S. global safeguard cases imposed on steel in February 2000 (line pipe) and March 2002 (many steel

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

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

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

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

[119] USITC. "Antidumping and Countervailing Duty Orders In Place As of May 29, 2014, by Country." Available at http://www.usitc.gov.

products) also significantly reduced South Korean steel imports to the United States.[120] Of the 16 WTO dispute resolution complainant cases South Korea has brought to date, 10 have been disputes against U.S. trade remedy actions.[121] South Korea is also a member of the "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.

The KORUS FTA, just as in earlier FTAs the United States has entered into, indicates that each party to the agreement will retain all rights and obligations under the WTO agreements—meaning that the trading partners will 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 remedy provisions 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.[122]

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.[123]

As such, the agreement did not require any changes to U.S. AD or CVD laws, or regulations. However, in an apparent departure from previous FTAs, the KORUS FTA includes additional administrative steps prior to initiation of a trade remedy investigation involving goods from the other party. First, each party will 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.[124] Additionally, the party initiating an AD or CVD investigation will 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),[125] 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.[126]

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

[121] 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").

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

[123] Article 10.4, Compensation.

[124] Chapter 10, §B. Antidumping and Countervailing.

[125] 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.

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

The KORUS FTA established a Committee on Trade Remedies (which is to meet at least once a year) made up of representatives from each party who has responsibility for trade remedies matters. Committee functions include enhancing knowledge of the parties' trade 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.[127]

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 will delay and politicize the process.[128] It also objected to the "undertakings" provisions, saying that these provisions will encourage the use of suspension agreements and introduce actions of foreign governments into trade remedy procedures.[129] (For more information on the steel industry's reaction, see discussion in section on "Other Manufactured Goods.)

The ITAC 12 also opposed the establishment of a Committee on Trade Remedies, saying that it such a forum will give South Korea an opportunity to attempt to further try to weaken U.S. trade remedy laws.[130] 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 will focus on information sharing and "will not provide a forum to discuss specific cases."[131] 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.[132]

Kaesong Industrial Complex[133]

A 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 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).

[127] Chapter 10, §C. Committee on Trade Remedies, Article 10.8, paragraph 2.

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

[129] Ibid., p. 4.

[130] Ibid.

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

[132] Ibid.

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

The KIC 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 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. On the one hand, the agreement does not include any reference to the complex, and KIC products are not eligible for the agreement's special treatment provisions.[134] On the other hand, a binational committee was formed to study the possibility of eventually incorporating products from "Outward Processing Zones" (OPZs), including those—like the KIC—that are located in North Korea.[135] 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, business management practices, 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, both governments must seek "legislative approval for any amendments to the Agreement with respect to outward processing zones." The agreement does not lay out the procedures by which the committee is to arrive at decisions, except that decisions would have to be reached by unified consent.[136]

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."[137]

Some observers, particularly opponents of the KORUS FTA, argued that the agreement could lead to increased U.S. imports of goods or components made in North Korea.[138] 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

[134] In July 2011, South Korea's largest opposition party, the Democratic Party, called for the KORUS FTA to be re-written to recognize KIC-made products as South Korean in origin.

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

[136] 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.

[137] 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.

[138] For a summary and analysis of these arguments, see CRS Report R41843, *Imports from North Korea: Existing Rules, Implications of the KORUS FTA, and the Kaesong Industrial Complex*, coordinated by Mark E. Manyin.

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. In addition, imports from North Korea require U.S. government approval. This restriction includes finished goods originating in North Korea as well as goods that contain North Korea-made components.

Another criticism of the KORUS FTA was 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 will 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 will 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 increased to $32.8 billion by the end of 2012 (latest data available). South Korean FDI in the United States has increased even more substantially. In 1997, the stock of South Korean FDI in the United States was valued at $0.6 billion and had increased to $32.5 billion by the end of 2013.[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

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

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.

The FTA sets down general principles 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 non-discriminatory 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 sets 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 will be provided with prompt and adequate compensation (fair market value). It also requires 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 prohibits 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 will 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 also prohibits a requirement that senior managers be of a particular nationality but will allow a requirement that the majority of board of directors be of a particular nationality.

Similar to other U.S. FTAs, the KORUS FTA establishes 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 provides 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."

[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 of 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.

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.

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 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 made IPR commitments beyond those agreements with provisions that

- 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.

Worker Rights

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

142 USITC. p. 6-5.

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.

standards and would require that the commitment be enforceable under the FTA.[144] Neither country is to waive or otherwise derogate from its labor statutes that reflect the five labor rights in a manner that affects trade or investment between the two FTA countries. Each country is to ensure that those affected by their respective labor laws have access to tribunals that enforce their rights under those laws. During his nomination process, former-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 formed a Labor Affairs Council made up of officials from the respective labor ministries and agencies.The council first met March 18-19, 2013, to discuss the implementation of the Labor Chapter's provisions and to provide a forum to engage with the public on related issues. 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

[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 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.

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 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 41 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 $203,000 and above. The KORUS FTA applies 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 added nine more agencies to be covered.

Environment

In keeping with the May 10, 2007, understanding on labor and the environment between the Bush Administration and congressional leaders, KORUS commits the United States and South Korea 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 "**Worker Rights**" section above.)[150] In addition, the FTA contains provisions that prohibit the two countries from easing environmental standards in order to allow firms on their territory from gaining a competitive trade advantage.

[148] *Ibid*.

[149] OECD, *Economic Survey—Korea 2007*, pp. 128-140.

[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.

Furthermore, violations of the environmental provisions are to be handled in the same manner as commercial provisions through the dispute settlement mechanism.

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 the KORUS FTA, the United States and South Korea commit to: publish relevant regulations and administrative decisions as well as proposed regulations; hhallow persons from the other party to make comments and ask questions regarding proposed regulations; notify such persons of administrative proceedings and allow them to make presentations before final administrative action is taken; and allow such persons to request review and appeal of administrative decisions.

Institutional Provisions and Dispute Settlement

The KORUS FTA provides 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 requires 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 trade agreement provides for the establishment of 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 "Automobiles") 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 commits both countries to uphold their obligations under the WTO Agreement on Technical Barriers to Trade (TBT). In addition, South Korea and the United States will 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 promotes joint cooperation to ensure compliance with each other's customs laws and regulations and requires both parties to adopt or maintain various practices designed to facilitate more efficient processing of international trade transactions. For example, it requires that customs authorities release goods in a timely manner and stipulates that both countries adopt procedures and regulations to facilitate express delivery shipments.

Rules of origin define what are goods that originate in the FTA region and therefore are eligible for preferential treatment. (Textiles and apparel have separate rules of origin.) The KORUS FTA requires that goods must be wholly obtained or produced in the territory of both countries and country. The FTA sets a regional value threshold to be met to be considered originating in the FTA territory and provides formulas for determining the regional values for other products such as autos.[151]

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 requires 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 will cooperate in enforcing competition laws through the exchange of information and consultation. In addition, designated monopolies and state-enterprises will 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 prohibit discrimination against digital products and imposing customs duties on these products. They also require the recognition of electronic authentication and electronic signatures and promote consumer access to the Internet.

[151] See, CRS Report R41868, *The Proposed U.S.-South Korea Free Trade Agreement (KORUS FTA): Automobile Rules of Origin*, by Vivian C. Jones and Michaela D. Platzer, for a discussion of automotive-specific rules of origin.

Appendix. 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.[152] 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 2013, according to the International Organization of Motor Vehicle Manufacturers (OICA), South Korean production of cars and commercial vehicles totaled 4.5 million units; South Korea ranked as the global number five national producer, behind, in order, China, the United States, Japan, and Germany.[153] Yet, South Korea remains only a mid-level consumer of motor vehicles, with domestic sales of around 1.4 million in recent years. Exports accounted for about 70% of Korea's motor vehicle production volume in 2013, a figure that is matched by no other major motor vehicle producing country.[154]

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.[155] 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 1997-1998, 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.[156] The lone major South Korean-owned producer, the Hyundai-Kia combination, in 2012 produced 6.8 million passenger cars worldwide, ranking it fourth globally, behind Toyota, G.M., and Volkswagen.[157]

Hyundai is a world-class global competitor, with current and planned assembly operations in the United States, the European Union, and other countries.[158] The export orientation of the South Korean motor vehicle industry, the quality of South Korean cars, and the relatively low U.S. tariff

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

[153] International Organization of Motor Vehicle Manufacturers (OICA), *World Motor Vehicle Production by Country*, 2013 Production Statistics, http://oica.net/category/production-statistics/.

[154] For instance, Japan exported about half of its motor vehicle production volume in 2013. American Automotive Policy Council, "*Statistical Overview of the Korean Automotive Industry/Market & U.S. Trade Relationship, 1990-2013*," http://www.americanautocouncil.org/industry-facts.

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

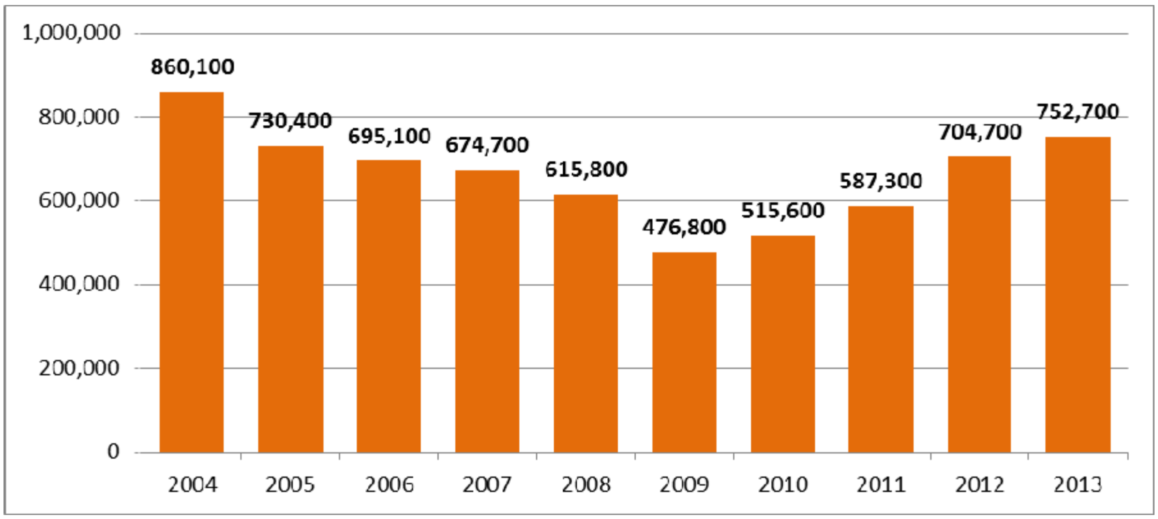
[156] Ibid., pp. 60-61; Graeme P. Maxton and John Wormald, *Time for a Model Change*: *Re-Engineering the Global Automotive Industry.* Cambridge, U.K.: Cambridge University Press, 2004. pp. 101-2; CRS Report RL32883, *U.S. Automotive Industry: Recent History and Issues*, by Stephen Cooney and Brent D.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

[157] OICA, *World Motor Vehicle Production*, World Ranking of Manufacturers, Year 2012, http://www.oica.net/wp-content/uploads/2013/03/worldpro2012-modification-ranking.pdf.

[158] Hyundai, About Hyundai Motor Company, Fact Sheet, http://www.hmmausa.com/our-company/about-hmma/hmc-fact-sheet/.

on all imported motor vehicles, except trucks, has made the United States a good market of opportunity for South Korean automobile exports. Until 2016 and 2021, respectively, the United States will impose a 2.5% duty on imported passenger vehicles and a 25% duty on trucks. South Korean automakers export 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 dropped every year through 2009, but increased to more than 750,000 passenger vehicles and light trucks in 2013 (see **Figure A-1**). U.S.-based automobile exporters, which could include South Korean and other foreign-owned manufacturers, shipped more than 27,550 passenger cars and light trucks to South Korea in 2013, up from slightly more than 22,600 units in 2012.[159]

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



Source: U.S. Department of Commerce, Office of Transportation and Machinery and the American Automotive Policy Council.

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.[160] Thus, Hyundai's Montgomery, AL, plant and Kia's West Point, GA, facilities allow them to substitute for some imports. In 2013, Hyundai and Kia sold 1.26 million light vehicles in the United States, of which some 60%, or about 770,000 units, were produced in the United States.[161] Nearly 400,000 Sonata's, Elantra's, and Santa Fe's were assembled in Hyundai's Alabama facilities and about 370,000 Kia Sorento's and Optima's and Hyundai Santa Fe's were produced in Georgia in 2013.[162] At full capacity, the Georgia Kia plant can produce 360,000 vehicles.[163] Meanwhile, GM Korea, which is the South

[159] American Automotive Policy Council, "*Statistical Overview of the Korean Automotive Industry/Market & U.S. Trade Relationship, 1990-2013*," http://www.americanautocouncil.org/industry-facts

[160] The Hyundai Group owns Hyundai and has a 33.8% stake in Kia as of March 2013.

[161] "*U.S. Light Vehicle Sales by Company, December & YTD*," WardsAuto, January 26, 2014, http://www.wardsauto.com and data from the American Automotive Policy Council.

[162] "*North American Vehicle Production by State and Plant*," WardsAuto, February 25, 2014, http://wardsauto.com.

[163] Kia, "Kia Motors Manufacturing Georgia Begins Expansion Projects to Support Increased Volume Beginning in (continued...)

Korean arm of U.S. automaker GM, builds and sells cars in South Korea. In 2013, GM Korea sold 145,300 domestically built cars.[164] Since these vehicles are not exported they are not covered by the KORUS FTA.

The total value of South Korean automotive exports to the United States, including parts, was $19.7 billion in 2013, compared with U.S. exports of similar products to South Korea of $1.5 billion. The United States ran a bilateral trade deficit in autos of $18.2 billion in 2013, which widen from $10.6 billion five years ago.[165] One analyst who examined the effects of the 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."[166]

Through aggressive and successful marketing, Hyundai and Kia together have significantly increased U.S. market share from the 2000s. Recent data show that Hyundai's sales of their domestic and imported vehicles rose by 3% from 2012 to 2013, while Kia's car sales were virtually flat, up 1% during the same time period. By comparison, overall sales of U.S. light vehicles grew to 15.6 million units in 2013 from 14.5 million in 2012, rising 8%.[167] Despite their growth in sales in recent years, South Korean automakers' share of the U.S. market dropped in 2013 to 8.1% from 8.7% in 2012. Sales of Chevrolet's Spark EV model, which is imported from South Korea, totaled 34,130 units in 2013, its first full year on the market.[168]

For years, 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.[169] 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 10.2% market share by 2013 (156,500 units).[170] Together, European manufacturers accounted for more than

(...continued)

2012," press release, June 2, 2011, http://www.kiamedia.com/us/en/media/pressreleases/3948/kia-motors-manufacturing-georgia-begins-expansion-projects-to-support-increased-volume-beginning-in-2012.

[164] American Automotive Policy Council, *Facts about the Korean Auto Industry and Economy*, http://www.americanautocouncil.org/.

[165] Ibid.

[166] 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.

[167] "*U.S. Light-Vehicle Sales December & YTD,* " Automotive News, January 3, 2014, http://www.automotivenews.com and data from the American Automotive Policy Council.

[168] Ibid.

[169] CRS Report RL32883, *U.S. Automotive Industry: Recent History and Issues*, by Stephen Cooney and Brent D. Yacobucci.

[170] Korea Automobile Importers & Distributors Association, Market Share, http://www.kaida.co.kr/en/statistics/kaidaShareList.do.

three-quarters of imported cars in the South Korean market in 2013 and Japanese manufacturers combined comprised another 14%. U.S.-headquartered automakers constituted the remainder with a 7.4% share of new imported cars sold in South Korea (i.e., Ford at 7,200, Chrysler at 4,100, and GM at 300).[171]

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[171] General Motors has sold over 100,000 cars annually since 2005 through its South Korean subsidiary, the GM Korea operations. General Motors Corporation and Korea's Daewoo Motor Company launched the GM Daewoo Auto & Technology Company in 2002, renamed GM Korea in 2011. GM holds a 72% stake in the Korean automaker, with the rest of the company controlled by the state run Korea Development Bank. GM Korea operates four manufacturing facilities in Korea and one assembly plant in Vietnam.