

United States International Trade Commission

# **U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects**

Investigation No. TA-2104-24  
USITC Publication 3949  
September 2007



# U.S. International Trade Commission

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# **U.S. International Trade Commission**

Washington, DC 20436

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**September 2007**

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## Abbreviations and Acronyms

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3G	third generation
AAfA	American Apparel & Footwear Association
ACE	American Council on Education
ACLI	American Council of Life Insurers
AD-CVD	antidumping and countervailing duty
ADOGA	American Dehydrated Onion and Garlic Association
ADSL	asymmetric digital subscriber line
AdvaMed	Advanced Medical Technology Association
AEA	American Electronics Association
AIA	Aerospace Industries Association of America, Inc.; American Insurance Association
AMCHAM Korea	American Chamber of Commerce in Korea
AMI	American Mushroom Institute, American Meat Institute
AMTAC	American Manufacturing Trade Action Coalition
APEC	Asia-Pacific Economic Cooperation
APTA	American Potato Trade Alliance
ASA	American Soybean Association
ASEAN	Association of Southern Asian Nations
“aT”	Korean Agro-Fishery Trade Corporation
ATC	Agreement on Textiles and Clothing
AVE	ad valorem equivalent
BEA	Bureau of Economic Analysis (U.S. Department of Commerce)
BIT	bilateral investment treaty
BLS	Bureau of Labor Statistics
B2B	business to business
B2C	business to consumer
BSE	bovine spongiform encephalopathy
CAFTA-DR	U.S. Free Trade Agreement with Central America and the Dominican Republic
CAWG	California Association of Winegrape Growers
cc	cubic centimeters
CCAMLR	Convention on Conservation of Antarctic Marine Living Resources
CCGAC	Cheju Citrus Grower’s Agricultural Cooperative
CEA	Consumer Electronics Association
CE	consumer electronics
CGE	computable general equilibrium
c.i.f.	cost, insurance, and freight
CITES	Convention on International Trade in Endangered Species
CNC	computerized numerically controlled
CPA	certified public accountant
CRA	Corn Refiners Association
CRS	Congressional Research Service
CSI	Coalition of Service Industries
C-Trade	Canadian federal-provincial committee for trade consultations
DDGS	distiller’s dried grains with solubles
DOL	Department of Labor
DRAM	dynamic random access memory
EBS	Educational Broadcasting System

## **Abbreviations and Acronyms—Continued**

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ECA	Environmental Cooperation Agreement
ECAT	Emergency Committee for American Trade
EDI	Electronic Data Interchange
EFTA	European Free Trade Area
EIC	Entertainment Industry Coalition for Free Trade
EIU	Economist Intelligence Unit
EPS	Employment Permit System for Migrant Workers
ERS	Economic Research Service (USDA)
EU	European Union
FAS	Foreign Agricultural Service
FCC	Federal Communications Commission
FCM	Florida Citrus Mutual
FCOJ	frozen concentrated orange juice
FLC	foreign legal consultant
FDI	foreign direct investment
f.o.b.	free on board
FPA	Food Products Association
FSIS	Food Safety and Inspection Service
FTAP2	Foreign direct investment and Trade Analysis Project model version 2
FTA	free trade agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GePS	Government e-Procurement Services
GDP	gross domestic product
GM	General Motors Corp.; genetically modified
GMA	Grocery Manufacturers Association
GMAP	genetically modified agricultural products
GMO	genetically modified organism
GPA	WTO Agreement on Government Procurement
GPHA	Generic Pharmaceutical Association
GSP	General System of Preferences
GTAP	Global Trade Analysis Project
HS	Harmonized System
HTS	Harmonized Tariff Schedule of the United States
IATTC	Inter-American Tropical Tuna Convention
ICT	information and communication technology
IDFA	International Dairy Food Association
IIPA	International Intellectual Property Alliance
ILAB	Bureau of International Labor Affairs
ILO	International Labor Organization
IMF	International Monetary Fund
IMT-2000	International Mobile Telecommunications-2000
IPR	intellectual property rights
IPTV	Internet-protocol television
IT	information technology
ITA	Information Technology Agreement
ITAA	Information Technology Association of America
ITI	Information Technology Industry Council



## Abbreviations and Acronyms—*Continued*

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IWC	International Whaling Convention
KBS	Korea Broadcasting System
KCC	Korea Communication Commission
KCS	Korean Customs Service
KFDA	Korea Food and Drug Administration
KFTC	Korea Fair Trade Commission
kg	kilogram
KIC	Kaesong Industrial Complex
KIEP	Korean Institute for International Economic Policy
KIET	Korea Institute for International Economics and Trade
KITA	Korean International Trade Association
KLSI	Korea Labor & Society Institute
KOFOTI	Korea Federation of Textile Industries
KORUS	Korea-U.S. Free Trade Agreement
K-ULEV	Korea's Ultra Low Emission Vehicle (standard)
LDP	landed duty paid
LEV II	Low Emission Vehicle (program)
LMO	living modified organism
MAF	Ministry of Agriculture and Forestry
MAT	marine, aviation, and transit
Mbps	megabit per second
MBC	Munhwa Broadcasting Corporation
MEAs	multilateral environmental agreements
MFA	Multifiber Arrangement
MFN	most-favored-nation
MIC	Ministry of Information and Communication (Korea)
MOCIE	Ministry of Commerce, Industry, and Energy
MOU	Memorandum of Understanding
MPAA	Motion Picture Association of America
MRL	maximum residue level
MVNO	mobile virtual network operators
mt	metric tons
NAFTA	North American Free Trade Agreement
NAM	National Association of Manufacturers
NCBA	National Cattlemen's Beef Association
NCC	National Chicken Council
NCGA	National Corn Growers Association
NCTO	National Council of Textile Organization
NCM	nonconforming measure
n.e.c.	not elsewhere classified
NEMA	National Electrical Manufacturers Association
nesoi	not elsewhere specified or included
NIM	net interest margin
NMOG	nonmethane organic gas
NMPF	National Milk Producers Federation
NOPA	National Oilseed Processors Association
NPC	National Potato Council

## Abbreviations and Acronyms—*Continued*

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NPPC	National Pork Producers Council
NTM	nontariff measure
NTR	normal trade relations (same as MFN)
OECD	Organisation for Economic Co-operation and Development
OIE	World Organization of Animal Health
OTEC	Office of Technology and Electronic Commerce
OTEXA	Office of Textiles and Apparel
PhRMA	Pharmaceutical Research and Manufacturers of America
PIC	Production Incentive Certificate
PSF	polyester stable fibers
P2P	peer to peer
PVC	polyvinyl chloride
PVP	Process Verified Programs
R&D	research and development
ROW	Rest of World
RPFMA	Rubber and Plastic Footwear Manufacturers Association
SDR	Special Drawing Rights
SFA	Snack Food Association
SIA	Semiconductor Industry Association
SME	small and medium-sized enterprises
SPS	sanitary and phytosanitary
SRM	specified risk material
STE	state trading entity
SUV	sport utility vehicle
TBT	technical barriers to trade
TGA	Travel Goods Association
TIA	Telecommunications Industry Association
TPA	trade promotion agreement
TPRM	Trade Policy Review Mechanism
Trade Act	Trade Act of 2002
TE	Tariff Equivalent
TPL	tariff preference level
TRE	tariff rate equivalent
TRIPS	Trade-Related Aspects of Intellectual Property Rights
TRQ	tariff-rate quota
UAW	United Automobile, Aerospace and Agricultural Implement Workers of America
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
USA-ITA	United States Association of Importers of Textiles and Apparel
USCIB	U.S. Council for International Business
USCS	U.S. Commercial Service
USDA	U.S. Department of Agriculture
USDEC	U.S. Dairy Export Council
USDOC	U.S. Department of Commerce
USFCS	U.S. Foreign & Commercial Service
USITC	United States International Trade Commission

## Abbreviations and Acronyms—*Continued*

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USKBC	U.S.-Korea Business Council
USMEF	United States Meat Exporters Federation
USTR	United States Trade Representative
VAT	value-added tax
VoIP	voice-over-internet protocol
WCO	World Customs Organization
WCT	WIPO Copyright Treaty
WIPO	World Intellectual Property Organization
WP-29	World Forum for Harmonization of Vehicle Regulations
WTO	World Trade Organization
XLA	Express Delivery and Logistics Association

### U.S. Trade Advisory Groups

ACTPN	Advisory Committee for Trade Policy and Negotiations
APAC	Agricultural Policy Advisory Committee for Trade
ATAC	Agricultural Technical Advisory Committee
IGPAC	Intergovernmental Policy Advisory Committee
ITAC	Industry Trade Advisory Committee
ITAC 1	Industry Trade Advisory Committee for Aerospace Equipment
ITAC 2	Industry Trade Advisory Committee on Automotive Equipment and Capital Goods
ITAC 3	Industry Trade Advisory Committee for Chemicals, Pharmaceuticals, Health/Science Products and Services
ITAC 4	Industry Trade Advisory Committee on Consumer Goods
ITAC 5	Industry Trade Advisory Committee on Distribution Services for Trade Policy Matters
ITAC 6	Industry Trade Advisory Committee on Energy and Energy Services
ITAC 7	Industry Trade Advisory Committee on Forest Products
ITAC 8	Industry Trade Advisory Committee for Information and Communications Technologies, Services and Electronic Commerce
ITAC 9	Industry Trade Advisory Committee on Non-Ferrous Metals and Building Materials
ITAC 10	Industry Trade Advisory Committee on Services and Finance Industries
ITAC 11	Industry Trade Advisory Committee on Small and Minority Business
ITAC 12	Industry Trade Advisory Committee on Steel
ITAC 13	Industry Trade Advisory Committee on Textiles and Clothing
ITAC 14	Industry Trade Advisory Committee on Customs Matters and Trade Facilitation
ITAC 15	Industry Trade Advisory Committee on Intellectual Property Rights
ITAC 16	Industry Trade Advisory Committee on Standards and Technical Barriers to Trade
LAC	Labor Advisory Committee
TEPAC	Trade and Environment Policy Advisory Committee



# Executive Summary

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## Overview

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If fully implemented, the U.S.-Korea Free Trade Agreement (FTA) is expected to affect the U.S.-Korea trade and investment relationship substantially, including bilateral trade in goods and services, procedures governing trade and investment, and the regulatory environment. Tariffs and TRQs applied to U.S. exports to Korea are, on average, substantially larger than those applied to U.S. imports from Korea. Although Korea's average ad valorem equivalent tariffs (AVE tariffs) for manufacturing imports from the United States are typically less than 10 percent, tariffs and TRQs on many U.S. agricultural and food products exceed 30 percent. In contrast, most of the U.S. average AVEs for imports from Korea are less than 5 percent, with a few agricultural products exceeding 5 percent. The Commission estimates that the FTA would result in the following effects:

- **U.S. GDP** would likely increase by \$10.1–11.9 billion as a result of tariff and tariff-rate quota (TRQ) provisions related to goods market access.
- **Merchandise exports to Korea** would likely increase by an estimated \$9.7–10.9 billion as a result of tariff and TRQ provisions.
- **Merchandise imports from Korea** would likely increase by an estimated \$6.4–6.9 billion as a result of tariff and TRQ provisions.
- **U.S. services exports** would likely increase as a result of the FTA, given the increase in levels of market access, national treatment, and regulatory transparency that would be afforded by the FTA in excess of the current General Agreement on Trade in Services (GATS) regime.
- **Aggregate U.S. output and employment** changes would likely be negligible, primarily because of the size of the U.S. economy relative to that of the Korean economy.

**Sector-specific exports:** Agricultural exports to Korea that would be likely to increase primarily because of the removal of high tariffs and TRQs, include grains, oilseeds, animal feeds, fruit (especially oranges, apples, and pears), vegetables (such as potatoes, tomatoes, sweet corn, and lettuce), nuts, dairy products, meat products (beef, pork, and poultry), seafood, and various processed foods and nonalcoholic beverages. These increases are expected to lead to relatively small increases in output and employment, with the largest increase of as much as 2 percent for the meat sector (beef, pork, and poultry) and sectors supplying it. Exports of machinery, electronics, and transportation equipment and of motor vehicles and parts would likely experience relatively large increases, primarily as a result of small tariff changes to large pre-existing trade flows. Certain high technology products, such as pharmaceuticals and medical devices, would likely also experience increased exports as a result of FTA-induced improvements in the regulatory environment in Korea.

**Sector-specific imports:** Imports of textiles, apparel, leather products, and footwear from Korea would likely increase due to a reduction in the relatively high U.S. tariffs. Potential increases in U.S. imports of machinery, electronics, and transportation equipment, including passenger vehicles, would be driven by small tariff changes to pre-existing large import volumes. For some of these sectors, however, much of the import increase (e.g., approximately 85–90 percent for textiles and apparel and 55–57 percent for passenger

vehicles) would likely be diverted from other import sources. For this reason, declines in output or employment for textiles and apparel and the broader passenger vehicles and parts sector would likely be negligible (less than 1 percent).

**Services sector:** Services sector exports to Korea would likely increase as a result of the FTA, because Korea has agreed to provide levels of market access, national treatment, and regulatory transparency that would exceed levels currently afforded the United States by Korea under GATS obligations. A primary benefit of the FTA is the implementation of a “negative list” approach, whereby all disciplines included in the FTA would automatically cover all services industries and industry segments except for those specifically exempted in FTA. Although increases in market access would vary by industry, the FTA would expand access to Korea's services market and would provide substantial opportunities for financial, telecommunications, professional, and audiovisual services. No significant change in U.S. output is likely given the small size of U.S. services exports to, and imports from, Korea relative to the size of the U.S. services market.

**Regulatory environment:** Changes in trade facilitation and the regulatory environment provisions could substantially increase U.S.-Korea trade and investment by reducing transaction costs, increasing transparency, and improving the regulatory environment. For example, a more secure and stable investment environment and enhanced implementation of intellectual property rights enforcement would likely increase trade and investment in a wide array of goods and services.

# Summary of Findings

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## *Goods Market Access*

**Tariff commitments:** Thirty-eight percent of U.S. tariff lines and 13 percent of Korean tariff lines currently have free rates of duty. Upon implementation of the FTA, more than 82 percent of U.S. tariff lines and more than 80 percent of Korean tariff lines would have free rates of duty for their FTA partner. Approximately 99 percent of U.S. tariff lines and 98 percent of Korean tariff lines would have free rates of duty by year 10.

## *Impact of Tariff- and Tariff-rate Quota-related Provisions on the U.S. Economy*

The Commission's simulation of the economy-wide impact of tariff and TRQ elimination under the FTA estimates that upon full implementation U.S. GDP would likely increase by \$10.1–11.9 billion (approximately 0.1 percent). This increase reflects higher U.S. export prices as the removal of relatively large Korean tariffs and TRQs, primarily in the agriculture sector, increases demand for U.S. exports. Without a full quantitative analysis of services trade and international investment patterns, however, these simulation results should not be interpreted as changes in total imports and exports, or as implying meaningful information about the balance of trade impact of the entire U.S.-Korea FTA.

**U.S. exports to Korea:** Based on the results of the economy-wide model simulation, U.S. exports to Korea are estimated to be \$9.7–10.9 billion higher once the FTA is fully implemented. The largest estimated increases in U.S. exports, by percent, would likely be in dairy products, other meat products (primarily pork and poultry), wearing apparel, and bovine meat products (beef). The largest estimated increases in U.S. exports, by value, would likely be in various machinery and equipment; chemical, rubber, and plastic products; bovine meat products; other meat products; and certain other food products.

**U.S. imports from Korea:** Based on the results of the economy-wide model simulation, U.S. imports from Korea are estimated to be \$6.4–6.9 billion higher once the FTA is fully implemented. The largest estimated increases in U.S. imports, by percent, are in dairy products, wearing apparel, and footwear and leather products. The largest estimated increases in imports, by value, are in textiles, motor vehicles and parts, and wearing apparel.

**U.S. industries:** The FTA would likely result in a small to negligible impact on output or employment for most sectors of the U.S. economy, as expected losses in output and employment in contracting sectors are expected to be offset by gains in expanding sectors. The bovine meat products sector; the upstream cattle, sheep, goats, and horses sector; and the other meat products sector are estimated to experience the largest percentage increases (up to 2.0 percent) in output and employment. Textiles, wheat, wearing apparel, and electronic equipment are anticipated to experience the greatest declines, although generally less than 1 percent. The modest declines in some industries, such as wheat, are primarily driven by the reallocation of resources to higher value products.

## *Sector-specific Assessments*

The U.S.-Korea FTA would likely increase U.S. exports to Korea substantially for specific products, particularly in the agricultural sector, where Korea maintains relatively high tariffs and TRQs. The potential increases in exports would likely occur gradually, with much of the impact back-loaded as a result of interim TRQs and safeguard measures. In general, no significant changes in total U.S. output or employment are likely given the small size of Korea's market relative to that of the United States (Korean GDP is less than 10 percent of U.S. GDP). In addition, the extent to which the FTA addresses nontariff measures (NTMs)—for example, sanitary and phytosanitary (SPS) measures for many agricultural products and regulatory measures for pharmaceuticals and medical devices and for passenger vehicles—could substantially affect the ability of U.S. exporters to take advantage of increased market access. The FTA chapters addressing, for example, SPS, technical barriers to trade (TBT), customs administration, and transparency would likely further support increased trade and investment across numerous products.

Given current very low U.S. tariff rates, it is not expected that substantial increases in imports to the United States would occur for more than a few products. Potential increases in imports of general machinery, electronics, and transportation equipment and of passenger vehicles would be largely a result of small tariff changes to pre-existing large import volumes, whereas potential increases in imports of leather goods, footwear, textiles and apparel would be largely a result of reductions in relatively high U.S. tariff rates.

Key Commission findings for specific sectors are:

**Grains:** The FTA would likely increase U.S. exports of grain to Korea, particularly exports of corn. Tariff reductions should increase U.S. competitiveness in the Korean market, especially relative to Brazil and China. Substantial freight costs and remaining TRQs, however, would likely limit substantial market shifts in favor of the United States. In addition, increases in grains exports could be dampened by decreasing demand from the Korean cattle sector for U.S. feed grain as a result of increased U.S. exports of meat to Korea.

**Oilseed products:** The FTA would likely substantially increase U.S. oilseeds exports to Korea. This increase would likely result from tariff elimination and the expansion of TRQ in-quota quantities, as well as the shift of some purchasing from the state-owned enterprise to the private sector. The remaining, although increasing, TRQs, however, would likely hamper long-term increases in market access.

**Animal feeds:** Although tariff reductions resulting from the FTA may modestly increase animal feeds exports to Korea, the tariff reductions are unlikely to increase U.S. price competitiveness significantly relative to other suppliers of soybean meal, such as Argentina, Brazil, and India. Of greater potential importance is the indirect upstream effect of increased market access for U.S. meat exports to Korea as a result of the FTA. Increased meat production in the United States and exports to Korea would likely increase the domestic usage of soybean meal, as livestock feed accounts for the majority of the soybean meal consumption in the United States.

**Starches:** The FTA would likely increase U.S. exports of unmodified starches, such as corn starch to Korea, in the long term after the elimination of Korea's TRQs and safeguard measures. Although U.S. exports of dextrins and other modified starches could benefit from



increased market access after the elimination of tariffs and safeguard measures, the relatively small Korean market for these products would limit increased exports to Korea in the short term.

**Citrus fruit:** Tariff reductions, in-quota quantity increases, and NTM reductions would likely result in increased U.S. exports of citrus fruit, especially lemons and grapefruit, to Korea. Long-term increased exports of oranges to Korea would likely be limited by the permanent, though increasing, duty-free seasonal TRQ on orange exports.

**Noncitrus fruit:** Tariff reductions, quota reduction or elimination, and provisions to address SPS measures would likely result in increased U.S. exports to Korea of noncitrus fruit such as apples, peaches, pears, cherries, grapes, raisins, and strawberries and the increased competitiveness of U.S. exports in the Korean market, especially relative to Chile. The potential resolution of SPS issues by the committee established by the SPS chapter of the FTA would be key to the potential increases in U.S. exports.

**Potato products:** U.S. exports of potato products to Korea are expected to increase substantially, primarily as a result of the elimination of relatively high duties and the subsequent increase in U.S. price competitiveness in the Korean market. Increased exports would likely be tempered, however, by the remaining, though increasing, TRQs.

**Other vegetables:** U.S. producers of various fresh and processed vegetables would likely increase exports to Korea as a result of the FTA. This increase would likely be driven primarily by the elimination of relatively high tariffs facing U.S. exporters. Although expected gains vary by product, substantial increases are expected for canned tomato products, canned sweet corn, and fresh vegetables such as lettuce. NTMs could, however, continue to hamper U.S. market access.

**Tree nuts:** The FTA would likely increase U.S. exports of tree nuts, especially pistachios, almonds, and walnuts to Korea as a result of immediate tariff eliminations. The FTA could also bolster U.S. competitiveness with respect to other foreign suppliers such as China and Iran that have recently increased their market share in Korea.

**Dairy products:** Despite relatively long phaseout periods for tariffs and TRQs, the eventual elimination of tariffs and removal of almost all TRQs under the FTA is expected to increase U.S. dairy exports to Korea substantially. Increased exports would consist primarily of cheese, whey, lactose, and infant formula.

**Meat:** Assuming the resolution of SPS issues facing U.S. beef exports to Korea, the FTA is expected to increase U.S. exports substantially as a result of the elimination of relatively high tariff rates after the removal of safeguard measures. U.S. pork and poultry exports, which also face relatively high tariff rates, are expected to increase when the tariffs are eventually eliminated. Increased access to the Korean market is particularly attractive for U.S. meat exporters, as Korea provides a large market for many products that are less popular in the United States.

**Seafood:** The eventual elimination of Korean tariffs and TRQs is expected to increase U.S. seafood exports to Korea, especially flatfish and Alaska pollack. Exports of frozen fish fillets such as salmon, Pacific cod, and halibut to Korea would likely increase. Despite the relatively high U.S. tariff and TRQ on tuna imports that would be eliminated under the FTA,

total increased fish imports from Korea would be limited by the generally low U.S. tariff rates on other fish imports.

**Selected processed foods:** U.S. exports of selected processed foods are expected to increase in the medium to long term as tariffs are eventually phased out. This increased market access should increase U.S. competitiveness with respect to other suppliers such as China, the EU, and Japan. The U.S. processed food industry, however, has noted the full realization of market access opportunities would depend upon how the SPS and TBT provisions of the FTA are interpreted and implemented.

**Nonalcoholic beverage products:** The reduction of tariffs on nonalcoholic beverages is expected to increase exports of numerous products, including grape juice, orange juice, frozen juice concentrates, vegetable juices, and other beverage products such as carbonated soft drinks and bottled water. The potential resolution of NTM-related issues, such as SPS measures and TBTs, would further facilitate the export of nonalcoholic beverage products.

**Textiles and apparel:** The elimination of U.S. tariffs on Korean exports of textiles and apparel would likely increase U.S. imports of such products from Korea, especially for man-made fibers and man-made fiber goods for which Korea is a competitive and major supplier and for which the United States maintains relatively high tariffs. Approximately 85–90 percent of the estimated increase in U.S. imports from Korea would be diverted from other import sources. U.S. exports of textiles and apparel to Korea may experience a relatively large percentage increase, although the increase in value would be small. Both the potential increase in U.S. imports from and exports to Korea would be tempered by the general decline in competitiveness of both countries' industries, especially with respect to China, the major foreign supplier of textiles and apparel in both countries' markets.

**Leather goods and footwear:** Despite the FTA's elimination of relatively high U.S. tariffs on leather goods and footwear, the increase in U.S. imports from Korea is expected to be limited given Korea's decline in production and exports to the United States of such products, as well as the dominance of China in the U.S. market for leather goods and footwear.

**Pharmaceuticals:** U.S. exports of pharmaceuticals to Korea are likely to increase because of the more rigorous intellectual property standards to be applied to pharmaceutical products in Korea. The FTA would also provide a more facilitating environment in Korea for U.S. pharmaceutical companies by emphasizing the importance of innovative pharmaceutical products, promoting ethical business practices, and improving the transparency of the Korean national health care system. The FTA would also eliminate Korean tariffs on pharmaceutical products either immediately or within 3 years of implementation of the agreement.

**Machinery, electronics, and transportation equipment:** The FTA is likely to increase U.S. exports of machinery, electronics, and transportation equipment to Korea. U.S. suppliers of these products would likely benefit from the immediate or phased elimination of Korean tariffs, as well as from provisions of the FTA that would address NTMs, such as those on intellectual property rights and TBTs. Although many electronic products, such as semiconductors, telecommunications equipment, and computer equipment currently receive duty-free access to the Korean market under the World Trade Organization's Information Technology Agreement, they are also expected to benefit from the FTA's NTM-related provisions.

**Passenger vehicles:** U.S. exports of passenger vehicles to Korea could experience a large percentage increase; however, given the current small U.S. market share and regulatory environment issues, short- to medium-term increases would likely be small by value. The long-term impact on U.S. exports of passenger vehicles to Korea depends on the implementation of FTA provisions addressing NTMs, for example, burdensome standards and certification requirements, taxes, and the opaque regulatory environment. Addressing these NTMs could increase U.S. exports, whereas shortfalls in their elimination could reduce the estimated impact. An increase in U.S. imports of passenger vehicles from Korea would likely be large in value terms, but small in percentage terms, because of the current relatively small U.S. tariff and the large pre-existing trade value of passenger vehicles from Korea. Approximately 55–57 percent of this estimated increase in U.S. imports from Korea would be diverted from other import sources.

**Medical devices:** The FTA would likely result in increased exports of medical devices to Korea by reducing or eliminating a number of tariffs and NTMs. By eliminating tariffs, the FTA is expected to make U.S.-made medical devices more competitive with those of Korean and foreign competitors. The FTA's pharmaceuticals and medical devices chapter would address Korea's NTMs and encourage ethical business practices. U.S. medical device manufacturers would likely also benefit from provisions of the FTA's TBT chapter, which would provide increased regulatory transparency and reduced bureaucratic duplication, and encourage the use of international standards in Korea's regulatory approval process.

### ***Impact of Market Access Provisions for Services***

The U.S.-Korea FTA would provide U.S. services firms with levels of market access, national treatment, and regulatory transparency that generally exceed those currently afforded by Korea's commitments under the GATS. Korea's services market is large and the FTA would likely increase total U.S. services exports to Korea, although the impact would vary by industry. Improved access for U.S. services firms in Korea is partly attributable to the "negative list" approach in the agreement. This approach extends the trade disciplines found in the services chapters of the FTA to services for which Korea made limited or no commitments under GATS, such as sporting and other recreational services. Substantial trade impediments could remain, however, after the FTA enters into force. The FTA is not likely to have a substantial impact on U.S. imports of services from Korea because the U.S. services market is already generally open to foreign firms.

**Financial services:** Sector liberalizations and resulting reforms offered by the FTA would likely result in sizable new cross-border exports of financial services and investment by U.S. firms. Significant new imports of financial services from Korea are not expected in the near term due to the relatively open nature of the U.S. financial services market. Based on the Commission's quantitative analysis, the tariff equivalents (TEs) of Korea's nontariff impediments to banking services decline significantly under the FTA, as compared to Korea's GATS commitments.

**Telecommunications:** The FTA's investment provisions would likely benefit U.S. firms seeking to offer corporate data, virtual private network, and Internet Protocol-based services to multinational customers. High levels of competition, market maturation in some segments, and certain FTA exclusions, however, would likely deter U.S. firms from entering the domestic Korean market for both wireline and wireless services. In addition, competition-induced price declines for international calls between the United States and

Korea would likely limit the impact of the FTA on cross-border imports and exports of telecommunication services.

**Professional services:** Although the FTA would likely have only a small positive impact on professional services trade in the near term, as Korea's market for such services would open only gradually and for a limited range of services, the medium-to long-term impact would likely be larger.

**Audiovisual services:** U.S. firms' access to the Korean audiovisual services market would likely increase significantly in the medium to long term due to the reduction of a number of content quotas. The impact of FTA provisions on U.S. cross-border exports is likely to be modest in the short term, however, as a result of Korea's relatively mature and domestically oriented audiovisual services market.

### *Impact of Trade Facilitation Provisions*

The U.S.-Korea FTA provisions on trade facilitation are designed to expedite the movement of goods and the provision of services between the United States and Korea through specific improvements in customs administration, SPS measures, TBTs, and rules governing electronic commerce.

A summary of the key findings are presented as follows:

**Customs administration and trade facilitation.** U.S. industries that export to and invest in Korea would likely benefit from the customs administration and trade facilitation provisions of the FTA. The chapter's provisions are likely to benefit U.S. industry through reduced transaction costs and an enhanced investment climate in Korea. Benefits from the FTA provisions would likely be realized more quickly than with previous agreements because of the Korean Customs Service's greater capacity to implement its FTA obligations.

**Sanitary and phytosanitary measures (SPS).** The SPS provisions of the FTA would likely have a positive impact on U.S. agricultural producers and exporters over the lifetime of the agreement, although the agreement does not mandate any changes in SPS rules. While the FTA does not contain any commodity-specific SPS provisions, the FTA does establish a bilateral standing committee to address relevant SPS issues. The effectiveness of this committee would potentially have a substantial, though varying, impact on a large number of products.

**Technical barriers to trade (TBT).** The TBT chapter of the FTA would benefit U.S. companies in a wide range of industries—such as processed food products, passenger vehicles, and medical devices—by (1) reinforcing transparency obligations in rulemaking, (2) increasing opportunities for direct participation on a nondiscriminatory basis in Korea's standards development activities, (3) establishing informal mechanisms for rapid resolution of disputes, and (4) reinforcing the WTO TBT obligations. For the first time in the TBT chapter of a U.S. FTA, standards and regulatory provisions are included that specifically address TBTs with respect to a specific industry—the automotive industry.

**Electronic commerce (e-commerce).** The FTA provisions on e-commerce would likely promote e-commerce activity between the United States and Korea. E-commerce is well established in Korea, and Korea has a relatively advanced IT infrastructure, along with one

of the most comprehensive policy frameworks for e-commerce in Asia. The FTA introduces new principles not included in previous FTAs that (1) are intended to promote consumer access to the Internet to conduct e-commerce, and (2) emphasize the importance of maintaining unrestricted cross-border information flows.

### ***Impact of Regulatory Provisions***

The impact of regulatory provisions of the FTA on U.S. companies is often difficult to quantify. It is likely, however, that the FTA regulatory-related provisions would improve the overall regulatory climate for bilateral trade and investment between the United States and Korea, benefitting U.S. companies conducting business in Korea. While some provisions are likely to have a greater impact than others, for example intellectual property rights and regulatory transparency, U.S. firms would likely benefit overall from the provisions stated in these nine sections.

**Trade remedies:** The FTA provisions of this chapter provide a bilateral safeguard provision similar to bilateral safeguard provisions in other U.S. FTAs. The chapter authorizes the application of a safeguard measure if a competent authority finds that as a result of the reduction or elimination of a duty under the agreement, imports of a good are in such increased quantities as to be a substantial cause of serious injury or threat to a domestic industry producing a like or directly competitive good. The FTA does not mandate changes to U.S. antidumping and countervailing duty (AD-CVD) laws, or alter domestic processes for making such changes. The chapter does, for the first time, provide for the establishment of a Committee on Trade Remedies, the opportunity for certain consultations in the course of AD-CVD investigations, and the exchange of information concerning AD-CVD practice. These provisions, however, are not likely to have a significant effect on current U.S. trade remedy and AD-CVD procedures due to the limited nature of the consultations and the limited scope and mandate of the committee.

**Investment:** The FTA chapter on investment would likely provide a more secure and stable investment environment for U.S. investors in Korea. While the list of nonconforming measures taken by Korea is significantly longer than for previous U.S. bilateral FTA partners, the FTA is expected to lead to increased bilateral investment flows and provide significant gains for U.S. investors.

**Competition-related matters:** U.S. firms seeking to invest in Korea would likely benefit from greater regulatory transparency and improved due-process procedures regarding the competition policy provisions of the FTA. The FTA provisions on competition policy seek to address business concerns regarding the administration and enforcement of Korean competition laws, transparency in antitrust investigations, and inconsistency in the application of competition laws and regulations. The FTA provisions are likely to affect trade and investment with Korea in general rather than in a sector-specific manner.

**Government procurement:** The government procurement provisions of the FTA are likely to provide improved opportunities for U.S. firms seeking to bid on government procurement contracts in Korea. The FTA would increase the number of Korean government agencies for which U.S. companies could bid on contracts, reduce by nearly one-half the contract thresholds available to bid on, and address in a broad manner procedural concerns such as inefficient and nontransparent procurement procedures.

**Intellectual property rights (IPR):** Full and effective implementation of the IPR provisions of the FTA would likely benefit U.S. industries that rely on intellectual property by reducing their losses from infringement and increasing export and foreign sales opportunities for their products. For example, U.S. copyright industries have reported substantial losses in Korea, and U.S. pharmaceutical industries have noted that generic drugs are approved for marketing in Korea in violation of patent and data protections. The IPR provisions of the FTA would address these and other problems identified by U.S. industries conducting business in Korea.

**Labor and environment:** The labor and environment provisions of the FTA are expected to have little impact on the U.S. economy or U.S. trade with Korea because the FTA provisions focus on the enforcement of existing regulations. Unlike some previous FTAs, however, there are additional provisions allowing parties to challenge the failure to enforce labor and environment laws through consultations or dispute settlement procedures.

**Transparency:** The FTA's provisions on regulatory transparency would likely enhance the security of business transactions and promote potential U.S.-Korea trade and investment by offering substantial improvements over the current policies and practices.

**Dispute settlement:** The dispute settlement chapter of the FTA would provide guidelines for developing a conducive environment for dispute settlement. The FTA provisions would provide a formalized way to settle disputes concerning major obligations of the FTA by requiring that hearings be open and public, that the public has access to the legal submissions, and that interested persons have the opportunity to submit views to the panel.

## *Literature Review*

**Consensus:** Regardless of the model used, the base year selected, or the liberalization scenario, all studies covered in the literature review estimate that agricultural and manufacturing liberalization under a U.S.-Korea FTA would result in a modest increase in U.S. welfare. Studies also conclude that U.S. exports to Korea would increase by more than imports from Korea, in both percentage and value terms. Results for individual U.S. sectors are also generally consistent across studies—much of the increase in U.S. exports would be for agricultural products. The largest import increase would be for textiles. In two studies, researchers estimated the effect of removal of U.S. and Korean service barriers. These studies estimated larger welfare gains than the other studies reviewed because of increased bilateral trade in service sectors, but reported that the removal of services-sector barriers would have little overall effect on output in that sector.

The Commission's findings resulting from its analysis of a fully implemented FTA are broadly consistent with those identified in other studies employing a similar model and scenario assumptions. The main differences are that the Commission's analysis is based on the negotiated FTA rather than a proposed or hypothetical FTA, and the Commission's analysis incorporates more recent trade and production data.

# CHAPTER 1

## Introduction

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### Scope and Approach of the Report

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This report assesses the likely impact of the U.S.-Korea Free Trade Agreement (FTA) on the U.S. economy as a whole and on specific industry sectors, including the impact the FTA would have on the U.S. gross domestic product (GDP); exports and imports; aggregate employment and employment opportunities; the production, employment, and competitive position of industries likely to be significantly affected by the FTA; and the interests of U.S. consumers.<sup>1</sup> The assessment is based on a review of all 24 chapters of the text of the U.S.-Korea FTA, including its annexes and associated side letters.<sup>2</sup> A chapter-by-chapter summary of the FTA provisions is presented in appendix D of this report.

To assess the impact of tariff and tariff-rate quota (TRQ) liberalization under the FTA on the U.S. economy, the U.S. International Trade Commission (USITC, Commission) employed a global computable general equilibrium (CGE) model.<sup>3</sup> The model permits the Commission to estimate the possible effects of the negotiated liberalization of tariffs and TRQs in the FTA. The static nature of the model assumes that the FTA will be fully implemented on January 1, 2008, and not phased in over time;<sup>4</sup> therefore, the estimated impact reflects long-term adjustments to a fully implemented FTA. Other policy assumptions of the model are described in chapter 2 and in appendix F of this report.

The Commission supplemented the CGE model-based analysis with sector-specific analysis of the economic impact of specific market access provisions, including the impact of the staged reductions of certain tariffs and TRQs. The U.S. product sectors analyzed were grains; oilseeds; animal feeds; starches; citrus fruit; noncitrus fruit; potatoes; other vegetables; tree nuts; dairy products; meat; seafood; selected processed foods; nonalcoholic beverages; textiles and apparel; footwear and leather products; pharmaceuticals; machinery, electronics, and transportation products; passenger vehicles; and medical devices.

U.S. services sectors analyzed were cross-border services, financial services, telecommunications, professional services, and audiovisual services. With the exception of financial (specifically, banking) services, the impact on these service sectors was not quantified because of limited data availability on the ad valorem equivalent value of service

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<sup>1</sup> A copy of the request letter from United States Trade Representative (USTR) is in app. A of this report. These components may not be assessed in every chapter of this report for every product or sector, although all are assessed, where applicable and feasible, throughout this report.

<sup>2</sup> This assessment is primarily based on the text of the U.S.-Korea FTA available at [http://www.ustr.gov/Trade\\_Agreements/Bilateral/Republic\\_of\\_Korea\\_FTA/Draft\\_Text/Section\\_Index.html](http://www.ustr.gov/Trade_Agreements/Bilateral/Republic_of_Korea_FTA/Draft_Text/Section_Index.html) as of July 5, 2007.

<sup>3</sup> The Global Trade Analysis Project (GTAP) model and database were used in this investigation. GTAP is a multicountry CGE model with economy-wide coverage of merchandise and service sectors. The GTAP model framework is described in app. F of this report.

<sup>4</sup> Under this FTA, duty elimination on some tariff lines is to be phased in over a period of up to 20 years, with some TRQs phased out over a period of up to 18 years for U.S. exports and 10 years for U.S. imports; some TRQs on U.S. exports are subject to in-quota growth rates of 3 percent per year, compounded annually in perpetuity. Information on the tariff commitments of the United States and Korea is provided in chap. 2 of this report.

sector barriers.<sup>5</sup> These merchandise and service sectors were selected for analysis based on a number of criteria, including the extent of trade liberalization under the FTA, the potential for increased bilateral trade as a result of the FTA, the importance of the sector or key sector components in terms of bilateral trade, and industry and Commission views regarding the FTA commitments or the U.S.-Korea trade relationship in that sector.

At the conclusion of each section of the report is a short section that summarizes the views of interested parties. The views summarized include those provided directly to the Commission in the form of written statements or in the form of testimony at the Commission's public hearing. Also included as views of interested parties are summaries of the Industry Trade Advisory Committee and Agricultural Technical Advisory Committee reports, summaries of relevant recent testimony on the FTA before the Office of the U.S. Trade Representative and before the House Committee on Ways and Means, and, where appropriate, summaries of recent positions on the FTA of industry and other groups posted on Web sites or otherwise publicly available.

The Commission also assessed the impact of the FTA's trade facilitation provisions (e.g., customs administration, technical barriers to trade, and electronic commerce) and regulatory environment provisions (e.g., government procurement, investment, competition policy, intellectual property rights, labor, and dispute settlement). The impact of these provisions were not quantified because of limited data availability; however, these provisions can affect U.S. GDP, exports and imports, employment, production, and consumers, by reducing costs, increasing the variety of goods and services, or improving producers' competitiveness.

Data and other information for the study were obtained from a number of sources, including written submissions received in response to the Commission's *Federal Register* notices announcing institution of the investigation and the public hearing,<sup>6</sup> testimony at the public hearing held by the Commission in connection with this investigation,<sup>7</sup> industry reports, official reports of the trade advisory committees, interviews with government and industry contacts, and studies conducted by research institutions. Other sources include the U.S. Department of Agriculture, the U.S. Department of Commerce, the U.S. Department of State, the Office of the United States Trade Representative, the World Trade Organization (WTO), the Global Trade Analysis Project (GTAP) database, and the Global Trade Information Services database.

## **U.S.-Korea FTA Overview**

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Like other free trade agreements (FTAs) to which the United States is a party,<sup>8</sup> the proposed agreement with the Republic of Korea (Korea) would create a bilateral preferential regime

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<sup>5</sup> The Commission estimated the tariff rate equivalent in Korea's banking sector consistent with commitments under the FTA. This analysis is described in chap. 4 and in app. H of this report.

<sup>6</sup> Copies of the *Federal Register* notices are in app. B of this report.

<sup>7</sup> The Commission held a public hearing for this investigation on June 20, 2007. A calendar of the hearing is included in app. C of this report, and a summary of hearing testimony and written submissions is provided in chap. 7 of this report.

<sup>8</sup> To date, the United States has implemented FTAs with Israel, Canada, Mexico, Jordan, Singapore, Chile, Australia, Morocco, Central America and Dominican Republic (as of the date of this report, Costa Rica has not implemented CAFTA-DR), and Bahrain. The U.S. Congress has approved implementing legislation for an FTA with Oman, but the agreement has not entered into force. FTAs between the United States and Peru, Colombia, and Panama have been signed but not yet approved by Congress.



with a specific, negotiated range of goods and services measures and with commitments covering other trade-related matters. Under this FTA, duties on categories of originating goods would be phased out over periods of up to 20 years, with certain goods not afforded any duty reduction.<sup>9</sup> It would also reiterate existing commitments on matters covered by the WTO regime or by other international agreements, while setting new disciplines in a few areas. The FTA would not cover every aspect of bilateral trade or give preferences to all goods covered by any single tariff category, but would accord benefits to originating goods as provided under chapter 6 of the agreement (Rules of Origin and Origin Procedures) upon importer claim. This chapter's rules of origin indicate the range of goods that would be provided special tariff treatment, while other goods would continue to be covered by ordinary tariff provisions. Certain agricultural products would be subject to TRQs controlling duty-free access for specific time periods; volume-based agricultural safeguards would be allowed under set procedures. Certain goods are subject to TRQs that are not eliminated, but rather the in-quota, duty-free quantities would be increased by 3 percent per year.<sup>10</sup> Among the FTA's objectives, the preamble states that a free trade area will create an expanded and secure market for goods and services, set clear and mutually advantageous rules to govern trade and investment, end barriers to trade and investment, and achieve labor and environmental objectives.

The text of the FTA is largely modeled on other recent U.S. FTAs, such as the U.S.-Central America-Dominican Republic and U.S.-Singapore FTAs. The agreement sets out general disciplines that apply to the parties and contains separate commitments of each party set forth in schedules of concessions and various annexes on market access, rules of origin, services, and procurement. Some provisions draw upon multilateral instruments of the WTO or other international agreements, or state that the same obligations apply under this FTA. Such obligations would exist separately and would apply between the parties even if the corresponding provisions of the WTO or other agreement were eliminated. Some FTA commitments relate to specific aspects of trade relations between the parties, and confirmation letters provide the parties' mutual statement of understanding on particular matters. Appendix D provides a chapter-by-chapter summary of the text of the U.S.-Korea FTA. Table 1.1 identifies the chapters of the FTA and where they are analyzed in this report.<sup>11</sup>

## **U.S.-Korea Trade Overview**

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Korea is the United States' seventh-largest trading partner based on total trade. The U.S. merchandise trade balance with Korea moved from a \$2.9 billion surplus in 1996 to a \$20.1 billion deficit in 2004 before the deficit decreased to \$13.9 billion in 2006.<sup>12</sup> In 2005 (latest year available), U.S. service exports to Korea were approximately \$10.3 billion, and

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<sup>9</sup> Information on the tariff commitments of the United States and Korea is available in chap. 2 of this report.

<sup>10</sup> These quantity increases would be compounded annually in perpetuity.

<sup>11</sup> Summaries are not intended to interpret the text or to identify the negotiators' intent. Chapters of the FTA that address primarily administrative and legal matters (FTA chaps. 1, 23, and 24) are not further analyzed in this report other than in app. D. Other chapters of the FTA are summarized and/or analyzed in chaps. 2–6 of this report.

<sup>12</sup> Compiled from official statistics of the U.S. Department of Commerce.

**Table 1.1** U.S.-Korea FTA: Location of analysis of FTA chapters in the Commission's report<sup>a</sup>

FTA Chapter	Chapter of Commission's report where primarily analyzed or summarized
1. Initial Provisions and Definitions	Appendix D
2. National Treatment and Market Access for Goods	Chapters 2 and 3
3. Agriculture	Chapters 2 and 3
4. Textiles and Apparel	Chapters 2 and 3
5. Pharmaceuticals and Medical Devices	Chapters 2 and 3
6. Rules of Origin and Origin Procedures	Chapters 2 and 3
7. Customs Administration and Trade Facilitation	Chapter 5
8. Sanitary and Phytosanitary Measures	Chapter 5
9. Technical Barriers to Trade	Chapter 5
10. Trade Remedies	Chapter 6
11. Investment	Chapter 6
12. Cross-Border Trade in Services	Chapter 4
13. Financial Services	Chapter 4
14. Telecommunications	Chapter 4
15. Electronic Commerce	Chapter 5
16. Competition-Related Matters	Chapter 6
17. Government Procurement	Chapter 6
18. Intellectual Property Rights	Chapter 6
19. Labor	Chapter 6
20. Environment	Chapter 6
21. Transparency	Chapter 6
22. Institutional Provisions and Dispute Settlement	Chapter 6
23. Exceptions	Appendix D
24. Final Provisions	Appendix D
Annex I: Nonconforming Measures for Services and Investment	Chapters 4 and 6
Annex II: Nonconforming Measures for Services and Investment	Chapters 4 and 6
Annex III: Nonconforming Measures for Financial Services	Chapters 4 and 6

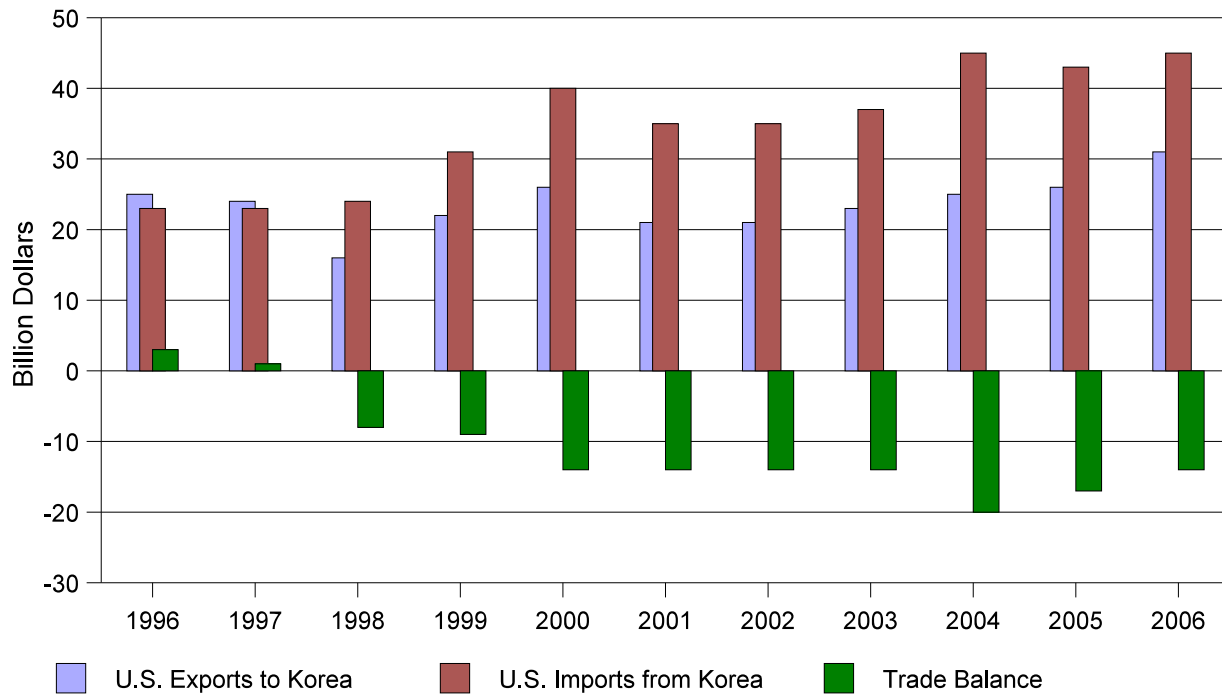
<sup>a</sup>Chaps. 1, 23, and 24 of the U.S.-Korea FTA address primarily administrative and legal matters with respect to the agreement, and, hence, are summarized in app. D, but not analyzed in this report.

U.S. service imports from Korea were \$6.3 billion. Total bilateral services trade increased 39 percent from 2000 to 2005.<sup>1</sup>

### U.S. Merchandise Exports

U.S. merchandise exports to Korea were valued at \$30.8 billion in 2006, and Korea accounted for 3.3 percent of total U.S. exports of \$929.5 billion in 2006. U.S. exports to Korea have increased at a compound annual rate of approximately 2 percent since 1996, and at a compound annual rate of approximately 8 percent since 2001 (figure 1.1). Appendix table E.1 shows the leading U.S. exports to Korea in 2006. Digital integrated circuits ranked as the single largest U.S. export to Korea in 2006, with exports valued at \$3.2 billion. Other leading exports to Korea were large civil aircraft, certain miscellaneous appliances and machinery, aircraft parts, and corn (other than seed corn). Table 1.2 summarizes Korea's most favored nation (MFN) ad valorem tariff rates faced by imports from the United States. This table shows that only 13 percent of tariff lines have free rates of duty, and the majority of tariff lines have rates ranging from 5 to 10 percent ad valorem. Approximately 14 percent have rates greater than 10 percent, with a small number (approximately 1 percent) having rates in excess of 100 percent.

Figure 1.1 U.S. merchandise trade with Korea, 1996–2006



Source: Compiled from official statistics of the U.S. Department of Commerce.

<sup>1</sup> USDOC, BEA, *Survey of Current Business*, October 2006, Table 2: Summary data for private service trade by area and country.

**Table 1.2** Korean tariff rates on imports from the United States

MFN ad valorem rate (percent)	Number of tariff lines	Share of total tariff lines (percent)
0	1,498	13.3
>0 to 5	1,267	11.2
>5 to 10	6,905	61.3
>10 to 25	1,013	9.0
>25 to 100	451	4.0
>100 to 500	82	0.7
>500	46	0.4
Total	11,262	100.0

Source: USTR, "Final - United States - Korea FTA Texts," 2007, Korean Tariff Schedule; and USITC staff calculations.

Note: Does not include tariff lines with missing data (less than 1 percent of tariff lines). If both percent values and specific rates were included, percent rates were used. Values may not sum to totals shown because of rounding.

### ***U.S. Merchandise Imports***

U.S. merchandise imports from Korea were valued at \$44.7 billion in 2006, ranking Korea as the seventh-largest U.S. import source. Korea accounted for approximately 2.4 percent of the \$1.8 trillion in total U.S. imports in 2006. U.S. imports from Korea have increased at a compound annual rate of approximately 7 percent since 1996, and at a compound annual rate of approximately 5 percent since 2001. In 2006, approximately one-half of U.S. imports from Korea (51 percent, by value) entered the United States free of duty. The trade-weighted average duty on all U.S. imports from Korea was 1.8 percent (3.7 percent on dutiable imports only). Appendix table E.2 shows the leading U.S. imports from Korea in 2006. Gas-powered passenger vehicles with engines between 1,500 and 3,000 cc ranked as the single largest U.S. import from Korea in 2006, with imports valued at \$6.1 billion. Other leading imports from Korea were "transmission apparatus incorporating reception" (including transceivers and cell phones), integrated circuits, certain computer parts, and distillate and residual fuel oils. Table 1.3 summarizes U.S. tariff rates on imports from Korea. Almost 30 percent of tariff lines have free rates of duty; 61 percent have rates of duty less than 5 percent; and less than 4 percent have rates that exceed 25 percent.

**Table 1.3** U.S. tariff rates on imports from Korea

MFN ad valorem rate (percent)	Number of tariff lines	Percent of total tariff lines
0	7,255	28.6
>0 to 5	8,199	32.4
>5 to 10	6,571	25.9
>10 to 25	2,421	9.6
>25	891	3.5
Total	25,337	100.0

*Source:* Compiled from official statistics of the U.S. Department of Commerce; and USITC staff calculations.

*Note:* Does not include tariff lines without AVE percent values (approximately 7 percent of tariff lines). Values may not sum to totals shown because of rounding.

## FTA Tariff Commitments

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The FTA will eliminate duties on a wide range of the partner countries' originating goods immediately, while phasing out duties on other originating goods over differing transition periods and providing for preferential TRQs on certain sensitive (primarily agricultural) goods. The U.S. and Korean tariff schedules (with annexes and notes) cover all goods. Table 1.4 summarizes the U.S. and Korean tariff commitments.<sup>13</sup> Whereas 38 percent (based on data different from table 1.3) of the U.S. tariff lines are already free of duty,<sup>14</sup> only 13 percent are so for Korea. Of the more than 10,600 U.S. and 11,200 Korean tariff lines, approximately 82 percent of U.S. tariff lines and approximately 80 percent of Korean tariff lines would have free rates of duty (currently and immediately free of duty) upon entry into force of the FTA. Approximately 93 percent of U.S. tariff lines and 92 percent of Korean tariff lines would have free rates of duty after 5 years; and approximately 99 percent of U.S. tariff lines and 98 percent of Korean tariff lines would have free rates of duty by year 10.

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<sup>13</sup> The market access provisions of the FTA—chap. 2 (national treatment and market access for goods), chap. 3 (agriculture), chap. 4 (textiles and apparel), chap. 5 (pharmaceuticals and medical devices), and chap. 6 (rules of origin)—are summarized in app. D of this report.

<sup>14</sup> Whereas table 1.3 is based on tariff schedules and information from the U.S. Department of Commerce, which include MFN ad valorem duty rates, table 1.4 is based on the U.S. tariff schedule included in the U.S.-Korea FTA, which does not contain MFN ad valorem rates for every tariff line. These different sources of tariff rate data also result in a differing total number of tariff lines.

**Table 1.4 U.S.-Korea FTA: Summary of tariff commitments**

Staging	U.S. commitments		Korea commitments	
	Number of lines	Percent <sup>a</sup>	Number of lines	Percent <sup>a</sup>
Already duty free (MFN)	3,990 included in 97 HS chapters	37.5	1,498 included in 30 HS chapters	13.3
Immediately duty free	4,761 included in 90 HS chapters	44.7	7,572 included in 92 HS chapters	67.1
2-year linear	10 included in HS chapters 08, 15, 17, 19, 20, 21, and 24	0.1	6 included in HS chapters 08, 12, and 21 (avocados, lemons, prunes, sunflower seeds, and dairy)	0.1
3-year linear	360 included in 27 HS chapters	3.4	760 included in 48 HS chapters	6.7
5-year linear	746 included in 52 HS chapters	7.0	511 included in 48 HS chapters	4.5
6-year linear	1 included in HS chapter 08 (walnuts)	0.0	2 included in HS chapters 08 and 15 (walnuts and vegetable oil)	0.0
7-year linear	91 included in 11 HS chapters	0.9	41 included in 13 HS chapters	0.4
9-year linear	None	—	1 included in HS chapter 08 (strawberries)	0.0
10-year linear and nonlinear	561 included in 42 HS chapters	5.3	657 included in 42 HS chapters	5.8
Duty free in year 2014	None	—	21 included in HS chapters 02 and 16 (meat and meat products)	0.2
Duty free in year 10	1 included in HS chapter 98 (articles of metal processed in the United States, exported for further processing, and re-exported to the United States)	0.0	None	—
12-year linear and nonlinear	17 included in HS chapter 64 (footwear)	0.2	35 included in 35 HS chapters	0.3
15-year linear	65 included in HS chapters 02, 04, 10, and 19 (bovine meat, milk and cream, buttermilk, whey, cheese, rice, and malt extract)	0.6	100 included in 17 HS chapters	0.9
16-year nonlinear	None	—	2 included in HS chapter 17 (sugar)	0.0
18-year linear	None	—	3 included in HS chapter 12 (ginseng products)	0.0
20-year linear	None	—	2 included in HS chapter 08 (apples and pears)	0.0
Seasonal	None	—	2 included in HS chapters 07 and 08 (potatoes and grapes — up to 17 years)	0.0
Free without bond	17 included in HS chapter 98	0.2	None	—
Tariff-rate quotas	26 included in HS chapters 04, 15, 17, 18, 19, 21, and 22 (dairy products)	0.2	50 included in HS chapters 03, 04, 07, 08, 10, 11, 12, 19, 23, and 35 (fish, dairy products, honey, potatoes, oranges, barley, corn starch, soybeans, ginseng, fodder, animal feeds, and dextrins)	0.4
No change in treatment	None	—	16 included in HS chapters 10, 11, 18, and 19 (rice and rice products)	0.1
Total tariff lines	10,646	100.0	11,279	100.0

Source: USTR, "Final - United States - Korea FTA Texts," 2007, "U.S. Tariff Schedule" and "Korea Tariff Schedule."

Note: Percent figures may not sum to 100 because of rounding. "Free without bond" means the items now duty-free under bond become duty-free without bond; i.e., importers are no longer required to post a bond for goods that will be re-exported (e.g., items imported for samples, repair, or exhibit).

<sup>a</sup>"0.0" indicates value less than 0.05 percent.

# CHAPTER 2

## Impact of Tariff- and Tariff-rate Quota-related Provisions on the U.S. Economy

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This chapter provides an estimate of the quantifiable impact of the fully-implemented U.S.-Korea FTA on the U.S. economy, exports, imports, and aggregate agriculture and manufacturing sectors.<sup>1</sup> To illustrate the likely impact of the U.S.-Korea FTA on the United States, an analysis was performed implementing the agreement's tariff and tariff-rate quota (TRQ) reductions in a computational simulation of the U.S. economy. To assess the relative importance of those products subject to immediate liberalization under the FTA, a separate analysis was performed for those products that are liberalized fully and immediately upon implementation of the FTA.

### Analytical Framework

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The Commission's analysis of the possible economy-wide effects of the removal of tariffs and TRQs under the FTA includes a number of measures of U.S. economic activity, including the possible impact on U.S. exports, imports, production, and employment. The lack of necessary data precludes the quantification of the impact of the FTA provisions relating to services, investment, labor, and environment. A qualitative assessment of the impact of these provisions is provided in chapters 4 to 6 of this report. The method chosen for the quantitative analysis is a computable general equilibrium (CGE) simulation. The specific CGE model used for this analysis is the Global Trade Analysis Project (GTAP) model, described more fully in appendix F.<sup>2</sup> The model includes domestic economic activity and trade patterns for the United States and Korea, as well as for multiple regions<sup>3</sup> of the world economy and for multiple products produced in those regional economies. The model describes production and trade in 54 aggregate industry sectors, including 40 merchandise sectors and 14 service sectors.<sup>4</sup>

The use of a CGE model permits the Commission to measure the possible incremental effect of the negotiated U.S.-Korea FTA tariff and quota reductions on exports and imports, aggregate economic sectors, and labor markets. The model estimates the effects of tariff- and TRQ-related provisions of the agreement on an economy that resembles the U.S. economy in 2008, when the agreement is anticipated to enter into effect. The standard GTAP model begins with data reflecting conditions in 2001; for the present analysis the standard model has been updated in two steps to reflect the 2008 economy. The model was first updated to reflect the state of the economy in 2005 (e.g., reflecting U.S. trade with major partners and

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<sup>1</sup> The analysis in this chapter is primarily based on chapters 2–5 of the U.S.-Korea FTA.

<sup>2</sup> The model variant employed in this report is similar to that used by other researchers who also use the GTAP model to assess the impact of the U.S.-Korea FTA on the U.S. economy. There are important differences in simulation structure between studies, however. This report analyzes the negotiated FTA, in contrast to other studies, which analyze a proposed or hypothetical FTA. The baseline data used in the Commission's model also more accurately reflect current data. See chap. 7 for a review of the literature.

<sup>3</sup> GTAP regions were aggregated to include, in addition to the United States and Korea, Canada, Chile, China, the EU, Japan, the Rest of Asia, Mexico, and the Rest of World.

<sup>4</sup> Chap. 3 provides an assessment of the effects at a more disaggregated level for selected sectors/products.

observed GDP for model regions). These 2005 values were then projected to 2008, when the FTA is estimated to take effect, based on current economic trends as described in appendix F. Consequently, the simulation results discussed below are relative to the estimated 2008 base, measured in 2005 dollars.

This analysis ties together many of the interrelated effects of the agreement. It shows, among other things, how prices of U.S. exports and imports change because of tariff and TRQ liberalization, how increased U.S. exports to Korea of some commodities are linked to increased U.S. imports, how industries that grow in response to increased export opportunities draw resources from other industries, and how all of these effects can be summarized in a measure of the net benefit (i.e., welfare) to the U.S. economy resulting from the agreement.

The model results are not intended as a forecast of what will happen to trade and output in 2008, or after full implementation of the FTA's tariff and TRQ liberalization schedules.<sup>5</sup> Rather, they are estimates of the marginal effect on the economy, relative to the constructed baseline, of the removal or reduction of tariffs and TRQs as specified in the FTA. For example, a negative effect, such as a decrease in a commodity price or decrease in a sector's output, does not imply that the overall value will be negative as a result of the FTA. Rather the marginal effect of the FTA would buttress or suppress existing economic trends, which may be positive or negative.<sup>6</sup> Additional information for interpreting the model results is presented in box 2.1. It is also important to note that model results reflect long-term adjustments of supply, demand, and resource allocations to the FTA. The model does not consider interim or phased effects that might be felt as different provisions of the agreement enter into force, nor does it consider various adjustment costs (such as temporary unemployment or changes in asset prices) that may occur over time.<sup>7</sup> The simulation results presented in this report are given as ranges.<sup>8</sup>

Korea's average ad valorem equivalent tariffs (AVE tariffs)<sup>9</sup> for manufacturing imports from the United States are typically less than 10 percent, although tariffs and TRQs on many U.S. agricultural and food products exceed 30 percent (figure 2.1). In contrast, most of the U.S. average AVEs for imports from Korea are less than 5 percent, with five sectors—dairy products (16.8 percent), wearing apparel (16.5 percent), textiles (11.0 percent), sugar (8.8 percent), and paddy and processed rice (7.5 percent)—exceeding 5 percent.

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<sup>5</sup> For a summary of the tariff and TRQ liberalization schedules, see chap. 1 of this report.

<sup>6</sup> In addition, the model results presented in the discussion below depend on a wide array of assumptions about the economic structure and relationship of variables (parameters that reflect how consumers and producers respond to price changes) in the model. Altering these variables, and the underlying assumptions they reflect, changes the resulting estimated effects accordingly, as shown by the sensitivity analysis conducted in this report.

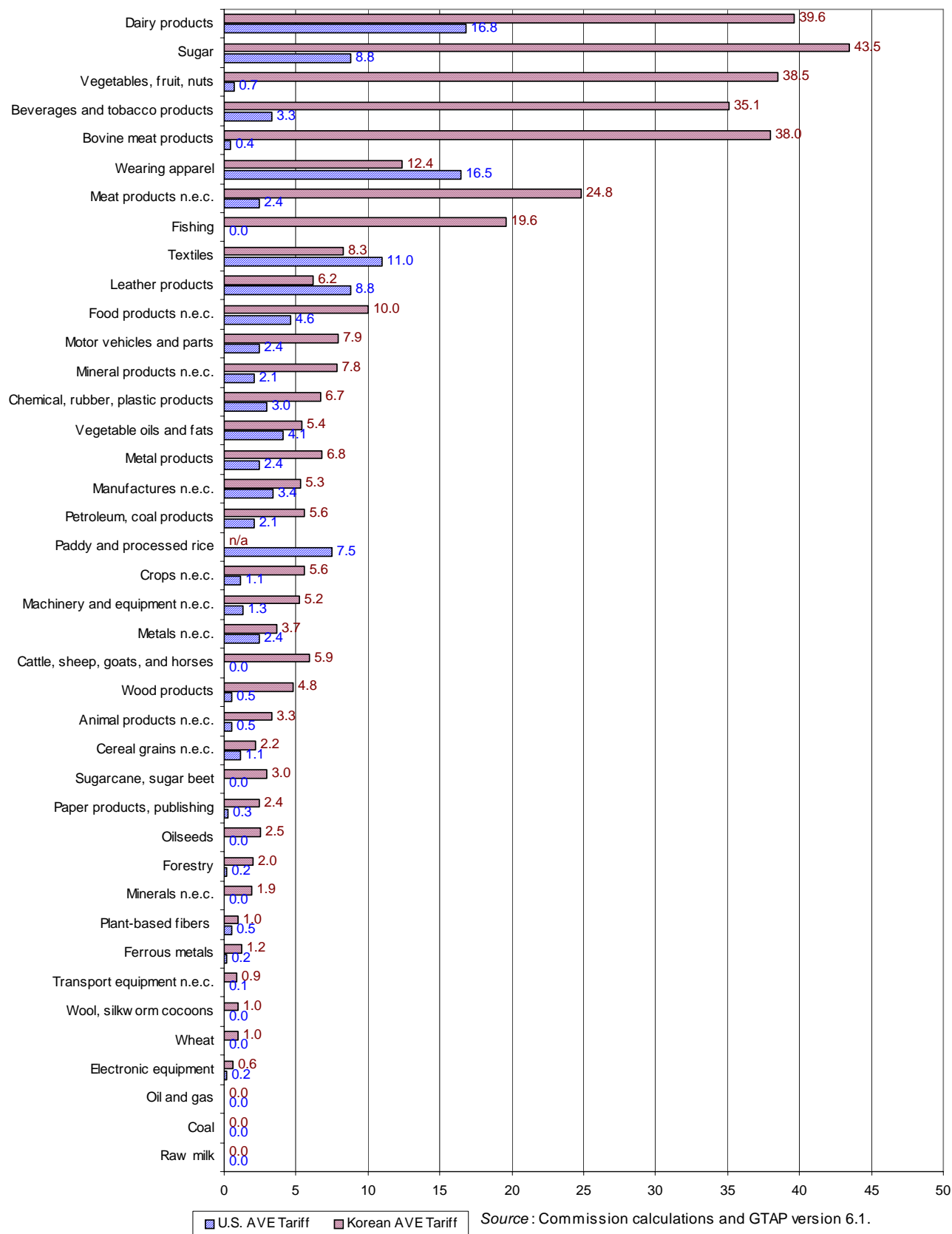
<sup>7</sup> See chap. 3 of this report, which discusses short- and medium-term effects for certain selected products.

<sup>8</sup> These ranges are established by conducting systematic sensitivity analysis using the simulation framework and information from the econometric estimates of a key model parameter, the elasticity of substitution between foreign and domestic varieties, also known as the Armington elasticity. This technique yields estimates of the mean and standard deviation for reported model statistics. Ranges are established as  $\pm 2$  standard deviations of each reported result. A full discussion of this technique is found in app. F.

<sup>9</sup> The U.S. AVE tariffs for some Korean products such as vegetables, fruits, and dairy products include the estimated effects of TRQs. Korean AVE tariffs on some U.S. agricultural products include the effects of agricultural price support programs. Table 2.2 reports current average AVEs for aggregate industry sectors.



Figure 2.1 U.S.-Korea FTA: Bilateral GTAP sector benchmark ad valorem equivalent tariffs (percent)



### **Box 2.1** Interpreting the model results

The analysis uses an economic model that compares a depiction of a world in equilibrium without a U.S.-Korea FTA to a world in equilibrium with the FTA. The latter situation is a world in which the removal of tariffs and TRQs under the FTA is fully implemented, all markets have fully adjusted to it, and all other things are held equal.

The Commission employs a comparative static model that does not show the adjustment path the economy might take in moving from the pre-FTA condition to the post-FTA condition, but that portrays the effects of full tariff and TRQ liberalization under the FTA relative to the projected state of the economy before liberalization in 2008. It maintains a balance in the factors of production—labor, capital, and natural resources—so that if some sectors expand and need more labor, other sectors must contract and release that much labor. In contrast, in the real world there is a dynamic process of adjustment to the policy changes inherent in a trade agreement. In growing economies, the expansion of certain sectors does not require the absolute contractions of other sectors, and the overall supply of labor may increase or resources may remain unemployed.

In addition, the model's depiction of industry sectors is highly aggregated—for example, it does not portray sufficient detail to show the man-made fiber fabrics industry (which is part of “textiles”). Nor does it incorporate the myriad of world events or economic trends that could counter or enhance the estimated effects of this analysis. For instance, it does not take into account the effect of increasing demand on commodity markets, changes in interest rates, or other factors that may affect the expansion or contraction of sectors.

Results identified in the analysis are illustrative. They are useful for showing the direction of sectoral change and factor movement in a world in which trade policy changes and in which these changes work their way through the interlinked sectors of the economy. The results are not a forecast of what will actually occur. They are best interpreted in the context of actual domestic and international economic trends. For example, the reduction of Korean tariffs on U.S. goods means Korea will import more from the United States. To pay for this, Korea must acquire more foreign exchange. It must either borrow more (or receive more foreign investment) or it must export more to earn foreign currency. The simulation model, focused on trade, assumes most of the foreign exchange comes from increased exports. Furthermore, much of the increase in Korea's imports from the United States comes as imports are diverted from other countries that do not receive the preferential liberalization of duties on their products in the Korean market. These products, formerly imported by Korea, must find new buyers in the world market and exert downward pressure on their world market prices. The model captures this price effect and, untouched by actual global trends, calculates the effect of a drop in world prices on U.S. imports.

The effect of removing import barriers related to services was not estimated in this simulation due to the lack of necessary data. The reported changes in trade and output in services arise from secondary (general equilibrium) effects, including trade balance effects, changes in demand for services by other sectors, and changes in supply of services resulting from the reallocation of labor and capital resources to other sectors that are growing more strongly as a result of the policy changes. Thus, while the reported results for service sectors reflect effects of some parts of the FTA, they are indirect effects, and do not result from FTA-negotiated policy changes in services trade. A detailed discussion of the changes in trade in services that might be expected from provisions of the FTA is presented in chapter 4 of this report. Similarly, the model analysis presented in this section does not consider effects of all provisions of the FTA discussed elsewhere in this report; for example, it does not consider changes in the investment or regulatory environments in Korea because of the lack of data on the scope of these changes that can be incorporated into the model. Hence, a qualitative assessment of these chapters of the FTA is provided in chapters 5 and 6 of this report.

The specific policy assumptions are that the bilateral AVEs<sup>10</sup> are all reduced to zero (i.e., free of duty), with certain exceptions. No change in quantity traded is anticipated in products that fall within the rice sector, the raw milk sector, the sugarcane and sugar beet sector, or the manufactured sugar sector.<sup>11</sup> In addition, as U.S. exports of oranges to Korea do not experience full liberalization because of the ongoing seasonal orange TRQ in the FTA, the Korea AVE tariffs in the vegetable, fruits, and nuts sector declines from an initial 38.5 percent to 6.7 percent rather than to zero. To isolate the effect of FTA tariff reductions on beef trade from the effects of SPS issues, U.S.-Korea beef trade is based on 2003 data, the most recent year of normalized trade prior to the Korean ban on beef imports from the United States. This assumption allows for an estimate that measures the potential changes in trade based solely on the removal of tariffs resulting from implementation of the FTA, and assumes no significant SPS measures that would restrict access to the Korean market.<sup>12</sup> Lastly, Korean liberalization with respect to motor vehicles also includes the reduction of the excise tax on automobiles with an engine displacement over 2,000 cubic centimeters (cc).<sup>13</sup> The tax, currently 10 percent, is expected to decline to 5 percent. Although the reduction is included in the FTA, it would apply to all producers; consequently, this change is implemented for all suppliers to the Korean market, including the United States and domestic Korean producers, prorated based on market share across the motor vehicles and parts sector.<sup>14</sup>

## Simulation Results<sup>15</sup>

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Table 2.1 presents the simulated gross domestic product (GDP) and welfare effects of tariff and TRQ elimination or liberalization under the fully implemented FTA relative to the projected 2008 baseline economy.<sup>16</sup> As a result of tariff and TRQ removal or liberalizations, U.S. GDP is expected to be higher by approximately \$10.1–11.9 billion (or by about

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<sup>10</sup> See table 2.2 for a list of the AVE tariffs.

<sup>11</sup> The agreement provides for no change in the treatment of rice and rice products; products within the model's raw milk sector and within the sugarcane and sugar beet sector are effectively not traded between the United States and Korea, and Commission staff have determined that no substantial change in manufactured sugar trade is expected as a result of the agreement.

<sup>12</sup> See the analysis of meat products in chap. 3 for additional information on U.S.-Korea beef trade and related SPS issues. The ability of the industry to quickly attain 2003 export levels was confirmed by industry representatives. Truitt, testimony before the USITC, June 20, 2007, 223.

<sup>13</sup> See the analysis of passenger vehicles in chap. 3 for additional information on the implications of the agreement.

<sup>14</sup> See app. F for a full description of the model assumptions, updates, and modifications.

<sup>15</sup> Findings of the Commission's analysis are broadly consistent with those identified in other studies employing a similar model and scenario assumptions. See chap. 7 of this report for a literature review of relevant studies.

<sup>16</sup> GDP, the measure of all economic activity within a country, consists of private consumption, investment, government consumption, and net exports. GDP here is defined as nominal GDP, which takes into account both the price and quantity changes of its components. Welfare, on the other hand, summarizes the real (i.e., exclusive of price effects) value of present and deferred consumption. Welfare may be expressed as the sum of real private consumption, real government consumption, and real net savings. Increases in the prices of consumption or investment will lead to an increase in GDP, but not in welfare. A decline in the depreciation rate of capital with no corresponding change in current investment will cause no change in nominal GDP, but will increase welfare as net savings (real current investment less depreciation) increases. These examples emphasize the difference in these two measures: GDP captures the nominal value of all economic activity within the country, while welfare measures consumers' benefit from economic activity at constant real prices.

**Table 2.1** U.S.-Korea FTA: Simulated effects of trade liberalization on U.S. GDP and welfare from a projected 2008 baseline

Indicator	Change from 2008 baseline	
	Million dollars	Percent of GDP
GDP	10,092 to 11,883	0.1 to 0.1
Payments to factors		
Land	409 to 692	0.6 to 1.0
Unskilled labor	2,674 to 3,119	0.1 to 0.1
Skilled labor	1,785 to 2,027	0.1 to 0.1
Capital	3,932 to 4,497	0.1 to 0.1
Natural resources	-71 to 0	-0.0 to 0.0
Welfare	1,785 to 2,070	0.0 to 0.0
Efficiency	44 to 67	0.0 to 0.0
Changes in the price of capital goods	450 to 528	0.0 to 0.0
Terms of trade (relative price of imports to exports)	1,282 to 1,483	0.0 to 0.0

Source: Commission calculations and GTAP version 6.1.

Note: Zero values indicate values less than 0.05 percent in absolute value. The difference between the sum of payments to factors and GDP is due to changes in net tax payments.

0.1 percent).<sup>17</sup> As shown in table 2.1, this increase in GDP represents primarily the increase in the returns to capital and labor. Payments in the United States to land owners are higher by \$409–692 million than in the 2008 baseline, an increase of about 0.5–1.0 percent (mainly reflecting the increase in agricultural production, shown below, especially cattle, bovine meat products, and other animal products, which use land more intensively directly and indirectly in their demand for various cereal and grain products). Payments to unskilled labor and skilled labor are higher by \$2.7–3.1 billion and \$1.8–2.0 billion, respectively. The agricultural sectors that are favored by the agreement use proportionately greater amounts of unskilled labor, hence contributing to the relatively greater gains. Payments to capital owners are higher by \$3.9–4.5 billion. Payments to natural resource owners are lower by \$71 million to near zero, reflecting a slight decline in output for oil and gas.<sup>18</sup>

The change in economic welfare provides a measure of the comprehensive effect of the simulated FTA. It summarizes the benefits to consumers, as well as the effects on households in their roles as providers of labor, owners of capital, and taxpayers. The Commission simulation estimates the welfare value to the United States of tariff and TRQ elimination or liberalization under the FTA to be \$1.8–2.1 billion, less than 0.05 percent of projected U.S. GDP. This effect can be interpreted as stating that, when fully implemented, the removal of tariffs and TRQs specified in the FTA will provide annual benefits to U.S. consumers worth \$1.8–2.1 billion in the economy of 2008.<sup>19</sup> The analysis decomposes the change in welfare into changes resulting from efficiency gains, changes in the price of capital goods, and changes resulting from the relative price of imports and exports.<sup>20</sup> Efficiency gains are the gains to the economy as a result of removing distortions imposed by taxes, tariffs, or subsidies on particular activities, which cause those activities to be engaged in or avoided

<sup>17</sup> The difference between GDP and welfare estimates reflects the substantial component of price changes in the GDP measure. Real GDP change is equal to allocative efficiency; the remainder of the difference is attributable to changes in the prices of components of GDP.

<sup>18</sup> The factor of production “natural resources” is employed in five sectors of the model: forestry, fishing, coal, oil and gas, and other mineral products.

<sup>19</sup> This welfare measure is often referred to as the “equivalent variation.”

<sup>20</sup> This effect is known as a “terms-of-trade effect.”

in ways that are economically inefficient. The model finds a small allocative efficiency gain, a relatively larger gain due to appreciation of U.S. capital goods, and the largest gain due to improvement in U.S. terms of trade.

The model estimates an approximate total welfare gain of \$1.3–1.5 billion stemming from changes in the relative prices of total U.S. exports and imports. A gain means that the trade-weighted average price of a country's exports increases relative to the trade-weighted average price of its imports. In this case, this effect is a result of a slight upward pressure on the prices of products exported by the United States, as a result of increased demand from Korea. Three sectors—machinery and equipment not elsewhere classified (n.e.c.); chemical, rubber, and plastic products; and business services n.e.c.—represent one-third of terms-of-trade gains. The sourcing shift of the United States and Korea toward one another and away from the rest of the world as a result of the FTA places downward pressure on rest of world export prices due to the reduced demand for rest of world exports, hence reducing U.S. import prices and improving the U.S. terms of trade.

### ***Estimated Changes in Trade Flows***

The tariff asymmetry between the United States and Korea suggests that the FTA is likely to result in a greater percentage increase in U.S. exports to Korea (because of the effect of lowering Korea's relatively higher trade barriers) than in U.S. imports from Korea (because the U.S. economy is relatively more open to Korea's imports).

Table 2.2 and figure 2.2 show the simulated changes in U.S. exports (free-on-board basis [f.o.b.]) to Korea as a result of the immediate removal of the tariffs and TRQs specified in the FTA. The trade effects are reported relative to the projected 2008 base, which is exclusive of any Korean tariffs. In general, the sectors facing the highest Korean tariffs (such as dairy; meat products; bovine meat products (beef); textiles and apparel; and vegetables, fruit, and nuts) or having large pre-existing trade volumes (such as machinery and equipment; chemical, rubber, and plastic products; electronic equipment; and transport equipment) are the ones that would experience the greatest percentage and value changes from the elimination of tariffs and TRQs under the FTA.

**Table 2.2 U.S.-Korea FTA: Simulated effects on U.S.-Korea bilateral trade from a projected 2008 baseline**

GTAP sector	U.S. exports to Korea (f.o.b.) <sup>a</sup>						U.S. imports from Korea (LDP) <sup>a</sup>					
	Benchmark		Change after FTA				Benchmark		Change after FTA			
	Base before FTA	Korean AVE tariff	Low		High		Base before FTA	U.S. AVE tariff	Low		High	
	Million dollars	Percent	Million dollars	Percent	Million dollars	Percent	Million dollars	Percent	Million dollars	Percent	Million dollars	Percent
Paddy and processed rice <sup>b</sup>	16	n/a	0	0	0.1	0.1	0	7.5	0	0	0.0	0.1
Wheat	191	1.0	-5	9	-2.9	4.9	0	0.0	0	0	-0.6	23.9
Cereal grains n.e.c.	291	2.2	-4	18	-1.5	6.1	1	1.1	0	0	-1.3	12.1
Vegetables, fruit, nuts	285	38.5	150	248	52.7	87.2	46	0.7	2	4	4.0	9.8
Oilseeds	236	2.5	12	25	4.9	10.5	1	0.0	0	0	3.8	11.7
Sugarcane, sugar beet	0	3.0	0	0	0.2	0.3	0	0.0	0	0	-0.1	-0.1
Plant-based fibers	195	1.0	11	26	5.6	13.1	0	0.5	0	0	-0.6	14.0
Crops n.e.c.	137	5.6	37	51	27.2	37.1	22	1.1	2	4	10.9	17.4
Cattle, sheep, goats, and horses	2	5.9	0	1	9.1	26.5	0	0.0	0	0	3.0	10.6
Animal products n.e.c.	464	3.3	55	72	11.9	15.5	2	0.5	0	0	2.2	5.3
Raw milk	0	0.0	0	0	0.1	0.2	0	0.0	0	0	0.1	0.1
Wool, silkworm cocoons	0	1.0	0	0	11.9	22.5	0	0.0	0	0	4.7	13.5
Forestry	144	2.0	9	16	6.0	10.9	3	0.2	0	0	1.6	3.9
Fishing	24	19.6	5	20	22.2	82.7	26	0.0	0	1	0.3	2.7
Coal	739	0.0	1	1	0.1	0.2	0	0.0	0	0	-0.3	-0.1
Oil and gas	10	0.0	0	0	-0.2	0.0	0	0.0	0	0	-0.1	0.0
Minerals n.e.c.	250	1.9	4	10	1.8	3.9	6	0.0	0	0	0.0	0.0
Bovine meat products <sup>c</sup>	1,084	38.0	628	1,792	57.9	165.3	7	0.4	0	2	2.1	26.3
Meat products n.e.c.	301	24.8	456	763	151.4	253.5	16	2.4	4	8	24.4	47.6
Vegetable oils and fats	19	5.4	4	6	19.5	32.6	1	4.1	0	0	25.6	46.6
Dairy products	70	39.6	175	336	249.1	477.6	4	16.8	4	11	107.1	258.0
Sugar	1	43.5	0	0	-1.9	0.8	4	8.8	0	0	0.0	0.0
Food products n.e.c.	903	10.0	333	377	36.9	41.7	257	4.6	38	44	14.7	17.2
Beverages and tobacco products	42	35.1	26	55	62.4	129.8	75	3.3	2	5	2.4	6.8
Textiles	153	8.3	130	140	85.2	91.7	1,958	11.0	1,692	1,842	86.4	94.1
Wearing apparel	31	12.4	39	45	125.0	146.5	700	16.5	1,012	1,222	144.6	174.6
Leather products	113	6.2	60	71	52.8	62.9	78	8.8	81	104	103.7	132.6
Wood products	99	4.8	33	38	33.5	38.3	136	0.5	3	3	2.1	2.5
Paper products, publishing	647	2.4	79	91	12.2	14.0	1,127	0.3	8	11	0.7	0.9
Petroleum, coal products	545	5.6	0	1	0.0	0.1	931	2.1	19	109	2.0	11.7
Chemical, rubber, plastic products	6,552	6.7	2,725	2,926	41.6	44.7	3,890	3.0	693	753	17.8	19.3
Mineral products n.e.c.	323	7.8	155	183	48.0	56.6	212	2.1	19	22	8.8	10.5
Ferrous metals	667	1.2	39	48	5.8	7.2	1,812	0.2	2	5	0.1	0.2
Metals n.e.c.	798	3.7	234	292	29.3	36.6	284	2.4	47	60	16.6	21.1
Metal products	222	6.8	122	139	55.2	62.8	1,471	2.4	201	230	13.7	15.6
Motor vehicles and parts	647	7.9	294	381	45.5	58.9	14,495	2.4	1,324	1,737	9.1	12.0

2-8

See footnote(s) at end of table.

**Table 2.2** U.S.-Korea FTA: Simulated effects on U.S.-Korea bilateral trade from a projected 2008 baseline—*Continued*

GTAP sector	U.S. exports to Korea (f.o.b.) <sup>a</sup>						U.S. imports from Korea (LDP) <sup>a</sup>					
	Base before FTA		Benchmark Korean AVE tariff		Change after FTA		Base before FTA		Benchmark U.S. AVE tariff		Change after FTA	
	Million dollars	Percent	Million dollars		Percent		Million dollars	Percent	Million dollars		Percent	
			Low	High	Low	High			Low	High	Low	High
Transport equipment n.e.c.	2,582	0.9	140	167	5.4	6.5	1,439	0.1	-16	-11	-1.1	-0.7
Electronic equipment	5,529	0.6	212	231	3.8	4.2	17,900	0.2	182	229	1.0	1.3
Machinery and equipment n.e.c.	7,786	5.2	2,774	2,939	35.6	37.7	8,501	1.3	715	769	8.4	9.0
Manufactures n.e.c.	190	5.3	78	88	40.9	46.2	518	3.4	109	125	21.1	24.1
Other sectors	10,898	0.0	14	23	0.1	0.2	8,673	0.0	-86	-73	-1.0	-0.8
Total <sup>d</sup>	43,186	4.4	9,741	10,909	22.6	25.3	64,596	1.6	6,399	6,874	9.9	10.6

Source: Commission calculations and GTAP version 6.1.

Notes: Zero values for million dollars indicate values less than \$500,000. Zero values for percent indicate values less than ±0.05 percent. The abbreviation “n.e.c.” stands for “not elsewhere classified.” Differences in low and high percent values may be less than 0.05 percent.

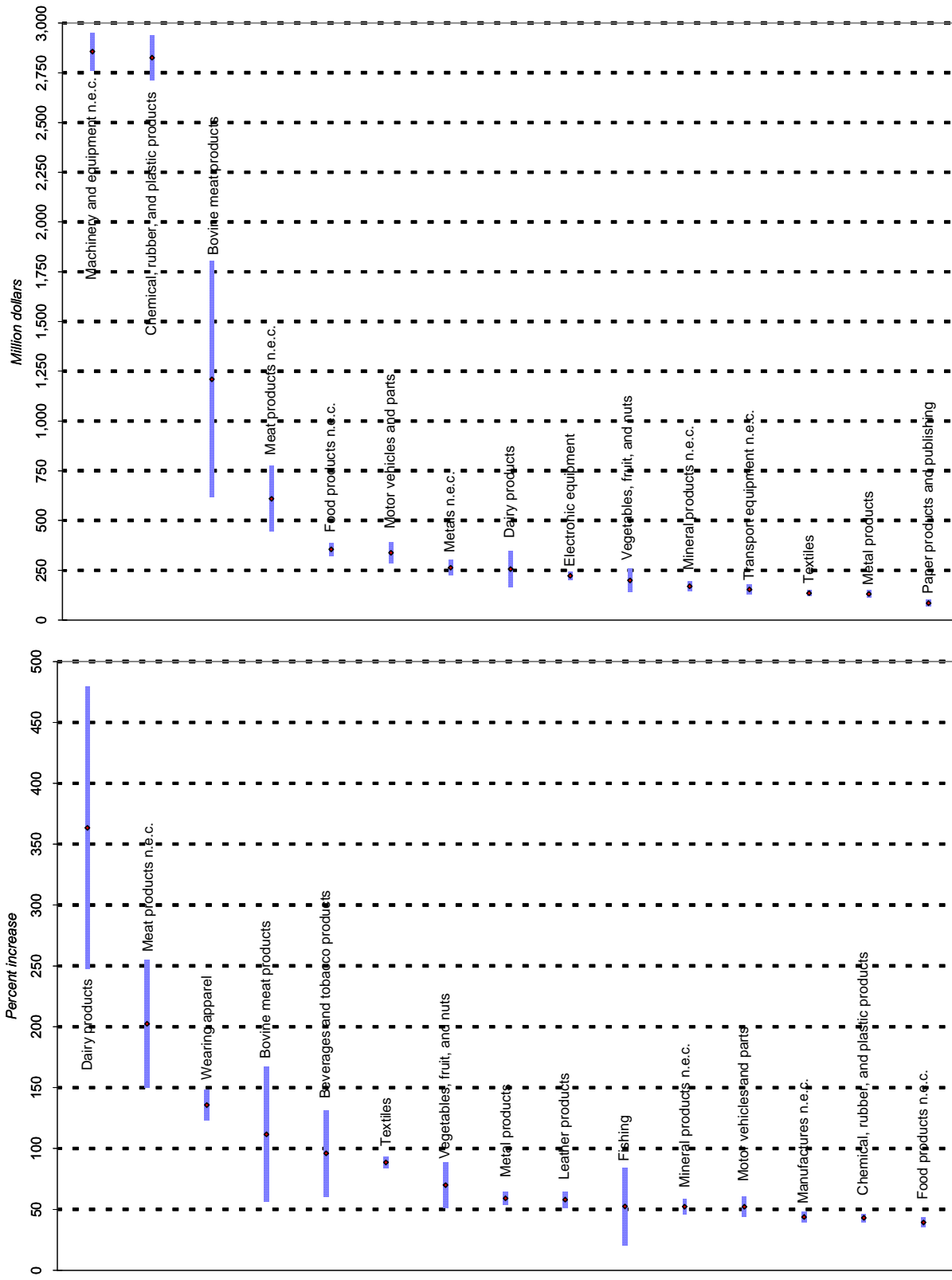
<sup>a</sup>Exports from the United States are on a free-on-board basis (f.o.b.). Imports into the United States are on a landed, duty-paid (LDP) basis.

<sup>b</sup>There is no change in treatment for the paddy and processed rice sector under the U.S.-Korea FTA.

<sup>c</sup>Base value for U.S. beef exports to Korea assumes full resumption of U.S. beef exports to Korea, based on 2003 (pre-bovine spongiform encephalopathy) values projected to 2008.

<sup>d</sup>Totals for ranges have been separately calculated and are not a summation of sectoral ranges. The ranges reflect statistically likely outcomes, and it is not likely that sector estimates will be simultaneously low or high.

**Figure 2.2 U.S.-Korea FTA: Simulated effects on U.S. exports to Korea in selected sectors, by percent and value change**

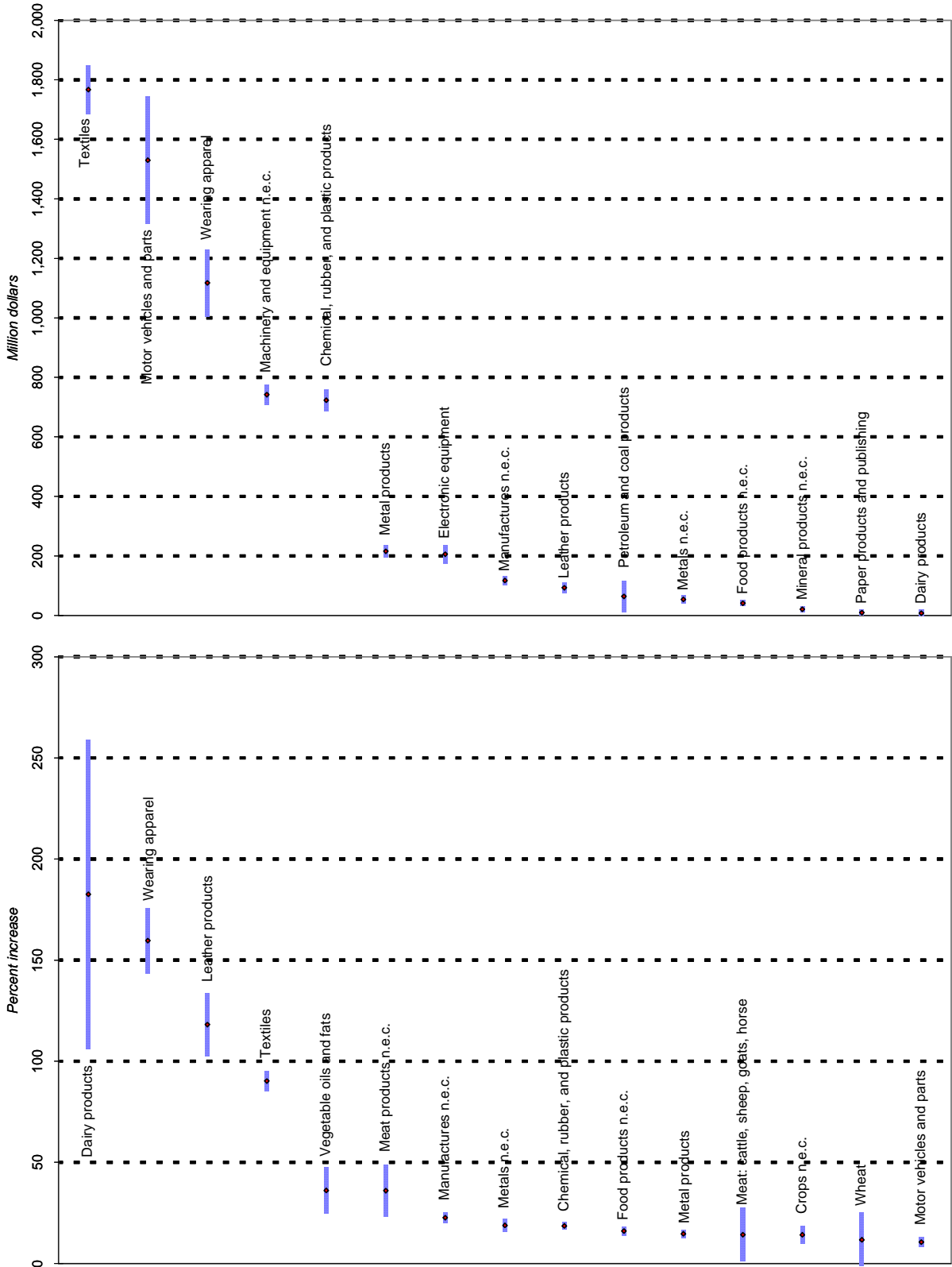


Source: Commission calculations and GTAP version 6.1.

Note: Sectors represented include the top 15 based on mean percent and value increases from a projected 2008 baseline. Point estimates represent mean values.



**Figure 2.3 U.S-Korea FTA: Simulated effects on U.S. imports from Korea in selected sectors, by percent and value change**



Source: Commission calculations and GTAP version 6.1.

Note: Sectors represented include the top 15 based on mean percent and value increases from a projected 2008 baseline. Point estimates represent mean values.

As shown in figure 2.2, the largest increases in U.S. exports to Korea, by percentage, are in dairy products (249–478 percent), other meat products (152–254 percent), wearing apparel (125–147 percent), bovine meat products (58–165 percent), and beverages and tobacco products (62–130 percent). These leading five sectors by percent change have Korean AVE tariffs ranging from 12.4 percent to 39.6 percent. The largest increases in U.S. exports to Korea, by value, are in machinery and equipment (\$2.8–2.9 billion); chemical, rubber, and plastic products (\$2.7–2.9 billion); bovine meat products (\$0.6–1.8 billion); other meat products (\$456–763 million); and food products n.e.c. (\$333–377 million). These leading five sectors by value change have base export values ranging from \$301 million to \$7.8 billion. As has been noted, in general, the high level of tariff and TRQ protection on many of Korea’s agricultural products suggests that the removal of tariffs under the FTA would have relatively large effects on U.S. exports to Korea of these products. In addition, the indirect impacts from product markets are the dominant component of change in some sectors. For example, the Korean tariff on U.S. wheat declines by 1.0 percent, but U.S. wheat exports to Korea could fall rather than rise, as other U.S. sectors benefitting from proportionately greater liberalization compete for land, labor, and capital, pulling these resources away from U.S. wheat producers.<sup>21</sup>

Table 2.2 and figure 2.3 show that the largest increases in U.S. imports (landed duty paid [LDP]) from Korea in percent terms would be dairy products (107–258 percent), wearing apparel (145–175 percent), leather products (104–133 percent), textiles (86–94 percent), and vegetable oils and fats (26–47 percent). These leading five sectors by percent change have U.S. AVE tariffs ranging from 4.1 percent to 16.8 percent. The largest increases in U.S. imports from Korea, by value, would be in textiles (\$1.7–1.8 billion); motor vehicles and parts (\$1.3–1.7 billion; predominantly motor vehicles);<sup>22</sup> wearing apparel (\$1.0–1.2 billion); machinery and equipment (\$715–769 million); and chemical, rubber, and plastic products (\$693–753 million). These leading five sectors by value change have pre-existing export base values ranging from \$700 million to \$14.5 billion. The substantial percentage and value increases in U.S. imports of textiles and wearing apparel from Korea are driven by the removal of relatively high tariffs (11.0 percent and 16.5 percent, respectively) on initial imports of \$2.0 billion of textiles and \$700 million of wearing apparel. The large value increases in imports of Korean motor vehicles and parts and Korean machinery and equipment stem from the removal of relatively small tariffs (2.4 percent and 1.3 percent, respectively) applied to much larger pre-existing trade flows (\$14.5 billion and \$8.5 billion, respectively).

The effect of the removal of the tariffs and TRQs specified in the U.S.-Korea FTA on U.S. global trade by sector is reported in table 2.3. For many sectors, a large portion of the increase in imports from Korea is the result of trade diversion from other countries. For example, total U.S. imports from Korea increase by \$1.7–1.8 billion for textiles and by \$1.0–1.2 billion for apparel under the FTA (table 2.2). Approximately 85 percent of the increase in textiles imports and approximately 91 percent of the increase in apparel imports from Korea represent imports diverted from other trade partners.<sup>23</sup> Similarly, total U.S. imports of motor vehicles and parts from Korea increase by \$1.3–1.7 billion (table 2.2), of which approximately 55–57 percent is represented by diverted imports from other trade partners.

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<sup>21</sup> For additional sector-specific analysis, see chap. 3 of this report.

<sup>22</sup> See chap. 3 of this report for additional analysis of U.S.-Korea passenger vehicles trade.

<sup>23</sup> Calculated from data in tables 2.2 and 2.3; [(change in U.S. sector imports from Korea - change in U.S. sector imports from world) / change in U.S. sector imports from Korea].

Aggregate U.S. trade with the world may increase somewhat as a result of the increased market access under the U.S.-Korea FTA. The last row in table 2.3 reports the simulated changes in total U.S. trade in sectors analyzed in this simulation. Total U.S. exports of these commodities is expected to be higher by \$4.8–5.3 billion, and total imports of commodities in this analysis is expected to be higher by \$2.8–3.1 billion, an increase of about 0.4 percent for exports and 0.3 percent for imports. As a result of the U.S.-Korea FTA, factors of production in the United States become more efficient within the simulation, thus attracting increased investment, which in turn is financed through changes in the trade balance. It should be noted that, without a full quantitative analysis of services trade<sup>24</sup> and international investment patterns, these simulation results should not be interpreted as changes in total imports and exports, or as implying meaningful information about the balance of trade impact of the entire U.S.-Korea FTA.

### ***U.S. Gross Output and Employment Effects***

Full implementation of tariff and TRQ elimination or liberalization under the FTA may result in expansion of those U.S. industries that experience higher export demand as a result of Korea's removal of tariffs and reduction of TRQs on imports from the United States. In addition, the reallocation of resources and direct competition from Korean goods that are given preferential import treatment into the United States may cause the output of other U.S. industries to be lower. As is suggested by the percentage changes for total U.S. sectoral trade in table 2.4, these marginal changes, whether positive or negative, are likely to be very small in most sectors and modestly positive in bovine meat products, cattle, meat products n.e.c., and animal products n.e.c.

According to the model estimates, there is likely to be only a modest effect on output or employment for most sectors in the U.S. economy. The sectors exhibiting the largest increases in output (quantity or revenue) relative to the 2008 baseline are bovine meat products (0.7–2.0 percent), cattle (0.7–2.0 percent), meat products n.e.c. (0.5–0.9 percent), cereal grains n.e.c. (0.2–0.7 percent), dairy products (0.2–0.5 percent), and animal products n.e.c. (0.4–0.8 percent). Eight sectors show a decline of more than 0.1 percent in output, revenue, or employment—paddy and processed rice, oilseeds, plant-based fibers, manufactures n.e.c., electronic equipment, wearing apparel, wheat, and textiles. Most of these changes are due to the direct effects of removal of Korean tariffs and TRQs, while other effects are induced by liberalization in related sectors. For example, although the output contraction in some sectors is driven primarily by increased imports from Korea (such as textiles and wearing apparel), in other sectors (such as wheat and rice), output contraction is driven primarily by the reallocation of resources toward sectors experiencing relatively greater liberalization. In addition, the raw milk sector is not liberalized in the simulation; rather, the 0.1–0.5 percent increase in output is due to Korea's liberalization of the dairy products sector. A similar explanation holds for the live cattle sector, which expands to supply the downstream bovine meat products sector.

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<sup>24</sup> See literature review in chap. 7 of this report for a description of other studies that include assumptions regarding service sector liberalization in the context of a U.S.-Korea FTA.

**Table 2.3 U.S.-Korea FTA: Simulated effects on U.S. global trade from a projected 2008 baseline**

GTAP sector	U.S. exports to the world (f.o.b.) <sup>a</sup>					U.S. imports from the world (LDP) <sup>a</sup>				
	Base before FTA	Change after FTA			Base before FTA	Change after FTA				
		Million dollars		Percent		Million dollars		Percent		
		Low	High	Low	High	Low	High	Low	High	
Paddy and processed rice <sup>b</sup>	1,283	-20	2	-1.5	0.1	304	0	3	0.0	1.1
Wheat	5,326	-68	-12	-1.3	-0.2	200	1	2	0.3	1.0
Cereal grains n.e.c.	6,654	-18	6	-0.3	0.1	470	2	4	0.3	0.9
Vegetables, fruit, nuts	12,782	110	170	0.9	1.3	9,671	26	47	0.3	0.5
Oilseeds	8,476	-37	-15	-0.4	-0.2	479	2	3	0.3	0.6
Sugarcane, sugar beet	9	0	0	-1.1	-0.8	10	0	0	0.0	0.0
Plant-based fibers	4,743	-20	8	-0.4	0.2	23	0	0	0.0	0.5
Crops n.e.c.	2,640	-4	14	-0.2	0.5	7,813	44	67	0.6	0.9
Cattle, sheep, goats, and horses	610	-4	-1	-0.7	-0.2	1,513	16	36	1.1	2.4
Animal products n.e.c.	3,311	48	59	1.4	1.8	1,923	9	14	0.5	0.7
Raw milk	4	0	0	-1.6	-1.2	24	0	0	0.9	1.4
Wool, silkworm cocoons	57	-1	-1	-2.2	-0.9	24	0	0	0.8	1.7
Forestry	1,872	5	8	0.3	0.4	661	1	1	0.1	0.2
Fishing	775	6	17	0.7	2.2	2,031	3	9	0.1	0.4
Coal	16,441	1	8	0.0	0.0	3,114	3	4	0.1	0.1
Oil and gas	2,532	-6	-4	-0.2	-0.1	215,037	123	229	0.1	0.1
Minerals n.e.c.	5,188	2	3	0.0	0.1	8,414	3	8	0.0	0.1
Bovine meat products	2,002	624	1,773	31.2	88.5	4,583	19	67	0.4	1.5
Meat products n.e.c.	6,086	406	682	6.7	11.2	2,142	12	21	0.6	1.0
Vegetable oils and fats	2,668	-16	-9	-0.6	-0.3	2,996	12	17	0.4	0.6
Dairy products	1,989	163	316	8.2	15.9	2,521	11	22	0.4	0.9
Sugar	159	-2	0	-1.0	-0.1	1,583	2	9	0.1	0.6
Food products n.e.c.	18,381	275	312	1.5	1.7	30,730	79	99	0.3	0.3
Beverages and tobacco products	3,969	21	44	0.5	1.1	15,258	9	21	0.1	0.1
Textiles	14,108	74	87	0.5	0.6	55,988	243	277	0.4	0.5
Wearing apparel	2,779	30	36	1.1	1.3	70,991	86	110	0.1	0.2
Leather products	2,202	35	43	1.6	2.0	35,123	45	57	0.1	0.2
Wood products	8,776	-12	-7	-0.1	-0.1	67,492	159	188	0.2	0.3
Paper products, publishing	24,647	-17	-5	-0.1	0.0	29,315	79	95	0.3	0.3
Petroleum, coal products	26,901	-12	0	0.0	0.0	100,848	40	95	0.0	0.1
Chemical, rubber, plastic products	163,394	2,027	2,192	1.2	1.3	198,767	667	748	0.3	0.4
Mineral products n.e.c.	9,292	115	137	1.2	1.5	24,140	63	75	0.3	0.3
Ferrous metals	17,410	-14	-7	-0.1	0.0	34,376	51	68	0.1	0.2
Metals n.e.c.	24,518	108	138	0.4	0.6	38,347	84	111	0.2	0.3
Metal products	18,387	27	41	0.1	0.2	41,387	196	228	0.5	0.6
Motor vehicles and parts	85,120	34	72	0.0	0.1	238,751	565	780	0.2	0.3
Transport equipment n.e.c.	67,233	-220	-143	-0.3	-0.2	42,323	120	150	0.3	0.4
Electronic equipment	81,620	-381	-293	-0.5	-0.4	269,162	409	469	0.2	0.2
Machinery and equipment n.e.c.	185,072	1,636	1,812	0.9	1.0	280,718	1,075	1,200	0.4	0.4
Manufactures n.e.c.	11,941	-9	2	-0.1	0.0	79,454	152	180	0.2	0.2
Other sectors	358,367	-1,151	-1,010	-0.3	-0.3	277,346	401	466	0.1	0.2
<b>Total<sup>c</sup></b>	<b>1,209,727</b>	<b>4,792</b>	<b>5,276</b>	<b>0.4</b>	<b>0.4</b>	<b>2,196,054</b>	<b>2,810</b>	<b>3,136</b>	<b>0.2</b>	<b>0.3</b>

Source: Commission calculations and GTAP version 6.1.

Note: The abbreviation "n.e.c." stands for "not elsewhere classified." Zero values for million dollars indicate values less than \$500,000. Zero values for percent indicate values less than ±0.05 percent. Zero values represent rounded numbers. Differences in low and high percent values may be less than 0.05 percent.

<sup>a</sup>Exports from the United States are on a free-on-board (f.o.b.) basis. Imports to the United States are on a landed, duty-paid (LDP) basis.

<sup>b</sup>There is no change in treatment for the paddy and processed rice sector under the FTA.

<sup>c</sup>Ranges for totals have been separately calculated and are not a summation of sectoral ranges. The ranges reflect statistically likely outcomes, and it is not likely that sector estimates will be simultaneously low or high.

**Table 2.4 U.S.-Korea FTA: Simulated effects on U.S. output and employment from a projected 2008 baseline**

GTAP sector	Output				Labor quantity			
	Quantity		Revenue		Skilled		Unskilled	
	Low	High	Low	High	Low	High	Low	High
	<i>Percent changes</i>							
Paddy and processed rice <sup>a</sup>	-0.5	0.1	-0.4	0.2	-0.5	0.1	-0.5	0.1
Wheat	-0.7	-0.2	-0.6	0.0	-0.7	-0.1	-0.7	-0.1
Cereal grains n.e.c.	0.2	0.4	0.4	0.7	0.2	0.5	0.2	0.5
Vegetables, fruit, nuts	0.1	0.2	0.4	0.5	0.2	0.3	0.2	0.3
Oilseeds	-0.3	-0.2	-0.1	0.0	-0.3	-0.1	-0.3	-0.1
Sugarcane, sugar beet	0.0	0.1	0.2	0.3	0.1	0.1	0.1	0.1
Plant-based fibers	-0.4	-0.1	-0.2	0.1	-0.3	-0.1	-0.4	-0.1
Crops n.e.c.	-0.2	-0.1	0.1	0.1	-0.1	0.0	-0.1	0.0
Cattle, sheep, goats, and horses	0.7	1.6	0.9	2.0	0.7	1.8	0.7	1.8
Animal products n.e.c.	0.4	0.6	0.6	0.8	0.5	0.7	0.5	0.7
Raw milk	0.1	0.3	0.3	0.5	0.2	0.4	0.2	0.4
Wool, silkworm cocoons	-0.1	0.3	0.0	0.4	0.0	0.4	0.0	0.4
Forestry	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0
Fishing	0.1	0.1	0.3	0.4	0.1	0.2	0.1	0.2
Coal	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0
Oil and gas	0.0	0.0	0.0	0.0	-0.1	0.0	-0.1	0.0
Minerals n.e.c.	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0
Bovine meat products	0.7	1.8	0.8	2.0	0.7	1.8	0.7	1.8
Meat products n.e.c.	0.5	0.8	0.6	0.9	0.5	0.8	0.5	0.8
Vegetable oils and fats	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0
Dairy products	0.2	0.3	0.3	0.5	0.2	0.4	0.2	0.3
Sugar	0.0	0.1	0.1	0.2	0.0	0.1	0.0	0.1
Food products n.e.c.	0.1	0.1	0.2	0.2	0.1	0.1	0.1	0.1
Beverages and tobacco products	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0
Textiles	-0.8	-0.7	-0.8	-0.7	-0.8	-0.7	-0.8	-0.7
Wearing apparel	-0.5	-0.4	-0.5	-0.4	-0.5	-0.4	-0.5	-0.4
Leather products	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.1
Wood products	-0.1	-0.1	0.0	0.0	-0.1	-0.1	-0.1	-0.1
Paper products, publishing	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0
Petroleum, coal products	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Chemical, rubber, and plastic products	0.1	0.2	0.2	0.2	0.2	0.2	0.1	0.2
Mineral products n.e.c.	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0
Ferrous metals	-0.1	-0.1	0.0	0.0	-0.1	-0.1	-0.1	-0.1
Metals n.e.c.	-0.1	-0.1	0.0	0.0	-0.1	0.0	-0.1	-0.1
Metal products	-0.1	-0.1	0.0	0.0	-0.1	-0.1	-0.1	-0.1
Motor vehicles and parts	-0.2	-0.1	-0.1	-0.1	-0.2	-0.1	-0.2	-0.1
Transport equipment n.e.c.	-0.2	-0.1	-0.1	-0.1	-0.2	-0.1	-0.2	-0.1
Electronic equipment	-0.4	-0.3	-0.3	-0.2	-0.4	-0.3	-0.4	-0.3
Machinery and equipment n.e.c.	0.0	0.1	0.1	0.1	0.0	0.1	0.0	0.1
Manufactures n.e.c.	-0.3	-0.2	-0.2	-0.1	-0.2	-0.2	-0.3	-0.2

Source: Commission calculations and GTAP version 6.1.

Notes: The abbreviation "n.e.c." stands for "not elsewhere classified." Zero values for percent indicate values less than ±0.05 percent; differences in low and high percent values may be less than 0.05 percent.

<sup>a</sup>There is no change in treatment for the paddy and processed rice sector under the FTA.

## ***Economy-wide Impact of Implementing the Immediate Duty-Free Tariff Lines***

Under the terms of the U.S.-Korea FTA, the phase-in period for liberalization ranges from immediate duty-free access to 15 years or more, with some products subject to temporary- or permanent-growth TRQs. In order to assess the relative importance of those products subject to immediate liberalization under the terms of the agreement, a separate simulation was conducted for only those products that are liberalized fully and immediately (i.e., subject to immediate duty-free treatment in the U.S. and Korean FTA tariff schedules). Approximately 65 percent by value of U.S. exports to Korea will be subject to immediate duty-free treatment, whereas approximately 55 percent by value of U.S. imports from Korea will benefit from immediate duty-free treatment. Because of Korea's higher pre-existing tariffs, the average level of protection remaining after the implementation of tariffs subject to immediate duty-free treatment will still be higher for Korea than for the United States. The average AVE tariff on U.S. imports from Korea falls from 1.8 percent to 1 percent in the simulation, while the average AVE tariff on Korean imports from the United States declines from 5.9 percent to 3.4 percent.

In the resulting economy-wide simulation of the elimination of duty for this subset of tariff lines, U.S. welfare increases by 45–55 percent of full liberalization levels. U.S. imports from Korea increase by 30–40 percent of the levels observed under full liberalization, and exports to Korea increase by 45–55 percent of the levels observed under full liberalization. U.S. total imports from and exports to the world rise by 45–55 percent of the levels observed under full liberalization. On a sectoral basis, the greatest value increases in U.S. imports from Korea occur in machinery and equipment n.e.c. (70–80 percent of full liberalization), in motor vehicles and parts (65–75 percent), and in chemical, rubber, and plastic products (20–30 percent). These increases are a reflection of the percentage of each sector that is subject to immediate liberalization: about 70 percent for machinery and equipment n.e.c.; about 70 percent for motor vehicles and parts; and about 20 percent for chemical, rubber, and plastic products. U.S. exports to Korea follow a similar pattern, with the machinery and equipment n.e.c. sector leading in value increase (65–75 percent of full liberalization); followed by chemical, rubber, and plastic products (50–60 percent of full liberalization); and motor vehicles and parts (90–100 percent of full liberalization). These increases are also a reflection of the proportion of each sector that is subject to immediate liberalization taking place in these sectors—about 65 percent, 60 percent, and almost 100 percent, respectively.

Much of the gain from immediate liberalization is attributable to manufacturing sectors and, in particular, to those goods with relatively low pre-existing tariffs and relatively significant trade flows. The rate of liberalization in food and agriculture is, by comparison, relatively more gradual. Among U.S. agricultural and food sectors, none are expected to see increases in exports to Korea above \$40 million as a result of immediate duty-free treatment. Gains in these sectors are more gradually spread out, as tariffs are phased out and TRQs expand.

# CHAPTER 3

## Sector-specific Assessments

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This chapter provides an assessment of the likely impact of the market access provisions of the U.S.-Korea FTA on specific U.S. sectors. It builds on the economy-wide analysis in the previous chapter by analyzing the impact of both the immediate and the phased elimination of tariffs and TRQs on more narrowly defined sectors. The chapter focuses on grain; oilseed products; animal feeds; starches; citrus fruit; noncitrus fruit; potatoes; other vegetables; tree nuts; dairy products; meat (beef, pork, and poultry); seafood; selected processed foods; nonalcoholic beverage products; textiles and apparel; leather goods and footwear; pharmaceuticals; machinery, electronics, and transportation equipment; passenger vehicles; and medical devices.<sup>1</sup> Certain selected sectors overlap significantly with sectors used in the model employed in the Commission's economy-wide analysis described in chapter 2 of this report. For these selected sectors, assessments in this chapter incorporate the results from the Commission's economy-wide analysis.<sup>2</sup>

Given that Korean tariffs and TRQs are high relative to U.S. tariffs and TRQs, most of these assessments focus exclusively on potential increases in U.S. exports to Korea. The potential impact on U.S. imports, production, and employment is analyzed only when potential changes are not negligible and, therefore, warrant an assessment or when the level of U.S. protection is relatively high.<sup>3</sup> In addition, a few selected sectors (selected processed foods, passenger vehicles, and medical devices) are highlighted in order to demonstrate the importance of and potential effect of Korean NTMs. International price and quantity comparisons are reported for these selected cases, as they represent cases in which high import prices and/or low import quantities, by international standards, coincided with reports of significant NTMs in the Korean market.<sup>4</sup>

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<sup>1</sup> Sectors were selected for analysis according to a number of criteria, including the importance of the sector or key sector components in terms of bilateral trade relationship, the extent of trade liberalization under the FTA, the potential for increased bilateral trade as a result of the FTA, and industry and Commission views regarding the FTA commitments. The assessments in this chapter are based on industry knowledge and expertise of USITC industry analysts, industry reports and interviews with industry contacts, reports by functional trade advisory committees on the FTA, testimony at the Commission's public hearing for this investigation, and written submissions received in response to the Commission's *Federal Register* notice for this investigation.

<sup>2</sup> These results are relative to an estimated 2008 baseline. The impact estimated by the Commission's economy-wide model represents a range obtained from conducting sensitivity analysis. See chap. 2 of this report for additional information regarding the Commission's economy-wide analysis.

<sup>3</sup> Given the substantial number of agriculture-related sectors highlighted in this chapter, an overview of selected agriculture-related regulations and requirements that may be encountered by U.S. exporters is provided in app. K.

<sup>4</sup> For additional information on the analytical method, see app. J of this report.

## Grain (Wheat, Corn, and Other Feed Grains)<sup>5</sup>

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### *Assessment*

The U.S.-Korea FTA would likely have a negligible impact on U.S. grain exports to Korea as a result of the increased market access afforded through tariff removal. Based on current export patterns and trends, about 80 percent of the expected additional U.S. grain exports to Korea would likely consist of yellow corn, with the remainder being wheat and barley. Estimates from the Commission's economy-wide analysis of the long-term effects of tariff and TRQ liberalization indicates that cereal grains exports, which include corn and other feed grains, would likely increase by approximately \$7 million (2.2 percent), and U.S. wheat exports would likely increase by approximately \$2 million (1.0 percent).<sup>6</sup> These increases depend substantially on the estimated increases in U.S. exports of meat products to Korea, as significant expansion in the meat sector could cause U.S. exports of cereal grains and wheat to Korea to decline. Such a decline would result from the effect of supply or demand changes in other upstream or downstream sectors. For example, on the U.S. supply side, the anticipated expansion in exports of beef and other food products increases demand for upstream agricultural products that may compete with wheat and cereal grains for resources, which may induce the reorientation of production for U.S. meat that will ultimately be exported to Korea, or may encourage switching to other crops or activities. On the Korean demand side, a substantial increase in shipment of bovine meat products to Korea would reduce Korean cattlemen's demand for wheat and corn for feed, dampening Korean demand for grain despite the removal of the tariff.<sup>7</sup>

Table 3.1 outlines the first full year of market access for U.S. grain exports to Korea under the FTA. The 2006 Korean tariff treatment for U.S. products is shown under the column, "Applied rate, 2006." U.S. wheat and yellow corn exports to Korea would attain immediate duty-free treatment upon implementation of the agreement. TRQs established are for barley and popcorn, although the United States has not exported significant amounts of these grains to Korea during 2002–06. The first-year quota levels for barley and popcorn are well above U.S. exports in 2006.

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<sup>5</sup> Includes Harmonized Tariff Schedule of the United States (HTS) headings 1001 through 1008, except rice (HTS subheading 1006). The grain sector as described in this section of the report focuses on corn and wheat, although the FTA also addresses sorghum, and barley, whose trade is negligible with Korea. Corn is destined for livestock feed in Korea, processing into corn byproducts, and direct food use. The products covered in this assessment represent 100 percent of U.S. exports to Korea in the GTAP "cereal grains" and "wheat" sectors, and represent 100 percent of U.S. imports from Korea in the GTAP "cereal grains" sector, for 2006.

<sup>6</sup> These estimated increases in exports of corn and other feed grains (\$7 million), and wheat (\$2 million) represent mean values of the range estimates provided by the economy-wide analysis, relative to an estimated 2008 base. Cereal grains exports could decrease by up to \$4 million (-1.5 percent) or increase by up to \$18 million (6.1 percent); and wheat exports could decrease by up to \$5 million (-2.9 percent) or increase by up to \$9 million (4.9 percent). As a result, the economy-wide analysis estimated that output and employment changes in the wheat and cereal grains sectors could range from -0.7 percent to 0.0 percent. See chap. 2 of this report for additional information regarding the economy-wide analysis.

<sup>7</sup> Given that the model assumes a fixed quantity of resources, it is possible for exports to decrease despite reduction in Korean tariffs as a result of the reallocation of resources in the United States to other more liberalized sectors. See chap. 2 of this report for additional information on the economy-wide general equilibrium analysis of tariff and TRQ liberalizations under the FTA.



**Table 3.1** U.S. grain exports to and market access in Korea

Product	U.S. exports to Korea		Korean market access		
	2002–06 average (1,000 metric tons)	2006	Applied rate, 2006 (Percent AVE)	First year TRQ (1,000 metric tons)	Over-quota tariff (Percent AVE)
Wheat:					
Milling	1,198	1,117	1	None	Free
Feed	55	15	Free	None	Free
Barley:					
Malting	0	0	20	9	513
Other	0	0	2 or 5	2.5	324–299.7
Corn:					
Yellow	2,749	6,035	1.8 or 3.0	None	328
Popcorn	2	0	1.8	5	601.2

Source: USTR, “Final - United States - Korea FTA Texts,” 2007, General Notes, Tariff Schedule of Korea, Annex 3-A, and Appendix 2-B-1; official statistics of the U.S. Department of Commerce; USDA, FAS, “Korea Grain and Feed Annual 2007,” May 1, 2007, 18–24; and USDA, FAS, “Fact Sheet U.S.-Korea Free Trade Agreement Benefits for Agriculture,” June 2007, 4–5.

U.S. grain exports to Korea in 2006 accounted for 7 percent of total U.S. grain exports to all countries.<sup>8</sup> Approximately 79 percent of grain exports to Korea in 2006 consisted of corn; 21 percent consisted of wheat; and a negligible percentage consisted of grain sorghum, rye, and oats. U.S. corn exports to Korea in 2006 consisted solely of yellow corn. The United States, a highly competitive grain exporter, supplied 63 percent of Korea’s 8.5 million metric tons (mt) of corn imports in marketing year 2005/06; China and Brazil together supplied the remaining 37 percent.<sup>9</sup> In marketing year 2005/06, Korea imported 92 percent of its corn consumption.<sup>10</sup> About three-quarters of Korean corn imports were consumed as animal feed, and most of the remaining one-quarter was consumed by the industrial wet-corn milling processing industry (made into corn oil, high fructose corn syrup, and corn starch).<sup>11</sup> Corn destined for animal feed can include genetically-modified (GM) corn, whereas corn destined for food products in Korea must be identity preserved (IP) and non-GM.<sup>12</sup> The estimated increase in U.S. exports of corn will likely result from increased corn consumption stimulated by a lower domestic price (as the tariff is removed), and by slightly lower Korea corn production. China tends to export low-priced corn and has a substantial freight advantage over the United States.

<sup>8</sup> Compiled from official statistics of the U.S. Department of Commerce.

<sup>9</sup> USDA, FAS, “Korea Grain and Feed Annual 2007,” May 1, 2007, 20.

<sup>10</sup> *Ibid.*, 9.

<sup>11</sup> *Ibid.*, 23.

<sup>12</sup> IP status requires product separation and origin identification of each grain of shipment. USDA, FAS, “Korea Biotechnology Agricultural Biotechnology Report 2006,” July 6, 2006, 5.

Korea imported 3.8 million mt of wheat in marketing year 2005/06, with 31 percent from the United States, 30 percent from Canada, 25 percent from Australia, and 11 percent from Ukraine.<sup>13</sup> About 60 percent of Korean wheat imports in marketing year 2005/06 was milled into wheat flour and about 40 percent was fed to livestock.<sup>14</sup> Korean wheat millers prefer white wheat for which Australia is a very competitive alternative supplier to U.S. white wheat.

The FTA is expected to have negligible benefits for exports of U.S. wheat to Korea. U.S. wheat exports would likely benefit immediately from the elimination in the first year of the applied 1 percent tariff on U.S. milling wheat. As a result, the United States would likely be able to gain market share from other leading wheat exporters to Korea, such as Canada and Australia, but the 1-percent duty savings would likely not induce a major market shift to the United States. Freight costs from Australia and Canada are generally lower than from the United States.

Korea imported nearly 41,000 mt of barley in marketing year 2005/06. The 11,500 mt of TRQ access for U.S. malting and feed barley in the first year of the FTA may allow an estimated \$2 million in U.S. exports of barley to Korea. Thereafter, the growth in U.S. barley exports to Korea would be limited by the quota, with prohibitive over-quota tariffs. The tariff and quota on U.S. popcorn and white corn are eliminated over 7 years. While there would be quota access for U.S. popcorn exports to Korea, U.S. popcorn exports have been small in most years even though the Korean tariff is 1.8 percent. U.S. exports of white corn for popping and popcorn reached \$2 million in 2004, but Korean repackaging requirements eliminated all U.S. exports in 2005–06.<sup>15</sup>

### ***Views of Interested Parties***

In the report of the Agricultural Technical Advisory Committee (ATAC) for Grains, Feed, and Oilseeds, the majority of members endorsed the FTA, because of the benefits expected to be realized by most U.S. producers of grains, feed, and oilseeds. According to the report, in the industry's view, the agreement is not a perfect agreement, as reflected in the lack of any improved access for U.S. rice, plus other limitations. The elimination of tariffs on U.S. corn will likely not significantly affect U.S. corn exports to Korea in the immediate- or mid-term given that Korea is already an open market to corn imports. The zero-bound duty for U.S. wheat under this FTA would allow American growers to recapture a larger share of Korea wheat imports; the U.S. share has fallen to less than 50 percent from 100 percent in the 1980s. The ATAC report indicates, however, that there are complications that may limit U.S. wheat export gains, including state trading monopolies in wheat exporting countries such as Canada and Australia, and past Korean use of sanitary and phytosanitary (SPS) standards as barriers to U.S. wheat.<sup>16</sup>

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<sup>13</sup> USDA, FAS, "Korea Grain and Feed Annual 2007," May 1, 2007, 13.

<sup>14</sup> *Ibid.*, 14.

<sup>15</sup> The prior U.S. quota for popcorn was 5,500 mt, with an in-quota tariff of 1.8 percent. The Korean market in 1996–2000 for microwave popcorn was \$13 million annually. USDA, FAS, "Korea Products Brief Popcorn Market Brief 2006," July 3, 2006, 5 and 10.

<sup>16</sup> ATAC for Grains, Feed and Oilseeds, *Advisory Committee Report*, April 25, 2007. In the past, Korean quarantine policies have been a major policy issue affecting U.S. wheat exports. The Korean National Plant Quarantine Service inspects for foreign weed seeds and for the presence of 108 agricultural chemicals. USDA, FAS, "Korea Grain and Feed Annual 1997," April 4, 1997, 5–6; and USDA, FAS, "Korea Grain and  
(continued...)

The National Association of Wheat Growers and the U.S. Wheat Associates indicated in a joint statement on June 25, 2007, that their two trade groups support the Korean FTA. They wrote that “the zero bound duty under this FTA, coupled with Korea’s strong economic growth, will help U.S. wheat growers capture a larger share of this [Korean] market.”<sup>17</sup> They noted that the FTA establishes a committee on agriculture and one on SPS matters, and a bilateral dispute settlement process giving U.S. officials vital new forums for negotiation with Korea on standards-related barriers to U.S. exports, including wheat.

The National Corn Growers Association (NCGA), which represents more than 32,000 U.S. corn growers from 48 states and 26 affiliated state corn organizations,<sup>18</sup> noted that Korea is one of the United States’ largest corn markets and represents a potentially large market for corn coproducts, such as distillers’ dried grains with solubles (DDGS).<sup>19</sup> The association also said that the U.S.- Korean FTA would remove trade barriers and create new export opportunities for U.S. corn growers. It reported that improvements in market access in Korea for U.S. corn and corn coproducts are positive and that any gains in additional U.S. meat market access to Korea would also benefit U.S. corn growers as a significant amount of corn ends up as livestock feed in the United States.

## **Oilseed Products (Soybeans and Soybean Oil)<sup>20</sup>**

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### ***Assessment***

The U.S.-Korea FTA would likely to have a significant positive impact on U.S. oilseeds exports to Korea. Estimates from the Commission’s economy-wide analysis of the long-term effects of tariff and TRQ liberalization indicate that exports in the oilseed, and vegetable oils and fats sectors (of which the products included here represent a large component) could increase by 5–11 percent for oilseeds and 20–33 percent for vegetable oils and fats.<sup>21</sup> Based on existing current export patterns and trends, approximately half of the expected additional U.S. oilseed product exports to Korea would likely consist of food-grade soybeans, and most of the other half would be soybean oil.

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<sup>16</sup> (...continued)

Feed Annual 2002,” April 1, 2002, 1–2. For additional analysis regarding SPS and other NTMs, see chap. 5 of this report.

<sup>17</sup> U.S. Wheat Associates, *Wheat Letter*, June 28, 2007, 5.

<sup>18</sup> National Corn Growers Assoc., “U.S.-Korea FTA Highlights Access and Beef Concerns (April 3, 2007).” Washington, DC, NCGA, 2007.

<sup>19</sup> DDGS are a feed ingredient which is a coproduct of dry mill ethanol production from grains.

<sup>20</sup> Includes HTS headings 1201 and 1507. The oilseed sector focuses on soybeans and soybean oil, although the FTA also addresses other oilseeds such as cottonseed, sunflower seed, and other vegetable oils whose trade with Korea is negligible. Soybeans are crushed into soybean oil (for cooking oil) and soybean meal for livestock feed in Korea; edible-grade soybeans are used directly in food as well in Korea. The products covered in this assessment represent approximately 88 percent of U.S. exports to Korea in the GTAP “oilseeds” sector and approximately 53 percent of U.S. exports to Korea in the GTAP “vegetable oils and fats” sectors, and represent approximately 67 percent of U.S. imports from Korea in the GTAP “oilseeds” sector and approximately 1 percent of U.S. imports from Korea of the GTAP “vegetable oils and fats” sector, for 2006.

<sup>21</sup> Impact relative to an estimated 2008 base. See chap. 2 of this report for additional information regarding the economy-wide analysis.

U.S. oilseed product exports to Korea in 2006 accounted for 2 percent of total U.S. oilseeds exports to all countries.<sup>22</sup> The United States was the world's leading soybean exporter in marketing year 2005/06, and supplied 43 percent of Korea's 1.2 million mt of soybean imports.<sup>23</sup> In that year, Brazil overtook the United States as the leading soybean supplier to Korea with a 52-percent share of Korean imports.<sup>24</sup> Korea had a global TRQ of 1.2 million mt of soybeans imports in marketing year 2005/06.<sup>25</sup>

Food-grade soybeans are IP, high valued (non-GM and IP) soybeans; nearly all Korean domestic production of soybeans consists of food-grade beans.<sup>26</sup> About 50 percent of U.S. soybean exports to Korea consisted of food-grade soybeans in marketing year 2005/06.<sup>27</sup> By comparison, nearly all the Chinese soybeans and only about 10 percent of the Brazilian soybean exports to Korea are food-grade. The U.S. share of food-grade soybean imports into Korea has declined sharply over the past 2 years. A state trading entity (STE), the Korea Agro-Fishery Trade Corporation ("aT"), imported most food-grade soybeans into Korea during marketing year 2005/06, purchasing mostly U.S. soybeans. However, in marketing year 2006/07, "aT" purchased more soybeans from China and Canada, and less from the United States because U.S. food-grade soybeans either were considered too highly priced or were unavailable.<sup>28</sup> The "aT" has reportedly marked up the price of imported food-grade soybeans sold in Korea by \$250 per mt. For comparison, the average import price for food-grade soybeans in 2006 without the mark up was \$330 per mt.<sup>29</sup>

The United States supplied 5 percent of Korea's 265,000 mt of soybean oil imports in marketing year 2005/06.<sup>30</sup> Argentina (with a 91-percent share) dominated Korean soybean oil imports and Brazil followed with the remaining 4 percent. Soybean oil from the United States, Argentina, and other suppliers has been facing declining demand in Korea owing to a consumer shift (because of trans fats dietary issues) to palm oil and other vegetable oils.<sup>31</sup> In addition, the Korean government, in late 2006 and early 2007, imposed antidumping duties on imports of U.S. and Argentine soybean oil.<sup>32</sup> Korea is likely to implement a biosafety protocol against genetically modified organism (GMO) soybeans which may

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<sup>22</sup> Compiled from official statistics of the U.S. Department of Commerce.

<sup>23</sup> The marketing year begins October 1, and ends September 30. In marketing year 2005/06, 70 percent of Korean soybean imports was crushed into soybean oil and meal; most of the remaining 30 percent was consumed directly in food use (tofu, miso, soybean paste, sprouts, and soybean seasonings). Soybeans imported into Korea for crushing can include GM soybeans, whereas those for direct food uses must be non-GM and IP soybeans. USDA, FAS, "Korea Biotechnology Agricultural Biotechnology Report 2006," July 6, 2006, 5.

<sup>24</sup> USDA, FAS, "Korea Oilseeds and Products Annual 2007," February 26, 2007, 9.

<sup>25</sup> The in-quota MFN rate was 1 percent on soybeans for crushing, and 5 percent on soybeans for food use. USDA, FAS, "Korea Oilseeds and Products Annual 2007," February 26, 2007, 15.

<sup>26</sup> Korean production of soybeans was 183,000 mt in marketing year 2005/06. Ibid.

<sup>27</sup> The marketing year begins October 1, and ends September 30. USDA, FAS, "Korea Oilseeds and Products Annual 2007," February 26, 2007, 12.

<sup>28</sup> USDA, FAS, "Korea Oilseeds and Products Annual 2007," February 26, 2007, 4.

<sup>29</sup> USDA, FAS, "Fact Sheet U.S.-Korea Free Trade Agreement Benefits for Agriculture," June 2007, 5.

<sup>30</sup> Based on official Korean import data. USDA, FAS, "Korea Oilseeds and Products Annual 2007," February 26, 2007, 25.

<sup>31</sup> Soybean oil is often hydrogenated thereby increasing its trans fats content, whereas palm oil is not.

<sup>32</sup> The antidumping duty on U.S. soybean oil was initially 17.5 percent in February 2007, but was then lowered to 4.69 percent in March 2007. USDA, FAS, "Korea Oilseeds and Products Annual 2007," February 26, 2007, 3; and USDA, FAS, "Oilseeds and Products Korean Soybean Oil Antidumping Petition Preliminary Determination 2007," April 2, 2007, 2-3.

further dampen the demand for U.S. soybeans and soybean oil (which are largely derived from GMO soybeans).<sup>33</sup>

Table 3.2 outlines the first full year of market access for U.S. oilseed product exports to Korea under the FTA. The 2006 Korean tariff treatment for U.S. products is shown under the column, “Applied rate, 2006.” Upon implementation of the agreement, there would be immediate duty-free treatment for soybeans for crushing. The 5.4 percent tariff on refined soybean oil would be eliminated over 5 years, and the 5.4 percent duty on crude soybean oil would be eliminated over 10 years. U.S. crude soybean oil exports in 2007 were assessed an additional antidumping duty of 4.7 percent.<sup>34</sup> A TRQ would be established for food-grade soybeans; the first-year quota level would amount to about 5 percent of U.S. exports in 2006. The TRQ quantity would expand to 26,523 mt (12 percent of the volume of U.S. exports in 2006) by the fifth year of the FTA, and by 3 percent annually thereafter.

The FTA would likely have positive benefits for exports of U.S. soybeans, particularly food-grade soybeans, entering Korea under the TRQ. This benefit is because the in-quota imports of U.S. food-grade soybeans under the TRQ would likely be sold directly for the first time to the private sector at a reduced price, rather than through “aT,” and would not be subject to the 76-percent AVE mark up.<sup>35</sup> Thus, U.S. exports would likely command a higher price at the border than food-grade soybeans sold into the traditional market system managed by “aT.”<sup>36</sup> U.S. food-grade soybean exports under the TRQ to Korea would likely increase immediately to the maximum allowed quantity.<sup>37</sup> Since above-quota soybeans are imported by the STE, which would continue to apply a very high mark-up fee to soybeans from the United States and all other origins, above-quota food-grade soybeans exports to Korea would remain restricted well into the future. Despite those restrictions, however, the volume of U.S. food-grade soybeans imported by “aT” may well be larger than the volume imported under the ever-expanding TRQ for many years.

U.S. soybean exports for crushing would likely benefit immediately from the elimination of the applied 1 percent tariff and may increase in the short term. Over the long term, U.S. soybean oil exports would likely increase substantially as a result of the removal of tariffs under the FTA. In 2007, Korea imposed a 4.7 percent antidumping duty on U.S. crude soybean oil, which would likely affect U.S. exports to Korea. If the antidumping duty were dropped, and the 5.4 percent tariff was eliminated after 10 years, an increase in exports of U.S. soybean oil would likely result from increased soybean oil consumption in Korea stimulated by a lower domestic price; and by slightly lower Korean soybean oil production.

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<sup>33</sup> USDOS, U.S. Embassy, Seoul, “January 30, 2007 Biotechnology Technical Talks (SEOUL 020217),” January 31, 2007; and USDA, FAS, “Korea Oilseeds and Products Annual 2007,” February 26, 2007, 3.

<sup>34</sup> USDA, FAS, “Oilseeds and Products Korean Soybean Oil Antidumping Petition Preliminary Determination 2007,” April 2, 2007, 2–3.

<sup>35</sup> A private association of Korean food-grade soybean processors will operate the TRQ outside the STE “aT.” USDA, FAS, “Fact Sheet U.S.-Korea Free Trade Agreement Benefits for Agriculture,” June 2007, 5.

<sup>36</sup> ATAC for Grains, Feed and Oilseeds, *Advisory Committee Report*, April 25, 2007, 6. The STE charges a \$250 per ton markup for food-grade soybeans (an 76 percent AVE mark up) to Korean purchasers which raises the price of the imported soybeans more than the 5 percent MFN duty. USDA, FAS, “Fact Sheet U.S.-Korea Free Trade Agreement Benefits for Agriculture,” June 2007, 5.

<sup>37</sup> The fifth year in-quota amount of 26,523 mt of food-grade soybeans is valued in 2006 prices at about \$9 million.

**Table 3.2** U.S. oilseed product exports to and market access in Korea

Product	U.S. exports to Korea		Korean market access		
	<sup>a</sup> 2002–06 average	<sup>a</sup> 2006	Applied rate, <sup>a</sup> 2006	First year TRQ	Over-quota tariff
	(1,000 metric tons)		(Percent AVE)	(1,000 metric tons)	(Percent AVE)
Soybeans for crushing	702	314	1	None	Free
Soybeans for food	244	212	5	10	<sup>b</sup> 5
Soybean oil: crude	37	49	<sup>c</sup> 4.7 +5.4	None	Free
Soybean oil: refined	2	0.1	5.4	None	Free

Source: USTR, "Final - United States - Korea FTA Texts," 2007, Tariff Schedule of Korea, Appendix 2-B-1; Global Trade Information Services, World Trade Atlas Database; official statistics of the U.S. Department of Commerce; USDA, FAS, "Korea Oilseeds and Products Annual 2007," February 26, 2007; and USDA, FAS, "Korea Oilseeds and Products Korean Soybean Oil Antidumping Petition Preliminary Determination 2007," April 2, 2007.

<sup>a</sup>Calendar year, January 1 to December 31.

<sup>b</sup>The Korean importing STE will continue to charge an additional \$250 per ton mark-up fee on above-quota imports.

<sup>c</sup>The 2006 duty treatment for crude U.S. soybean oil included a 4.7 percent antidumping duty.

### *Views of Interested Parties*

According to the report of the ATAC for Grains, Feed, and Oilseeds, the majority of its members endorse the FTA, because of the benefits expected to be realized by most U.S. producers of oilseeds.<sup>38</sup> According to the report, "in summary, Korea is a large and important market for soybeans, soybean meal and soybean oil, and the tariff reduction will help the United States achieve market share versus tough competitors such as Argentina and Brazil." The report also states that allowing the Korean private sector to import food-grade soybeans may open the door for sizable imports of U.S. food-grade soybeans in the future.

The American Oilseed Coalition (composed of the American Soybean Association, the National Cottonseed Products Association, the National Oilseed Processors Association, the National Sunflower Association, and the U.S. Canola Association) indicated in a letter to Congress that it strongly supports the FTA between the United States and Korea.<sup>39</sup> In the Coalition's letter, it noted that because of lower cost competition from China and South America, the United States is not currently a major exporter of soybean meal or soybean oil to Korea, but states that the FTA offers an opportunity to improve the U.S. competitive export position in Korea. The letter notes that, moreover, Korea's tariff on soybean meal will be eliminated immediately under the FTA; its tariffs on soybean oil phased out in 5 to 10 years; and U.S. food-grade soybean will have access to the South Korean market outside the STE import monopoly.

<sup>38</sup> ATAC for Grains, Feed and Oilseeds, *Advisory Committee Report*, April 25, 2007.

<sup>39</sup> American Oilseed Coalition, letter to Congress in connection with the U.S.-Korea Free Trade Agreement, July 12, 2007.

# Animal Feeds<sup>40</sup>

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## *Assessment*

The U.S.-Korea FTA would likely result in increased overall U.S. exports of animal feeds to Korea. The increase, however, is unlikely to have a significant effect on U.S. soybean meal exports because the modest tariff reduction would not likely improve U.S. competitiveness substantially. The U.S. soybean-crushing industry could experience relatively greater benefit from improved market access for U.S. meat exports to Korea under the FTA as these increased exports would generate greater domestic demand for meal consumption. Other animal feeds, such as prepared feeds, pet foods, and DDGS, should experience relatively greater export gains as the United States is already a leading supplier to Korea and this competitive position should be further enhanced through the immediate removal of almost all of these tariffs under the FTA (table 3.3).

As a result of its small arable land mass, Korea is very dependent on imports of animal feed for its domestic livestock and poultry sectors, which have grown significantly as Korean consumption patterns have changed over the past several decades as a result of increased affluence. According to the USDA, Korea's consumption of beef, pork, and poultry each has increased in the range of 100 to 400 percent during the period 1990–2006.<sup>41</sup> USDA projects continued increases in Korea's consumption of these meats, in the range of 14 to 47 percent over the period 2007 through 2016, which would further increase the demand for imported animal feeds.<sup>42</sup>

Soybean meal<sup>43</sup> is the leading vegetable protein source used in the manufacture of compound animal feeds in Korea.<sup>44</sup> Soybean meal imports from the United States have been relatively small and have declined 24 percent since 2002 (table 3.3) as imports from Argentina, Brazil, and India have become increasingly price competitive (table 3.4). The removal of a 1.8 percent tariff as a result of the FTA is unlikely to significantly improve the price competitiveness of the United States compared to these competing suppliers. Of greater potential importance is the effect of increased market access for U.S. meat exports to Korea. Increased meat exports and production would likely increase the use of U.S.-produced soybean meal as livestock feed, which accounts for 98 percent of total domestic soybean meal consumption in the United States.<sup>45</sup>

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<sup>40</sup> Products of chap. 23 of the HTS. This assessment will cover the leading U.S. exports to Korea for this chapter, which include soybean meal, mixed feeds, pet foods, and distiller's dried grains with solubles (DDGS). The products covered in this assessment represent approximately 27 percent of U.S. exports to Korea in the GTAP "vegetable oils and fats," approximately 10 percent of U.S. exports to Korea in the GTAP "beverages and tobacco products," and approximately 5 percent of U.S. exports to Korea in the "food products n.e.c." sectors, and represent less than 1 percent of U.S. imports from Korea in the GTAP "food products n.e.c." sector, for 2006.

<sup>41</sup> USDA, FAS, "Production, Supply, and Distribution Online."

<sup>42</sup> USDA, WAOB, "USDA Agricultural Projections to 2016," February 2007.

<sup>43</sup> HTS 2304.00 Oil cake and other solid residues, whether or not ground or in the form of pellets, resulting from the extraction of soybean oil.

<sup>44</sup> USDA, FAS, "Korea Oilseeds and Products Annual 2007," February 26, 2007, 20.

<sup>45</sup> USDA, ERS, "Briefing Room on Soybeans and Oil Crops—Background."

**Table 3.3** Animal feed exports to Korea, MFN tariff, and liberalization

	2002–06 U.S. average exports metric tons	2002–06 percent change	2006 U.S. exports metric tons	2007 base tariff percent	FTA tariff staging
Soybean meal	38,744	-23	60,396	1.8	Immediate duty free
Animal feed preps.	8,034	-8	8,089	5.0 or 4.2	Mostly immediate duty-free
Pet food	13,293	42	12,680	5.0	Immediate duty-free
Distiller's dried grains with solubles	6,025	35,024 <sup>a</sup>	24,587	5.0	Immediate duty-free
<b>Total</b>	<b>66,096</b>	<b>9</b>	<b>105,752</b>	<b>N/A</b>	<b>N/A</b>

Sources: Official statistics of the U.S. Department of Commerce; and USTR, "Final - United States - Korea FTA Texts," 2007, Tariff Schedule for the Republic of Korea.

Note: Includes HS 230330, 230400, 230910, and 230990. "N/A" = not applicable

<sup>a</sup>Percent change since 2004 because U.S. exports were zero until 2004; Percent increase is from a small base.

**Table 3.4** Exporters share of soybean meal exports to Korea

Country	(Percent)				
	2002	2003	2004	2005	2006
Brazil	43.6	57.0	36.9	60.3	34.7
Argentina	6.7	7.0	7.3	28.3	34.5
India	37.8	21.4	53.1	9.9	28.0
China	9.3	7.1	1.8	0.9	1.6
United States	2.2	7.1	0.1	0.2	0.7
Rest of World	0.4	0.4	0.8	0.3	0.4
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: Global Trade Information Services, World Trade Atlas Database.

Note: Values may not sum to totals shown because of rounding. Includes HS 2304.

The value of U.S. exports of animal feed preparations<sup>46</sup> (mixed feeds) to Korea has increased 51 percent over the 2002 to 2006 period.<sup>47</sup> The United States has been a leading supplier to Korea from 2002 to 2006 (table 3.5), and the immediate removal of Korean tariffs (4.2 or 5 percent) as a result of implementation of the FTA would likely improve the U.S. competitiveness against China and other leading exporters.

The United States is the leading supplier of pet food<sup>48</sup> exports to Korea, with a market share of more than 50 percent (table 3.6); Korea is the eighth-largest U.S. export market for pet foods.<sup>49</sup> Korea's pet food consumption is expected to increase over the next several years as the trend toward pet ownership becomes increasingly popular as disposable incomes continue to rise and multiple pet households become more common.<sup>50</sup> The immediate removal of the 5 percent tariff on pet food under the FTA would likely allow the United States to increase its already dominant market share against leading competitors.

<sup>46</sup> HTS 2309.90 Animal Feed Preparations (mixed feeds, etc.), other than dog or cat food, put up for retail sale.

<sup>47</sup> Official statistics of the U.S. Department of Commerce.

<sup>48</sup> HTS 2309.10 Dog or cat food, put up for retail sale.

<sup>49</sup> Official statistics of the U.S. Department of Commerce.

<sup>50</sup> Phillips, "US Petfood Exports Rebounding," December 2006, 25.



**Table 3.5** Exporters share of animal feed preparations exports to Korea

Country	(Percent)				
	2002	2003	2004	2005	2006
China	10.4	17.7	24.7	17.9	21.0
United States	21.9	19.8	16.2	12.2	16.1
Philippines	0.0	9.7	15.9	23.2	15.3
Netherlands	18.1	12.4	8.6	9.6	8.6
Japan	18.5	14.4	9.4	7.1	8.1
Rest of World	31.2	26.0	25.2	30.0	30.9
Total	100.0	100.0	100.0	100.0	100.0

Source: Global Trade Information Services, World Trade Atlas Database.

Note: Values may not sum to totals shown because of rounding. Includes HS 230990.

**Table 3.6** Exporters share of pet food exports to Korea

Country	(Percent)				
	2002	2003	2004	2005	2006
United States	46.6	63.5	53.8	55.1	58.6
Australia	35.9	17.5	22.5	21.2	18.6
China	0.8	2.5	4.9	7.8	9.3
France	2.7	3.5	3.9	2.6	5.1
Rest of World	14.0	13.0	14.8	13.3	8.4
Total	100.0	100.0	100.0	100.0	100.0

Source: Global Trade Information Services, World Trade Atlas Database.

Note: Values may not sum to totals shown because of rounding. Includes HS 230910.

Korea, however, has SPS and technical barriers to trade (TBT) measures that have constrained U.S. pet food exports. Interpretation and implementation of the FTA's TBT chapter and the actions of the standing committee established by the FTA's SPS chapter would likely be important to fully realize these gains in market access.<sup>51</sup> As a result of the U.S. outbreak of bovine spongiform encephalopathy (BSE) in 2003, Korea has banned U.S. exports of pet foods containing beef or other ruminant products. Additionally, Korea requires that U.S. exports of pet food containing animal proteins, including fish meal, need to be certified that they are entirely of U.S. origin. Consequently, animal proteins from other countries, which could be lower-cost, are prohibited in pet foods. In addition, pet food importers are required to provide a full ingredient list with percentages of each ingredient by weight for registration at provincial government offices. The absence of Korean safeguards to prevent disclosure of this proprietary information has disrupted U.S. exports of pet food to Korea.<sup>52</sup>

U.S. exports of distiller's dried grains with solubles (DDGS) to Korea were negligible until 2004, but have risen sharply since then (table 3.7). A large proportion of DDGS are

<sup>51</sup> For additional analysis regarding SPS, TBTs, and other NTMs, see chap. 5 of this report.

<sup>52</sup> Nancy K. Cook, director, Technical and Regulatory Affairs, Pet Food Institute, e-mail message to Commission staff, June 25, 2007.

consumed domestically by the U.S. livestock industry, but its domestic use is presently constrained in animal rations because of nutritional limitations such as digestibility, protein quality, and energy values.<sup>53</sup> As a result, the exportable surplus of DDGS has increased with the expansion of the U.S. ethanol industry, and the United States is now the leading exporter of DDGS to Korea with a market share of over 60 percent in 2006. The immediate removal of the 5 percent tariff on DDGS as a result of implementation of the FTA would further increase the competitiveness of the United States against China, the other primary supplier. This improved access would be expected to result in DDGS having a greater inclusion in feed rations in future years as Korea's feed manufacturers seek to diversify sources.<sup>54</sup>

**Table 3.7** Exporters share of distiller's dried grains with solubles exports to Korea

<i>(Percent)</i>					
Country	2002	2003	2004	2005	2006
United States	0.2	1.0	14.3	47.1	63.3
China	99.8	99.0	85.5	52.8	32.9
Australia	0.0	0.0	0.0	0.0	3.7
Brazil	0.0	0.0	0.3	0.1	0.1
Rest of World	0.0	0.0	0.0	0.1	0.0
Total	100.0	100.0	100.0	100.0	100.0

Source: Global Trade Information Services, World Trade Atlas Database.

Note: Values may not sum to totals shown because of rounding. Includes HS 230330.

### ***Views of Interested Parties***

The ATAC for Trade in Grains, Feed, and Oilseeds supports the U.S.-Korea FTA because Korea is one of the largest U.S. export markets for grains, feed, and oilseeds and is expected to further expand as a result of the FTA provisions.<sup>55</sup> The ATAC report also indicates that members expect enhanced export opportunities for U.S. exports of DDGS with the immediate removal of the 5 percent tariff in the FTA, the significant potential for greater usage of DDGS in feed rations, and the expanding supplies of DDGS in the United States. The report states that the FTA "is not a perfect agreement" primarily because of the exclusion of rice, and some ATAC members did not support the FTA because of this exclusion.

The American Soybean Association (ASA)<sup>56</sup> and National Oilseed Processors Association (NOPA)<sup>57</sup> have expressed support for the U.S.-Korea FTA because of the immediate duty-free access provided to U.S. exports of soybeans for crushing and soybean meal along with the phased tariff elimination for crude and refined soybean oil. ASA and NOPA also support the FTA because of the expected significant increase in U.S. meat exports, which utilize soybean meal as a primary protein source.

<sup>53</sup> Shurson, "Benefits and Limitations of Using DDGS in Swine Diets," January 25, 2007.

<sup>54</sup> ATAC for Grains, Feed, and Oilseeds, *Advisory Committee Report*, April 25, 2007, 6.

<sup>55</sup> *Ibid.*

<sup>56</sup> American Soybean Assoc., "American Soybean Association Applauds Korean Trade Agreement (April 3, 2007)."

<sup>57</sup> National Oilseed Processors Assoc., "NOPA Strongly Supports Korea Free Trade Agreement (April 4, 2007)."

The National Corn Growers Association (NCGA)<sup>58</sup> stated that the FTA will create new export opportunities for U.S. exports of corn and coproducts, with DDGS likely to see significant growth because of the potential for greater usage in feed rations and rapidly increasing production in the United States. The NCGA reported that it is pleased that the FTA is expected to increase U.S. pork exports to Korea, but noted that the FTA would not result in reopening the Korean market to U.S. beef exports. Pork and beef represent large consuming sectors for corn and coproducts.

The American Oilseed Coalition (composed of the American Soybean Association, the National Cottonseed Products Association, the National Oilseed Processors Association, the National Sunflower Association, and the U.S. Canola Association) indicated in a letter that it strongly supports the FTA.<sup>59</sup> It states that the United States is not currently a major exporter of soybean meal or soybean oil to Korea because of lower cost competition from China and South America, but that the FTA offers an opportunity to improve the U.S. competitive export position in Korea. The Coalition notes that Korea's tariff on soybean meal will be eliminated immediately under the FTA; its tariffs on soybean oil will be phased out in 5 to 10 years; and U.S. food-grade soybean will have access to the South Korean market outside the STE import monopoly. The Coalition also views the market access gains in the FTA for livestock products such as pork, poultry, and dairy as equally important to the oilseed industry because all of these products use protein meals derived from U.S. oilseed crops.

## **Starches<sup>60</sup>**

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### ***Assessment***

#### **Unmodified Starches<sup>61</sup>**

The U.S.-Korea FTA would likely result in significantly greater U.S. exports of unmodified starches to Korea. Unmodified corn starch would likely experience increased exports in the short term, as the United States would receive immediate duty-free access for a relatively large volume of exports. Because of relatively smaller volumes of duty-free access, as well as TRQs and safeguard measures, near-term U.S. exports of other unmodified starches (wheat, potato, and cassava) to Korea would likely be constrained until these impediments are eventually eliminated over a 15-year period after FTA implementation.

In Korea, corn starch is the dominant starch produced, followed by sweet potato starch.<sup>62</sup> Korea's leading starch import sources are China (corn and other starches) and Germany (potato), with the United States as a relatively smaller supplier of starches. Korea presently maintains very high duties on starch imports and TRQs with prohibitive over-quota tariff

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<sup>58</sup> National Corn Growers Assoc., "U.S.-Korea FTA Highlights Access and Beef Concerns (April 3, 2007)." Washington, DC: NCGA, 2007.

<sup>59</sup> American Oilseed Coalition, letter to Congress in connection with the U.S.-Free Trade Agreement, July 12, 2007.

<sup>60</sup> The products covered in this assessment represent less than 1 percent of U.S. exports to Korea and U.S. imports from Korea in the GTAP "food products n.e.c." sector, for 2006.

<sup>61</sup> This assessment is for starches in Harmonized System (HS) chap. 11 that are products of the milling industry. Dextrins and other modified starches found in HS chap. 35 are not included in this assessment.

<sup>62</sup> Fuglie and Oates, "Starch Markets in Asia," March 26–27, 2002, 3.

rates. For corn starch, the United States has a very small market share, as the duty-free access of 12,000 mt provided in Korea's WTO commitment has been largely filled by China.

Under the FTA, up to 10,000 mt of U.S. exports of corn starch would be able to enter Korea free of duty, which would grow at a rate of 3 percent per year until elimination in year 15 of the FTA. Corn starch would also have its base and safeguard tariffs reduced over a 15-year period (table 3.8). Because the FTA would provide immediate country-specific duty-free access of up to 10,000 mt solely to the United States, with subsequent 3 percent annual growth eventually leading to unlimited access, U.S. access to the Korean market should improve substantially. Given that recent U.S. corn starch exports to Korea have been less than the FTA quota allocations, this improved access would allow U.S. corn starch exports to increase significantly and to gain competitiveness against China, which is the dominant supplier, accounting for 99 percent of Korean imports in 2006.<sup>63</sup> Unlike corn starch, exports of starches manufactured from wheat, potato, cassava (manioc), and other starches would not be expected to increase substantially in the short term because of limited quota allocations. Therefore, the near-term improvement in market access afforded by the FTA would only be minimal for U.S. exports of these starches.

**Table 3.8** U.S. starch exports to and market access in Korea

	2006 U.S. exports metric tons	2006 base tariff percent	FTA tariff staging	First year TRQ or safeguard metric tons	First year safeguard tariff percent
Corn	373	226.0	15-year	10,000	221.2
Starch, nesoi	243	800.3	15-year	53	783.2
Wheat	401	50.9	10-year	None	N/A
Potato	79	455.0	15-year	239	445.3
Sweet potato	0	241.2	15-year	202	236.1
Cassava (manioc)	0	455.0	15-year	433	445.3

*Sources:* Official statistics of the U.S. Department of Commerce; and USTR, "Final - United States - Korea FTA Texts," 2007, Agricultural Tariff Schedule for the Republic of Korea, and Annex 3-A Agricultural Safeguard Measures, Schedule of Korea.

*Note:* Includes HS 110811, 110812, 110813, 110814, and 110819.

N/A= not applicable.

## Modified Starches

Dextrins and other modified starches<sup>64</sup> could benefit from the expanded access to the Korean market,<sup>65</sup> and exports of these products would increase slightly.<sup>66</sup> This increase would result from the eventual elimination of tariffs that currently range from 8 percent ad valorem for dextrins to 385.7 percent for various modified starches. Complete elimination of tariffs, however, would not occur until year 13. Korea has a sophisticated prepared foods industry

<sup>63</sup> Global Trade Information Services, World Trade Atlas Database.

<sup>64</sup> Includes products in HS 3505.10. Modified starches are starches from corn, potatoes, or other agricultures products that are chemically treated to break the starch into smaller molecules (dextrins) or to attach additional chemical groups. Modified starches are often used in prepared foods to enhance texture or viscosity.

<sup>65</sup> APAC for Trade, *Agricultural Policy Advisory Committee for Trade Report*, April 27, 2007, 2.

<sup>66</sup> Industry officials, telephone interviews by Commission staff, May 25–28 and June 26, 2007.

that uses modified starches; however, because the Korean market is relatively small, it is not as attractive to U.S. companies as other overseas Asian markets such as China and Indonesia, which have larger populations than Korea.<sup>67</sup> Modified starches produced in the United States tend to be “high-tech,” high-unit-value products that may not be available from Korean producers, as they currently do not have the same level of technical sophistication as U.S. producers.<sup>68</sup> Two Korean tariff lines covering pregelatinised or swelling starches and etherified or esterified starches would be subject to TRQs and over-quota duties in excess of 375 percent ad valorem in year 1.<sup>69</sup> Quantities of these modified starches below the safeguard quota would be free of duty. In 2006, U.S. exports of dextrans and modified starches to Korea were \$3.0 million and accounted for 4.2 percent of total Korean imports of these products.<sup>70</sup> For the Korean tariff lines subject to TRQs and safeguards, the U.S. exported a total of \$1.7 million and 785 mt to Korea,<sup>71</sup> well below the quantity that would trigger the safeguard. Given the typically high unit values for U.S.-produced modified starches, the low volumes for the quotas would still allow a moderately high value for U.S. exports.

### *Views of Interested Parties*

The Corn Refiners Association (CRA),<sup>72</sup> a national trade association representing much of the corn refining industry in the United States, indicated that it supports the FTA as it will create new market access for corn starch and modified starches. While noting that the duty phaseouts for corn starch and modified starch last several years, the CRA stated that it was pleased that the United States was able to obtain country-specific TRQs or safeguards that will facilitate the export of U.S. corn starch, dextrin, and modified starches. The CRA also notes that despite the relatively modest amounts of duty-free access provided in the TRQs for corn and modified starch, the CRA expects that the higher-value specialty starches for the food, pharmaceutical, and paper industries will fill these TRQs. The CRA estimates the value of this new market access at approximately \$50 million.

## **Citrus Fruit<sup>73</sup>**

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### *Assessment*

U.S. exports of citrus fruit to Korea would likely increase, primarily as a result of tariff reductions, quota removal, and the reduction of NTMs under the FTA. Korea has maintained a tariff-rate quota on U.S. oranges since 1997, although since 2004, the in-quota and over-

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<sup>67</sup> Industry official, telephone interview by Commission staff, June 26, 2007.

<sup>68</sup> Industry official, telephone interview by Commission staff, June 26, 2007.

<sup>69</sup> The safeguard measures are based on quantity rather than price. The safeguard quotas are equal to the TRQs except that the safeguards apply until year 13, one year longer than the TRQs.

<sup>70</sup> Global Trade Information Services, World Trade Atlas Database.

<sup>71</sup> Ibid.

<sup>72</sup> Erickson, “Re: Investigation No. TA-2104-24: U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects,” written submission to the USITC, June 21, 2007.

<sup>73</sup> The products covered in this assessment represent approximately 50 percent of U.S. exports to Korea in the GTAP “fruits, vegetables, nuts” sector, for 2006.

quota rates have been effectively equalized at 50 percent.<sup>74</sup> Korean tariff rates are relatively high, 50 percent for oranges and 30 percent for lemons and grapefruit. Under the provisions of the FTA, the Korean 30 percent tariff on U.S. lemons would be phased out over 2 years, while the 30 percent tariff on U.S. grapefruits would be phased out over 5 years. The 50 percent tariff rate on U.S. fresh oranges exported to Korea between March 1 and August 31 would be phased out over 7 years, with an immediate 20-percentage-point reduction of the 50 percent tariff in the first year of implementation to 30 percent ad valorem, followed by 5-percentage-point reductions each year thereafter to complete phaseout in year 7. Korea, however, would continue to maintain the 50 percent tariff on U.S. oranges imported between September 1 and March 1, but within that period, Korea would allow a duty-free permanent TRQ starting at 2,500 mt and increasing by 3 percent per year. This quota is relatively small compared to total U.S. fresh orange shipments to Korea, accounting for less than 5 percent of U.S. shipments in 2006.

In addition to these reductions in tariffs, the FTA's SPS chapter establishes a standing committee which is intended to address SPS issues related to U.S.-Korea bilateral trade.<sup>75</sup> The SPS chapter of the agreement reconfirms the commitment of both parties to use sound science in the application of SPS measures and generally refers to the WTO SPS Agreement to establish the means by which such measures would be applied.<sup>76</sup> Currently, U.S. fresh citrus exporters have entered into bilateral protocol agreements with Korea regarding Septoria, canker, and fruit fly. These protocols, which are outside the FTA framework, are in place between Korea and individual U.S. states such as California, Arizona, and Florida. For example, Korea prohibits the importation of fresh grapefruit from Florida unless they are certified under a bilateral protocol for Caribbean fruit flies, also known as the Caribfly Protocol.<sup>77</sup> The protocol restricts the Florida fruit to a small growing area in Florida that is certified to be free of fruit flies. Few grapefruits grown in Florida qualify because this area has been shrinking over the past decade.<sup>78</sup>

The provisions for fresh citrus fruit would likely have a significant effect on the U.S. citrus industry by significantly reducing tariffs on U.S. exports to one of the largest export markets for U.S. fresh citrus products. Fresh oranges accounted for the largest share of U.S. exports of fresh fruits, vegetables, and nuts to Korea, and fresh citrus of all types accounted for over half of the value in this category. In 2006, Korea imported approximately \$60 million of fresh oranges, \$45 million of fresh grapefruit, and \$5 million of fresh lemons from the United States.<sup>79</sup> Korea was the third-leading destination for U.S. fresh orange exports in 2006, after Canada and Japan. Korea was the second-leading destination for U.S. fresh grapefruit exports in 2006 after Japan and the fourth-leading destination for U.S. fresh lemon exports. In spite of the high tariff rates, U.S. fresh citrus is able to compete successfully in the Korean market against both domestically grown and imported products. In 2006, the United States accounted for about 95 percent of overall Korean citrus imports, South Africa

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<sup>74</sup> Under the orange tariff-rate quota, tariffs of 50 percent are applied within the quota. The size of the quota increased every year until 2004. The tariff on imports over the quota declined from 84.3 percent in 1997 to 50 percent in 2004. In practice, this eliminated the quota as the tariff was equalized for all oranges.

<sup>75</sup> For additional information regarding the FTA's chapter on SPS, see chap. 5 of this report.

<sup>76</sup> For additional analysis regarding SPS and other NTMs, see chap. 5 of this report.

<sup>77</sup> USDA, FAS, "Korea, Product Brief, Korean Grapefruit Market Brief 2005," July 29, 2005, 2; and Doug Bournique (General Manager, Indian River Citrus League), conversation with Commission staff, Vero Beach, FL, June 12, 2007.

<sup>78</sup> Barnes, Richardson, and Colburn (counsel), written submission to the Trade Policy Staff Committee, Office of the USTR on behalf of the Florida Citrus Mutual, Florida Citrus Packers, Gulf Citrus Growers Assoc., and Indian River Citrus League, March 24, 2006.

<sup>79</sup> Official U.S. Department of Commerce trade statistics.

accounted for about 3 percent, Chile about 2 percent, and Australia less than 1 percent.<sup>80</sup> Although the United States is a highly competitive exporter of fresh citrus, it owes much of its market share in Korea, in part, to the fact that Korea bans products from many other fresh citrus producers based on SPS concerns.

Among citrus products, the largest percentage export increase is expected to be for fresh lemons. The 30 percent tariff reduction over 2 years would make lemons relatively less expensive for Korean consumers, potentially increasing Korean demand and U.S. exports. It should be noted, however, that Korean tariffs are only a small portion of the cost of marketing lemons in Korea relative to the relatively high overhead in Korean supermarkets.<sup>81</sup>

U.S. grapefruit exports would also be expected to grow significantly over the 5 year phaseout of the 30 percent tariff, particularly California pomelos, which have sold well in Korea and are prized for their large size, particularly as gifts or ornaments. Grapefruit exports to Korea would be enhanced further if the SPS issues with Florida, such as the Mediterranean fruit fly, could be resolved. The United States dominates world grapefruit exports with about a 70 percent world share of all fresh grapefruits, and would be expected to be competitive with those from other suppliers.

Orange exports would be expected to increase, but not as rapidly, as much of the U.S. harvest season falls in the September through February period in which the seasonal TRQ remains, although the duty-free in-quota amount increases 3 percent per year. The agreement, however, would have an immediate and significant effect on exports of late-season U.S. oranges that can be shipped to Korea after March 1, when the tariff would decline from 50 percent to 30 percent in the first year, and 5 percent per year thereafter.

Anticipated increases in U.S. citrus exports, however, may be hampered by the administration of the remaining TRQs and other NTMs, which are not specifically addressed by the FTA. Korea does not grow lemons, grapefruit, or large oranges such as navels or Valencias. Korea has a domestic citrus industry located on Korea's southernmost island, Cheju Island, that grows mainly Unshu tangerines for domestic consumption. This citrus is a Korean and Japanese variety not grown in the United States, but which the Korean government historically has protected.<sup>82</sup> When Korea first granted an orange quota to U.S. exporters under the reduced tariff Minimum Market Access quota, the administration of the quota was given to the Cheju Citrus Grower's Agricultural Cooperative (CCGAC). CCGAC, whose members consist solely of domestic producers, has the authority to auction the quotas.<sup>83</sup> According to USDA/FAS, this composition of the CCGAC led to an appearance of a conflict of interest in the administration of the quota.<sup>84</sup> For example, in some years, the quota was not fully filled, even though U.S. oranges entered Korea at the over-quota rates.

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<sup>80</sup> Global Trade Information Services, World Trade Atlas Database.

<sup>81</sup> Mike Wooton (Vice-President of Corporate Affairs, Sunkist Growers), interview by Commission staff, Sherman Oaks, CA, June 12, 2007.

<sup>82</sup> USDA, FAS, "Korea Citrus Annual," December 1, 2006, 1.

<sup>83</sup> The WTO TPRM cites the Jeju Citrus Grower's Agricultural Cooperative as being an STE whose products include oranges, mandarins, and tangerines. The WTO TPRM states that the average fill ratio of tariff quotas is about 70 percent, and that the CCGAC is an STE that either utilized, administered, or allocated tariff quotas, raising "potential conflicts between their importing interests and those of their farm constituents."

<sup>84</sup> WTO, Trade Policy Review Body (TPRB), "Minutes of Meeting Held on 31 October," October 31, 2000.

## *Views of Interested Parties*

In its report, the ATAC on Trade in Fruits and Vegetables stated that it is generally supportive of the agreement and noted that it has long called for an FTA with Korea.<sup>85</sup> The ATAC expressed its preference to either phase out, within a reasonable period of time, the “permanent” seasonal 50 percent duty on U.S. oranges (September 1–March 1) or substantially increase the annual quota allowed by the TRQ beyond the limited 3 percent increase. The ATAC also expressed concern with the manner in which Korea has historically used SPS measures to protect its domestic producers from competition with imports, and urged that Korea commit to use sound science in the application of these measures. The ATAC added that the USDA and the USTR need to remain “vigilant regarding possible future SPS conflicts” and need to act on them as soon as they are identified.

In a submission to the USTR, Florida citrus growers, including Florida Citrus Mutual (FCM), stated that they have long been concerned that, although the Florida citrus industry does not compete directly with Korea’s specialized domestic production of Unshu mandarin oranges, Korea nevertheless “rigidly protects its domestic Unshu industry,” and thus has been a difficult market for U.S. citrus exporters to access.<sup>86</sup> Korea, they reported, is a large and growing market for exports of fresh citrus from the United States, and U.S. citrus products enjoy strong consumer recognition and acceptance in Korea. The growers noted that Korea’s tariffs on U.S. fresh citrus remain very high, and in addition, some of Korea’s SPS measures against fresh citrus from the United States have been “unreasonable” and have severely restricted trade. FCM commented that, while it recognizes Korea’s right to safeguard the health of its population as well as its domestic mandarin industry, excessive SPS measures, in conjunction with Korea’s very high citrus tariffs, have unfairly inhibited U.S. citrus exports to that growing market. FCM stated that it would support an FTA with Korea, but only if Korea significantly reduces its citrus tariffs and refrains from imposing unfair and unscientific SPS measures on U.S. citrus products. FCM said that it has always found the Caribfly Protocol troubling, applied by Korea as an SPS measure, because there is no scientific evidence that Caribbean fruit flies are harmful in nontropical climates like Korea’s.

## **Noncitrus Fruit<sup>87</sup>**

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### *Assessment*

The FTA would likely result in increased exports of U.S. noncitrus fruit as a result of tariff elimination, quota reduction or elimination and the establishment of a committee to address SPS issues.<sup>88</sup> Korea’s average import duty on U.S. agricultural products is about 52 percent

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<sup>85</sup> ATAC on Trade in Fruits and Vegetables, *Advisory Committee Report*, April 2007.

<sup>86</sup> Barnes, Richardson, and Colburn (counsel), written submission to the Trade Policy Staff Committee, Office of the USTR on behalf of the Florida Citrus Mutual, Florida Citrus Packers, Gulf Citrus Growers Assoc., and Indian River Citrus League, March 24, 2006.

<sup>87</sup> The products covered in this assessment represent approximately 8 percent of U.S. exports to Korea in the GTAP “vegetables, fruit, nuts” and less than 1 percent of the “food products n.e.c.” sectors, and represent approximately 81 percent of U.S. imports from Korea in the GTAP “vegetables, fruit, nuts” sector, for 2006.

<sup>88</sup> For additional analysis regarding SPS and other NTMs, see chap. 5 of this report.



ad valorem, more than four times the U.S. average.<sup>89</sup> The immediate removal and gradual reduction of tariffs on selected goods is expected to benefit U.S. exporters. Expanded U.S. exports may in turn result in the lowering of market prices for these products, stimulating increased demand.<sup>90</sup> Long-standing SPS issues are a major concern for U.S. fruit exporters and in some cases have effectively halted exports to Korea. The FTA has established a framework that may provide for the resolution of these issues. If these issues (described below) are resolved, U.S. exports of noncitrus fruit should grow significantly. While this increase in exports to Korea would likely be substantial, the impact on the U.S. industry is likely to be small because of the small size of the Korean market relative to total U.S. noncitrus fruit production.

The Korean fruit market is described as a sizeable, lucrative, and expanding one where commodity prices are considered high, but as per capita income has risen, consumers have shown a willingness to pay premium prices for high-quality U.S. products.<sup>91</sup> As the impact of the FTA on the U.S. noncitrus fruit industry will vary depending on the product, the assessment provided below focuses on selected product-specific effects (apples, peaches, pears, cherries, grapes, raisins, and strawberries).

U.S. apple exports to Korea amounted to only 29 mt in 2005 and 70 mt in 2006, valued at \$21,175 and \$82,415 respectively.<sup>92</sup> The current tariff on all varieties of apples is 45 percent. U.S. apple exports would likely benefit from the phaseout of tariffs that would begin upon the implementation of the FTA. The FTA would phase out the 45 percent tariff for the Fuji variety over 20 years and all other varieties over 10 years. If U.S. apples are given access to the Korean market and the SPS issues described below are resolved, U.S. apple exports would also be subject to potential safeguard duties (table 3.9).<sup>93</sup> Although Korea has a large apple-producing industry, with 380,000 mt produced in 2005,<sup>94</sup> U.S. apples are considered to be of higher quality and very competitive in terms of price compared to the high apple prices in the Korean market. Industry representatives have expressed hope that the U.S.-Korea FTA would bolster the long-term growth of U.S. apple exports to Korea by allowing exporters to increase their competitiveness.<sup>95</sup> Although apples, as well as fresh peaches and pears, should benefit from the elimination of tariffs as a result of the FTA (table 3.9), the cost advantages provided by the tariff reductions will likely have minimal impact on U.S. exports in the short term until SPS issues are effectively resolved.

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<sup>89</sup> Cooper and Manyin, *The Proposed South Korea-U.S. Free Trade Agreement*, May 24, 2007, 17.

<sup>90</sup> Lee and Sumner, "The Prospective Free Trade Agreement with Korea," January 2007, 3.

<sup>91</sup> *Ibid.*, 41.

<sup>92</sup> Official statistics of the U.S. Department of Commerce.

<sup>93</sup> The safeguard trigger level would be 9,000 mt for the first 4 years following implementation of the agreement and, in year 5, would increase by 3 percent per year until the safeguard is eliminated in year 24. The safeguard duty begins at 45 percent, and would be phased down to 22.5 percent in year 16, where it would remain until elimination in year 24.

<sup>94</sup> UN FAO, "Core Production Data," July 18, 2007.

<sup>95</sup> Northwest Horticulture Council representative, interview by Commission staff, June 1, 2007.

**Table 3.9** U.S.-Korea trade and tariff liberalization for selected fruit, 2006

		U.S. Exports				
HTS	Item description	U.S. exports to Korea (1,000 dollars)	Total U.S. exports (1,000 dollars)	Korean share in total U.S. exports (Percent)	MFN applied duty (Percent)	Tariff liberalization schedule
080920	Cherries, sweet or tart, fresh	10,217	216,417	4.7	24	• Immediate elimination
080620	Grapes, dried (including raisins)	5,201	211,085	2.5	21	• Immediate elimination
080610	Grapes, fresh	3,240	664,500	0.5	45	• May 1–Oct. 15: 17-year linear • Oct. 16–April 30: Reduced immediately to 24 percent and then removed in 4 equal annual stages beginning in year 2
081110	Strawberries, frozen, uncooked, or cooked by steaming or boiling in water, whether or not sweetened	223	25,892	0.9	30	• 5-year linear
080810	Apples, fresh	82	560,781	0.0	45	• Fuji variety: 20-year linear • All other fresh varieties: 10 year linear • Also subject to safeguards.
080820	Pears and quinces, fresh	58	132,970	0.0	45	• Asian variety: 20-year linear • Other fresh varieties: 10-year linear
080930	Peaches, including nectarines, fresh	0	132,260	0.0	45	• 10-year linear
081010	Strawberries, fresh	0	280,736	0.0	45	• 9-year linear
		U.S. Imports				
HTS	Item description	Imports from Korea (1,000 dollars)	Total U.S. imports (1,000 dollars)	Korean share in total U.S. exports (Percent)	MFN applied duty (Percent)	Tariff liberalization schedule
808204000	Pears and quinces, FRESH, entered during the period from July 1 to March 31 of the following year	20,833	66,445	31.4	0.3 cents per kg	• Immediate elimination

Sources: Official statistics of the U.S. Department of Commerce; and USTR, "Final - United States - Korea FTA Texts," 2007, U.S. Tariff Schedule and Korea Tariff Schedule.

Market access in Korea for several U.S. noncitrus fruit products has been hampered by SPS issues as well.<sup>96</sup> SPS issues, including alleged pests and diseases, such as codling moth and fire blight, have effectively halted U.S. apple exports to Korea.<sup>97</sup> Exports of fresh peaches have been halted as a result of specific SPS concerns, primarily fumigation protocols. U.S. exports of fresh pears have also been prohibited from entering the Korean market because of SPS issues that are naturally endemic to the Northwest pear growing industry. The proposed FTA would establish a Committee on Sanitary and Phytosanitary Matters in order to resolve SPS issues through science and risk-based assessments. If these SPS issues are resolved, then the industry predicts that the market has tremendous potential for U.S. exporters. An industry representative also stated that the resolution of these issues, along with the phasing out of tariffs, could lead to potential apple exports of between \$500,000 and \$1 million in the first year following the resolution of these issues.<sup>98</sup> The industry notes, however, that the effect on U.S. peach exports will likely be small if the protocol requires fumigation using methyl bromide, because U.S. industry is concerned that methyl bromide detracts from the product's quality.<sup>99</sup> An industry representative also estimates that if a science-based protocol is established and can resolve the naturally endemic SPS issues without exorbitant costs to the fresh pear industry, exports to Korea would increase to between \$500,000 and \$680,000 in the first year.<sup>100</sup>

Exports of cherries to Korea have grown significantly, averaging year-over-year growth of over 40 percent per year since 2003. This growth was initially spurred by the fact that, in 2004, all varieties of cherries were permitted for import into Korea. Prior to that only Bing variety cherries were permitted into the market.<sup>101</sup> In recent years, U.S. cherries have had an 85-percent market share in Korea.<sup>102</sup> U.S. fresh cherry exports would likely benefit from the immediate elimination of Korea's 24 percent tariff upon the implementation of the FTA. According to industry representatives, the immediate elimination of the tariff would equate to a cost decrease of approximately \$0.75 to \$0.90 per lb.<sup>103</sup> In total, U.S. cherry exports would be expected to increase by 30–40 percent or approximately \$3.5 million the first year following the implementation of the FTA.<sup>104</sup>

Upon implementation of the FTA, both out-of-season (October 16–April 30) and in-season (May 1–October 15) fresh grape exports would likely benefit from tariff reductions. Out-of-season grapes would benefit from a more accelerated schedule (table 3.9). The majority of U.S. fresh grapes are imported from October through January<sup>105</sup> and would therefore benefit from the out-of-season tariff reduction. Korean domestic fresh-grape production is the primary source of competition for U.S. grapes in Korea. The Korean domestic industry is significant in size, producing 360,000 mt in 2005.<sup>106</sup> Korean growers generally harvest in late summer and early fall, similar to when American growers harvest. The California growing season, however, is slightly longer and extends through the late fall which, along with the tariff reductions, would allow U.S. grapes to gain market share during the months when

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<sup>96</sup> According to official statistics of the U.S. Department of Commerce, exports of fresh apples, pears, or peaches to Korea have not exceeded \$100,000 over the past 5 years.

<sup>97</sup> Hansen, "Korean Agreement Reduce Fruit Tree Tariffs," May 15, 2007.

<sup>98</sup> Northwest Horticulture Council representative, interview by Commission staff, June 1, 2007.

<sup>99</sup> Industry representative, interview by Commission staff, June 11, 2007.

<sup>100</sup> Industry representative, interview by Commission staff, June 6, 2007.

<sup>101</sup> USDA, FAS, "Korea Product Brief, Fresh Stone Fruit 2005," February 1, 2005.

<sup>102</sup> USDA, FAS, "Republic of Korea Product Brief, Produce Market Brief Update 2005," October 5, 2005.

<sup>103</sup> Powers, written submission to the Trade Policy Staff Committee, Office of the USTR, March 14, 2006.

<sup>104</sup> Northwest Horticulture Council representative, interview by Commission staff, June 1, 2007.

<sup>105</sup> USDA, FAS, "Republic of Korea Product Brief, Produce Market Brief Update 2005," October 5, 2005.

<sup>106</sup> UN FAO, "Core Production Data," July 18, 2007.

Korean grapes are much more costly and the counterseasonal Chilean product is not yet in the market.<sup>107</sup> It is expected that the tariff reduction would allow U.S. exporters to be more price competitive compared to the Korean industry and other suppliers, such as Chile, and as a result expand their market share and increase the volume of exports to Korea.<sup>108</sup> For example, the California Table Grape Commission states that the FTA “provides improved access for California table grapes to the emerging South Korean market”; and that “California table grapes will be more competitive with Chilean grapes.”<sup>109</sup>

Raisin exports would likely benefit from the immediate elimination of Korea’s 21 percent tariff upon implementation of the agreement. The United States is the primary supplier to Korea and supplied approximately 94 percent of all Korean raisin imports in 2006.<sup>110</sup> According to industry sources, in recent years U.S. raisin producers have been exporting approximately one-half of the peak volumes of raisins that were exported to Korea in the early 1990s.<sup>111</sup> According to one industry source, the tariff elimination and resulting higher margins would allow industry associations to increase their in-country promotional efforts, which, combined with lower prices for the consumers, could increase raisin exports to approximately 12 million pounds from the 7.17 million pounds that were exported in 2006.<sup>112</sup>

Frozen strawberry exports would likely benefit from a 5-year linear reduction of the current 30 percent tariff upon the implementation of the FTA. U.S. frozen strawberries have a small foothold in the Korean market despite the 30 percent tariff, strong competition from China, and a large, but high-cost, domestic industry.<sup>113</sup> As a result of China’s significant cost advantage, even with the tariff elimination, U.S. exports are not expected to gain market share for those purchasing based on cost. U.S. frozen strawberry exports, however, serve the high-quality, ready-to-eat market.<sup>114</sup> Consequently, as the price for the consumer decreases for high-quality frozen strawberries from the United States as a result of the tariff elimination, demand and exports would be expected to increase slightly.<sup>115</sup>

Upon the implementation of the FTA, fresh strawberries would benefit from a 9-year linear reduction of the current 45 percent tariff. Despite the large Korean domestic industry, the United States (primarily California) strawberry season complements the Korean season. The Korean harvest season ends in June, while the U.S. season peaks in June and continues into the fall; this results in exports throughout the late summer and fall when Korean domestic production is essentially inactive. Fresh strawberry exports to Korea, however, have traditionally been limited because of high transport costs. Fresh strawberries require air freight shipping in order to maintain freshness. The decreasing FTA tariff rates are expected

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<sup>107</sup> Lee and Sumner, “The Prospective Free Trade Agreement with Korea,” January 2007, 24.

<sup>108</sup> California Table Grape Commission representative, interview by Commission staff, June 6, 2007. In 2004, Korea and Chile implemented an FTA.

<sup>109</sup> California Table Grape Commission, written submission to the USITC, June 25, 2007.

<sup>110</sup> Global Trade Information Services, World Trade Atlas Database.

<sup>111</sup> According to industry sources, the decline from the peak of business was brought on by two factors. First, the industry closed its industry representatives office and as a result the industry withdrew from actively promoting the product in the market. Second, the increased promotional efforts of competing groups, such as other dried fruit and nut groups, caused California raisins to not be the product of choice within the baking and confectionary communities.

<sup>112</sup> U.S. industry official, interview by Commission staff, May 31, 2007.

<sup>113</sup> Lee and Sumner, “The Prospective Free Trade Agreement with Korea,” January 2007, 26.

<sup>114</sup> Ready-to-eat type frozen strawberries refer to those that are one processing step away from being in the desired final form. Generally, U.S. exports of frozen strawberries are the high-quality strawberries used for products such as ice cream, smoothies, and baked goods.

<sup>115</sup> U.S. industry official, interview by Commission staff, June 11, 2007.

to offset some of these transport costs. As a result, U.S. exports of fresh strawberries are expected to increase.<sup>116</sup>

In general, Korea's noncitrus fruit exports are limited and U.S. imports from Korea have been negligible, as Korea's position as a net importer of agricultural products has become more pronounced. Imports of noncitrus fruits from Korea generally have very little impact on the domestic industry and Korea is considered to have limited potential to expand its already small fruit exports to the United States.<sup>117</sup> The Commission's economy-wide analysis of the long-term effects of tariff and TRQ liberalization indicate U.S. imports of vegetables, fruits, and nuts (of which the products included here represent a large component) could increase by \$2–4 million (4–10 percent).<sup>118</sup> Although Korea exports a large quantity of fresh pears to the United States, which would benefit from the immediate elimination of the 0.3 cents per kilogram tariff, the majority of pear imports from Korea are of the Asian variety, which compete only to a limited extent with domestic production. Consequently, Korean exports of Asian-variety pears may gain a slight advantage in their market niche as a result of the tariff elimination at the expense of other U.S. import sources, primarily China.<sup>119</sup>

### *Views of Interested Parties*

The report of the ATAC on Trade in Fruits and Vegetables stated that members were pleased with the agreement and, on the whole, see it as a positive agreement for the fresh fruit industry. The report notes that many of the tariff concessions were difficult to obtain and states that it will result in benefits for many fruit producers. The report expressed concern with Korea's past record of using SPS measures to protect its domestic producers and recommended that negotiators continue to identify and resolve existing and future SPS conflicts.<sup>120</sup>

Despite concerns regarding the lack of explicit resolutions for various SPS issues, several industry associations expressed support for the FTA.<sup>121</sup> The associations stated that they see the SPS agreement as a framework that may provide an avenue to resolve SPS issues in the future. They added that the potential to resolve these SPS issues, along with the accelerated tariff elimination schedules, will provide for further access into the Korean market for U.S. exports of noncitrus fruit.

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<sup>116</sup> U.S. industry officials, interviews by Commission staff, June 11, 2007.

<sup>117</sup> Lee and Sumner, "The Prospective Free Trade Agreement with Korea," January 2007, 1.

<sup>118</sup> Impact relative to an estimated 2008 base. See chap. 2 of this report for additional information regarding the economy-wide analysis.

<sup>119</sup> U.S. industry officials, interviews by Commission staff, June 6, 2007.

<sup>120</sup> ATAC on Trade in Fruits and Vegetables, *Advisory Committee Report*, April 2007.

<sup>121</sup> Industry representatives (from the Washington Apple Commission, the Northwest Horticulture Council, the California Cherry Advisory Board, the Northwest Pear Bureau, California Table Grape Commission, the California Raisin Marketing Board, the California Strawberry Commission, and the California Tree Fruit Agreement) interviews by Commission staff, June 2007.

# Potato Products<sup>122</sup>

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## *Assessment*

The U.S.-Korea FTA would likely result in increased U.S. exports of certain potato products<sup>123</sup> to Korea, especially in the near term for frozen potato products (primarily french fries) with the elimination of the 18-percent duty. Dehydrated (dehy) potato products and fresh potatoes for chipping,<sup>124</sup> would also benefit from reduced duties and increased TRQ allocations under the FTA. Increased U.S. exports of some potato products to Korea may be hampered by NTMs, and the potential impact of the FTA on frozen and other potato products depends upon the successful implementation of SPS-related provisions of the FTA, as well as the identification and resolution of problems associated with rules-of-origin and TBT issues.<sup>125</sup> Some industry representatives have expressed concern regarding these issues.<sup>126</sup>

## **Frozen Potato Products**

Global competition in international frozen-potato products' markets is intense and U.S. products compete in Korea with products from Australia, Canada, the EU, and New Zealand.<sup>127</sup> Korea is the fifth-largest export market for U.S.-produced frozen french fries,<sup>128</sup> and the United States currently supplies 80 percent of that market.<sup>129</sup> This market share is projected to expand as the elimination of the 18 percent duty provides a competitive advantage in the near term for U.S. exporters with respect to major competitors.<sup>130</sup> There would likely be a small positive impact on the U.S. industry as it strives to fill existing and new demand for frozen potato products; however, the extent of this impact would likely be tempered by the large market share already supplied by U.S. product.<sup>131</sup> Demand in the Korean frozen-potato products' market would be supplied by product produced in the United States, resulting in little if any effect on U.S. investment within Korea in this sector. The elimination of the duty may negligibly increase U.S. employment,<sup>132</sup> but would likely have no impact on U.S. consumers. The current 8-percent tariff on U.S. imports of frozen potato products from Korea would be eliminated, but the tariff elimination would likely have no

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<sup>122</sup> The products covered in this assessment represent approximately 4 percent of U.S. exports to Korea in the GTAP "food products n.e.c." and less than 1 percent of the "vegetables, fruit, nuts" sectors, and represent less than 1 percent of U.S. imports from Korea in the GTAP "food products n.e.c." sector, for 2006.

<sup>123</sup> Included here are potato seed and fresh potatoes (HS 0710), frozen potatoes (HS 0710.10), dehydrated potato products (HS 1105), frozen potato products including french fries and other frozen potato products (HS 2004.10), and other prepared or preserved potato products including chips, granules, and other products (HS 2005.20).

<sup>124</sup> Chipping potatoes are fresh potatoes grown specifically for processing into potato chips.

<sup>125</sup> ATAC for Trade in Processed Foods, *Advisory Committee Report*, April 27, 2007, 4. For additional analysis regarding TBTs and other NTMs, see chap. 5 of this report.

<sup>126</sup> ATAC on Trade in Fruits and Vegetables, *Advisory Committee Report*, April 2007, 4.

<sup>127</sup> APTA, written submission to the House Committee on Ways and Means, April 4, 2007.

<sup>128</sup> NPC, "National Potato Council Applauds Completion of U.S.-Korea Free Trade Agreement (April 3, 2007)."

<sup>129</sup> APTA, written submission to the House Committee on Ways and Means, April 4, 2007.

<sup>130</sup> *Ibid.*

<sup>131</sup> Also, there may not be much of an additional positive long-term impact on the U.S. industry, as several competitor countries with frozen potato-product sales in Korea, especially Canada and Australia, are currently negotiating free-trade agreements with Korea. APTA, written submission to the Trade Policy Staff Committee, Office of the USTR, March 20, 2006.

<sup>132</sup> APTA, written submission to the House Committee on Ways and Means, April 4, 2007.

effect on U.S. imports of potato products from Korea, as Korea currently has no frozen-potato processing facilities.<sup>133</sup>

### **Other Potato Products<sup>134</sup>**

Currently, Korean duties are 20 percent on potato chips, granules, and other prepared potato products, 27 percent on cooked or uncooked frozen potatoes, and 304 percent on fresh potatoes, seed potatoes, and dehydrated potato products. Under the FTA, the elimination of the 304 percent duty on fresh potatoes, seed potatoes, and dehy potato products and the 27 percent duty on frozen potato products would decline in two annual installments and would be eliminated effective January 1 of year 2. The elimination of the 20 percent duty on potato chips, granules, and other potato preparations would occur in three annual installments and be eliminated effective January 1 of year 3.

U.S. industry sources state that Korea has become an important export market for U.S. dehy potato products, but further significant growth is limited principally by Korea's TRQ on dehy products.<sup>135</sup> Although the in-quota duty is 5.4 percent, the over-quota duty is 304 percent. According to the American Potato Trade Alliance, this over-quota duty essentially restricts the dehy market for U.S. exporters.<sup>136</sup> Recently, the Korean government announced an expansion of the existing TRQ on dehy potato products from 10 mt to 60 mt,<sup>137</sup> an amount, which, according to a company representative, is still well below volumes the industry would like to ship.<sup>138</sup> Nevertheless, by reducing the restrictions on U.S. exports of dehy potatoes, the U.S. industry stands to increase its market share in Korea. Medium-term increases in exports of dehy potato products may, however, be hampered as the FTA TRQ is easily filled by U.S. exporters,<sup>139</sup> and the duty-free in-quota quantity increases by only 3 percent annually over the following 10 years after FTA implementation.<sup>140</sup>

There may be a small but growing Korean market for sales of U.S. fresh potatoes for chipping (chipping potatoes). Under the FTA, chipping potatoes from the United States enter duty-free and quota-free during December 1 through April 30, when Korean domestic product availability is usually low. In addition, the FTA contains a TRQ on fresh table-stock potatoes (excluding chipping potatoes and seed potatoes) that limits duty-free entry to 3,000 mt in year 1, which increases by 3 percent annually each year thereafter; the over-quota duty

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<sup>133</sup> APTA, written submission to the Trade Policy Staff Committee, Office of the USTR, March 20, 2006.

<sup>134</sup> Included here are potato seed and fresh potatoes (0710), uncooked or cooked frozen potatoes (0710.10), dehydrated potato products (1105), and other prepared or preserved potato products including chips, granules, and other products (2005.20).

<sup>135</sup> APTA, written submission to the Trade Policy Staff Committee, Office of the USTR, March 20, 2006.

<sup>136</sup> APTA, written submission to the USITC, June 22, 2007.

<sup>137</sup> USDA, FAS, "Republic of Korea Product Brief, Market Access Quota Increase 2007," May 4, 2007, 3.

<sup>138</sup> U.S. industry official, telephone interview by Commission staff, May 30, 2007.

<sup>139</sup> According to an industry source, current U.S. production for export to Korea is approximately ten times the 5,000 mt quota. U.S. industry representative, telephone interview by Commission staff, May 30, 2007.

<sup>140</sup> According to Annex 3-A, Agricultural Safeguard Measures, the quota is 5,000 mt. The quota increases by 3 percent annually and remains in effect for 10 years; within-quota amounts enter free of duty. The safeguard duty falls 3 percent annually between years 1, 2, and 3, 4 percent between years 3, 4, and 5, 16 percent between years 5 and 6, 7 percent between years 6, 7, and 8, 8 percent between years 8 and 9, 9 percent between years 9 and 10, and goes to zero in year 11.

rate is 304 percent ad valorem.<sup>141</sup> Although seed potatoes are excluded from the TRQ on fresh potatoes, according to a company representative, these exports are not considered an important trade item.<sup>142</sup>

Currently, only 5 percent of total Korean fresh-potato production is of potatoes for chipping. Korean chipping-potato production is limited to one variety of chipping potatoes, and then only if there is a contract with a potato-chip processor for the sale of such production.<sup>143</sup> Thus, supplies of locally produced potatoes for chipping are erratic. U.S. exports currently account for about 5 percent of the total chipping market.<sup>144</sup> Prices for U.S. chipping potatoes are believed to be more competitive than, and the quality better than, potatoes from Australia, the other major foreign supplier to the Korean chipping market.<sup>145</sup> Increased sales of U.S. chipping potatoes resulting from the FTA could increase U.S. market share in Korea. In addition to chipping potatoes, an industry trade association states that Korea is also an excellent market for expanded sales of potato chips.<sup>146</sup> One industry source indicated that exports of semifinished chips could increase, especially in larger containers, as they are more easily shipped than finished chips.<sup>147</sup> The industry source stated that U.S. exports of finished potato chips are generally not economically feasible, because margins on foreign-market sales of such chips are small and finished chips have a somewhat limited shelf life.<sup>148</sup>

### *Views of Interested Parties*

In its submission to the Commission, the National Potato Council (NPC) stated that the “U.S. potato industry strongly supports the implementation of the U.S.-Korea Free Trade Agreement.”<sup>149</sup> It noted that Korea is “an important and growing market for both dehydrated and fresh potato exports,” and that the FTA “will guarantee market share for U.S. potato products against our primary international competitors, Canada, New Zealand, Australia and the European Union.” The NPC added that “the potato industry saw major achievements for each of its priority products,” which are frozen fries, dehydrated potatoes, and fresh potatoes. The NPC concluded its submission stating that the “U.S. potato industry stands to benefit greatly from the U.S.-Korea Free Trade Agreement.”

The American Potato Trade Alliance (APTA) in a submission to the House Committee in April 2007 stated that it supports an FTA and that tariff reductions will create jobs in the U.S. potato industry.<sup>150</sup> APTA added that the FTA will allow for U.S. exports to maintain their dominant market share in an export market that is very competitive and price sensitive. APTA also stated that an FTA may provide an excellent opportunity for expanded exports of potato chips. The Snack Food Association (SFA) commented that it supports any efforts

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<sup>141</sup> There is no negotiated phaseout period after which the TRQ would expire.

<sup>142</sup> U.S. industry official, telephone interview by Commission staff, May 30, 2007.

<sup>143</sup> USDA, FAS, “Korean Fresh Potato Update 2007,” January 12, 2007.

<sup>144</sup> James McCarthy (President & CEO, Snack Food Association), e-mail message to Commission staff, May 30, 2007.

<sup>145</sup> USDA, FAS, “Republic of Korea Product Brief, Produce Market Brief Update 2005,” October 5, 2005, 4.

<sup>146</sup> APTA, written submission to the House Committee on Ways and Means, April 4, 2007.

<sup>147</sup> U.S. industry official, telephone interview by Commission staff, May 30, 2007.

<sup>148</sup> U.S. industry official, telephone interview by Commission staff, May 30, 2007.

<sup>149</sup> National Potato Council, written submission to the USITC, June 19, 2007.

<sup>150</sup> APTA, written submission to the House Committee on Ways and Means, April 4, 2007.



to improve accessibility to foreign markets for their products, especially in bulk containers or in a semifinished state of production.<sup>151</sup>

The report of the ATAC for Trade in Fruits and Vegetables reported that members view the negotiated FTA agreement as generally positive for the U.S. vegetable sector.<sup>152</sup> The report notes that Korea is a net food importer and expresses the view that Korea is likely to increase food imports from the United States in the future. The report also states that the FTA should place U.S. vegetable producers in a better position to benefit from agreed-upon tariff concessions that could provide additional benefits to vegetable export interests.<sup>153</sup> The report expresses concern, however, with the way in which Korea has used SPS measures in the past to protect certain industries from import competition, and said that preferential FTA tariff treatment would do little for improved bilateral trade if SPS barriers continue to be imposed.<sup>154</sup>

In its report, the ATAC for Trade in Processed Foods took no position on the U.S.-Korea FTA. It noted, however, that it strongly endorses the goal of opening foreign markets, the promotion of tourism, trade, and investment, the expansion of economic opportunity, and the strengthening of political stability and national security for all nations.<sup>155</sup> It also expressed concern about the creation of special rules of origin, and stated that it was important to resolve existing SPS and TBT issues.<sup>156</sup> In its report, this ATAC said that it endorses the provision for tariff-free status of more than one-half of all food and agriculture exports (including many processed products) to Korea upon enactment of the agreement, and the 5-year tariff phaseout program for many other processed foods.<sup>157</sup> The report noted, however, that members were particularly concerned about the possibility that benefits otherwise accrued to many processed food items would be lost because of continuing technical trade barriers not addressed in the FTA. The report said that Korea does not allow the use of a number of U.S. FDA-approved food additives commonly used in the U.S. food-manufacturing process, preventing export to the Korean market of foods containing such additives.<sup>158</sup>

The report of the Agricultural Policy Advisory Committee (APAC) for Trade stated that a majority of its members believe that the U.S.-Korea FTA will benefit U.S. farmers (including vegetable farmers). This report states further that priority must be given to comprehensive agricultural trade reform.<sup>159</sup> This APAC calls for the elimination of barriers to trade in agricultural products, through negotiations at the multilateral, regional, and bilateral levels, for the purpose of improving market opportunities for U.S. agriculture through fairer and more open trade conditions.<sup>160</sup> The report notes that two-thirds of all Korean imports of U.S.-produced agricultural products will receive duty elimination upon enactment of the agreement and 90 percent of Korean imports from the United States will be duty-free within 15 years.<sup>161</sup>

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<sup>151</sup> U.S. industry official, telephone interview by Commission staff, May 30, 2007.

<sup>152</sup> ATAC on Trade in Fruits and Vegetables, *Advisory Committee Report*, April 2007, 2.

<sup>153</sup> *Ibid.*, 2-3.

<sup>154</sup> *Ibid.*, 4.

<sup>155</sup> ATAC for Trade in Processed Foods, *Advisory Committee Report*, April 27, 2007, 3.

<sup>156</sup> *Ibid.*, 4.

<sup>157</sup> *Ibid.*, 5.

<sup>158</sup> *Ibid.*

<sup>159</sup> APAC for Trade, *Agricultural Policy Advisory Committee for Trade Report*, April 27, 2007, 2.

<sup>160</sup> *Ibid.*, 3.

<sup>161</sup> *Ibid.*

## Other Vegetables<sup>162</sup>

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### *Assessment*

The U.S.-Korea FTA would likely result in increased U.S. exports of a number of fresh and processed (i.e., frozen, dried, and canned) vegetables<sup>163</sup> to Korea, especially in the near term, although export volumes and associated tariffs vary considerably by commodity.<sup>164</sup> U.S. global exports of most of these items generally have accounted for a small share of U.S. production and sales, as well as a small share of Korean consumption, but under an FTA U.S. domestic production and Korean-market sales are expected to increase. The Korean vegetable market is described as a sizeable, lucrative, and expanding market where commodity prices are considered high, but consumers have shown a willingness to pay premium prices for high-quality U.S. products.<sup>165</sup> Consequently, this market offers significant potential for expanded U.S. fresh- and processed-vegetable exports.<sup>166</sup>

Korean duties on the U.S. fresh and processed vegetable products currently range from 5 percent ad valorem on some canned tomato products to 607.5 percent for some dried beans.<sup>167</sup> Duties on nearly all of these items would be phased out over 2 to 3 years,<sup>168</sup> but some of these items subject to TRQs. Global competition in the Korean market for U.S. sales of these vegetables is coming primarily from China but also from Chile. China, supported by its very large community-based vegetable production areas and its close proximity and, consequently, lower shipping costs to the Korean market, already accounts for nearly all Korean imports of certain vegetables and products. China is also likely to become an even greater supplier of vegetables to Korea in the future,<sup>169</sup> especially in light of its recent partnership with the Association of Southeast Asian Nations (ASEAN) to form an ASEAN+3 trade group.<sup>170</sup> For those U.S. products currently competing in the Korean market with products from Chile, which already benefit from an FTA with Korea, U.S. producers stand to gain parity with Chile as a result of the U.S.-Korea FTA.<sup>171</sup> Tariff liberalization on many fresh and processed vegetables would provide a near-term competitive advantage for

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<sup>162</sup> The products covered in this assessment represent approximately 6 percent of U.S. exports to Korea in the GTAP “vegetables, fruit, nuts” and approximately 3 percent of the “food products n.e.c.” sectors, and represent less than 1 percent of U.S. imports from Korea in the GTAP “food products n.e.c.” and “vegetable, fruits, nuts” sectors, for 2006.

<sup>163</sup> Included here are fresh, frozen, and canned sweet corn (HTS 0709.90.45, 0710.40, and 2005.80), canned tomatoes and products (2002.10 and 2002.90), other fresh vegetables (onion sets, onions, and shallots [0703.10.20 and 0703.10.50]), lettuce (0705.11 and 0705.19), carrots (0706.10.30), other dried vegetables and mixtures of dried vegetables (0712.90.9002), dried leguminous vegetables (0713.10, 0713.20, 0713.31, 0713.32, and 0713.39), and other processed, frozen vegetables and mixtures of vegetables (2004.90.8580).

<sup>164</sup> One industry study states that U.S. agricultural exports to Korea under an FTA would expand substantially, and that exports from California alone could more than double their current amounts within a few years. Lee and Sumner, “The Prospective Free Trade Agreement with Korea,” January 2007, 1.

<sup>165</sup> Lee and Sumner, “The Prospective Free Trade Agreement with Korea,” January 2007.

<sup>166</sup> *Ibid.*

<sup>167</sup> The items covered here, together with their Korean MFN applied duties, are as follows: fresh onions (135 percent; fresh garlic (360 percent), fresh lettuce (45 percent), fresh carrots (40.5 percent), other dried vegetables (27 percent), dried peas and chickpeas (27 percent each), dried mung beans (607.5 percent), dried small red beans (420.8 percent), dried kidney beans and other dried beans (27 percent each), other frozen vegetables (30 percent), and canned olives (20 percent).

<sup>168</sup> For canned tomatoes and tomato products and other frozen or processed vegetables and mixtures of vegetables, duties are scheduled to be phased out over 3 years.

<sup>169</sup> Lee and Sumner, “The Prospective Free Trade Agreement with Korea,” January 2007.

<sup>170</sup> CRS, “The Proposed South Korea-U.S. Free Trade Agreement (KORUS FTA),” April 23, 2007, 6.

<sup>171</sup> Lee and Sumner, “The Prospective Free Trade Agreement with Korea,” January 2007.

U.S. producers with respect to these major competitors and should enable the United States to maintain or expand its current small market share.<sup>172</sup> In addition, the lowering of tariffs and the removal of other trade barriers may result in the lowering of Korean market prices for these products, which in turn may cause demand to rise.<sup>173</sup> Over a longer period, however, China would be expected to increase exports of many of these same products to the Korean market and would likely gain an even greater share of the market and any growth, possibly at the expense of products from both the United States and other foreign suppliers.<sup>174</sup>

Canned tomatoes and tomato products (i.e., processed tomato products) would likely experience increased exports, especially in the near term.<sup>175</sup> Processed tomato products have been one of the top ten U.S. agricultural exports to Korea in recent years.<sup>176</sup> The United States is a global producer and exporter of these products, and is currently a major supplier of processed tomato products to the Korean market, accounting for 46 percent of the total Korean market for such products in 2005.<sup>177</sup> U.S. shipments of canned tomatoes and tomato products to Korea currently face duties of 5 percent and 8 percent, respectively, and, under the FTA, these duties would be eliminated at the beginning of the third year after implementation. U.S. processed tomato products' exports to Korea account for only 5 percent of total U.S. processed-tomato exports, leaving substantial U.S. supplies (both from increased U.S. production and from trade diversion) from which to draw for greater exports to Korea in the near future.<sup>178</sup> In addition, U.S. exports are supported by the lack of a domestic processed-tomato-products industry in Korea. Any projected increase in trade, however, is not expected to have as great a long-term effect on the U.S. industry, in part because Korea expects to have an FTA in place in the next year or so with the EU, the other major global supplier of processed tomato products to Korea. In the event that an EU-Korea FTA were concluded, a U.S.-Korea FTA would help U.S. exporters maintain market share.

U.S. exports of sweet corn (fresh, frozen, and canned corn) would also likely increase with an FTA.<sup>179</sup> Korean import duties on fresh or frozen corn and canned corn are high at 27 percent and 17 percent, respectively. The United States has been a global producer and exporter of this product for many years. Korea, with little or no domestic production but with a stable consumer preference for U.S. product, has relied on imports from the United States to satisfy market demand; this is especially true for canned corn because of its ease in shipping and relatively long shelf life. Increased U.S. exports of fresh and frozen corn, however, may be hampered by the need for greater care in handling and the attendant higher shipping costs relative to exports of canned products.

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<sup>172</sup> APTA, written submission to the House Committee on Ways and Means, April 4, 2007.

<sup>173</sup> Lee and Sumner, "The Prospective Free Trade Agreement with Korea," January 2007.

<sup>174</sup> Also, any projected increase in U.S. exports to the Korean market could be negatively affected by Korean FTAs currently being negotiated with Canada, India, Japan, and Mexico, as well as possibly with New Zealand and Australia. Lee and Sumner, "The Prospective Free Trade Agreement with Korea," January 2007.

<sup>175</sup> Included here are tomatoes prepared or preserved otherwise than by vinegar or acetic acid, whole or in pieces (HTS 2002.10) and tomato paste and other tomato products including puree (2002.90); not included here are ketchup and other canned tomato-based sauces (2103.20).

<sup>176</sup> Lee and Sumner, "The Prospective Free Trade Agreement with Korea," January 2007.

<sup>177</sup> Ibid.

<sup>178</sup> Ibid.

<sup>179</sup> Included here are fresh sweet corn (HTS 0709.90.45), frozen sweet corn (0710.40), and canned corn (2005.80).

U.S. exports of other fresh and processed vegetables would likely increase as a result of tariff elimination and trade-barrier removal under the FTA. Gains would be tempered, however, by small duty-free in-quota TRQ quantity increases that would be phased in over 10 or more years and be accompanied by very large over-quota duties.<sup>180</sup> In the Korean fresh-vegetable market sector, the United States has maintained a 5-percent market share in recent years.<sup>181</sup> Driven by increasing demand, U.S. exports of lettuce have been rising in recent years despite the high 45 percent tariff, mainly because U.S. lettuce exports enter during the Korean off-season for field-grown lettuce, when Korean-produced lettuce is a high-priced, greenhouse-grown product.<sup>182</sup>

Other U.S. products are believed to be price competitive in the Korean market with other imports and with vegetables produced locally. In some cases, little or no competition exists for some U.S. vegetables.<sup>183</sup> Korean consumers may be more likely to purchase certain fresh vegetables such as artichokes and asparagus not customarily consumed in Korea because of their appeal as healthy foods and their falling prices as duties are eliminated.<sup>184</sup> Demand for other foods, such as canned pickles or pickled relish, has fallen in recent years as consumers look to new and different foods.<sup>185</sup> Also, for items such as canned olives, where Spain and Italy recently accounted for 76 percent and 14 percent, respectively, of Korean consumption, the FTA would not be likely to boost U.S. exports.<sup>186</sup>

Even with the elimination of duties and other barriers under the FTA, U.S. products would face a number of obstacles to gaining greater share of the Korean market. Some of the fresh vegetables covered here are perishable (i.e., fresh sweet corn, onions, lettuce, and carrots), and success in exporting these products to Korea may be limited by the costs and logistics involved in keeping the products refrigerated during transport to Korea. In addition, increased U.S. exports of fresh and processed vegetables may continue to be subject to TBTs, quotas, licensing requirements, and SPS measures.<sup>187</sup>

The FTA would unlikely significantly affect U.S. vegetable imports from Korea. Korean vegetable exports have little potential for expansion in light of the large number of small farms and the shrinking share of the Korean economy held by agriculture.<sup>188</sup> Consequently, the elimination of high U.S. duties on a number of products (e.g., fresh garlic, certain fresh root crops, and other miscellaneous fresh vegetables) may create incentive for Korean exporters, but is unlikely to result in greatly increased U.S. imports. Canned mushrooms, however, could increase if Korean producers were to modernize mushroom-growing and canning facilities, although Korean sales in the U.S. market would have to compete with

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<sup>180</sup> Included here are onion sets and other onions (HTS 0703.10.20 and 0703.10.50), lettuce (0705.11 and 0705.19), carrots (0706.10.30), dried leguminous vegetables (0713.10-0713.39), other dried vegetables (0712.90.9002), other processed frozen vegetables (2004.90.85780), and canned olives (2005.70).

<sup>181</sup> USDA, FAS, "Republic of Korea Product Brief, Produce Market Brief Update 2005," October 5, 2005, 2.

<sup>182</sup> Lee and Sumner, "The Prospective Free Trade Agreement with Korea," January 2007.

<sup>183</sup> USDA, FAS, "Republic of Korea Product Brief, Produce Market Brief Update 2005," October 5, 2005, 2.

<sup>184</sup> Lee and Sumner, "The Prospective Free Trade Agreement with Korea," January 2007.

<sup>185</sup> USDA, FAS, "Korea Product Brief, Condiments, Sauces, and Salad Dressings 2005," November 1, 2005, 2.

<sup>186</sup> Lee and Sumner, "The Prospective Free Trade Agreement with Korea," January 2007.

<sup>187</sup> For additional analysis regarding SPS, TBTs, and other NTMs, see chap. 5 of this report.

<sup>188</sup> USDA, FAS, "Korea Product Brief, Produce Market Brief Update 2005," October 5, 2005.

product from China, a global mushroom producer currently commanding the greatest share of the U.S. market.<sup>189</sup>

### ***Views of Interested Parties***

The California Tomato Growers Association, Inc., made up of growers of tomatoes for processing, states that the FTA could result in California processed-tomato industry sales to Korea of \$15 million annually as compared with sales of \$11.2 million in 2004.<sup>190</sup> The association states that, although it has been successful in the past at exporting processed tomato products to Korea, it identified three major issues that will affect future success at export sales: (1) Korean tariffs, (2) Korean import and inspection procedures, and (3) Korean government enforcement actions.<sup>191</sup>

The American Dehydrated Onion and Garlic Association expressed opposition to the FTA in a written submission to the Commission. The association cited potential harm to the industry from rising imports of dehy onions and garlic.<sup>192</sup> It points out that the industry continues to struggle with rising levels of lower-priced imports from China and other countries, and that the FTA is unlikely to provide any opportunity for U.S. exports of dehy onions or garlic to Korea, a market already supplied by products from China. The association stated that U.S. imports of dehy onions and garlic are subject to high U.S. duties and, although there have not been any appreciable import volumes recorded in recent years, members of the industry are concerned with the possibility that imports from China transshipped through Korea could rise dramatically.<sup>193</sup>

The American Mushroom Institute (AMI),<sup>194</sup> which represents U.S. growers and processors of cultivated mushrooms, expressed concern about the potential for Korea, historically a global producer and exporter of canned mushrooms and already well established in the growing, canning, and exporting of mushrooms, to ship large amounts of canned mushrooms into the U.S. market in both the near term and well into the future. AMI also expressed concern about the effectiveness of regulations preventing transshipments of canned mushrooms from China through Korea.<sup>195</sup>

In its report on the FTA, the ATAC for Trade in Fruits and Vegetables stated that the negotiated agreement would generally be positive for the U.S. vegetable sector.<sup>196</sup> The report noted that Korea is already a net food importer and likely will grow even more dependent on food products imported from the United States in the future. The report also said that the FTA should place U.S. vegetable producers in a better position to benefit from agreed-upon

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<sup>189</sup> U.S. industry official, telephone interview by Commission staff, May 24, 2007.

<sup>190</sup> California Tomato Growers Assoc., written submission to the USITC, June 25, 2007.

<sup>191</sup> *Ibid.*, 1-4.

<sup>192</sup> Ringwood (counsel), "Submission to the USITC regarding the U.S.-Republic of Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects," written submission to the USITC on behalf of the American Dehydrated Onion and Garlic Assoc., June 19, 2007.

<sup>193</sup> Ringwood (counsel), "Submission to the USITC regarding the U.S.-Republic of Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects," written submission to the USITC on behalf of the American Dehydrated Onion and Garlic Assoc., June 19, 2007.

<sup>194</sup> U.S. industry official, telephone interview by Commission staff, May 24, 2007.

<sup>195</sup> U.S. industry official, telephone interview by Commission staff, May 24, 2007.

<sup>196</sup> ATAC on Trade in Fruits and Vegetables, *Advisory Committee Report*, April 2007, 2.

tariff concessions that could accrue additional benefits to many vegetable export interests.<sup>197</sup> The report, however, expressed concern about how Korea has used SPS measures in the past to protect certain industries from import competition; it further noted that preferential FTA tariff treatment would do little for improved bilateral trade if Korea imposes SPS barriers in the future.<sup>198</sup>

In its report on the FTA, the ATAC for Trade in Processed Foods took no position on the agreement, but said that it strongly endorses overall trade goals of opening foreign markets, promoting tourism, trade, and investment, expanding economic opportunities, and strengthening political stability and national security for all nations.<sup>199</sup> The report also noted concern about the creation of special rules of origin and about the importance of resolving existing SPS and TBTs.<sup>200</sup> The report stated that members are particularly concerned that benefits that would otherwise be gained by processed food exporters would be lost because of continuing technical trade barriers not addressed in the FTA. The report noted that a number of U.S. FDA-approved food additives commonly used in the U.S. food-manufacturing process are not permitted for use in Korea, and said that this would result in the denial of entry into the Korean market of foods containing such additives.<sup>201</sup>

In its report, the APAC for Trade said that the U.S.-Korea FTA will benefit U.S. farmers (including vegetable farmers) by increasing their export opportunities following the elimination of tariff and nontariff barriers. The report also said that priority must be given to comprehensive agricultural trade reform.<sup>202</sup> It called for the elimination of barriers to trade in agricultural products for the purpose of improving market opportunities for U.S. agriculture through fairer and more open trade conditions.<sup>203</sup>

## **Tree Nuts (Pistachios, Almonds, and Walnuts)<sup>204</sup>**

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### *Assessment*

The U.S.-Korea FTA would likely have a significant positive impact on U.S. exports of tree nuts to Korea. The immediate elimination of Korea's current high tariffs on certain raw tree nuts would likely make U.S. tree nuts more price-competitive in the Korean market relative to other foreign suppliers. The United States is a leading global producer and exporter of tree nuts, particularly almonds, pistachios, and walnuts, due to their high quality. An increase in exports of U.S. tree nuts is most likely to benefit producers in California, where the vast majority of U.S. tree nut production takes place.

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<sup>197</sup> Ibid., 2-3.

<sup>198</sup> Ibid., 4.

<sup>199</sup> ATAC for Trade in Processed Foods, *Advisory Committee Report*, April 27, 2007, 3.

<sup>200</sup> Ibid., 4.

<sup>201</sup> Ibid., 5.

<sup>202</sup> APAC for Trade, *Agricultural Policy Advisory Committee for Trade Report*, April 27, 2007, 2.

<sup>203</sup> Ibid., 3.

<sup>204</sup> Chestnuts are not included in this assessment as U.S. production is only a cottage industry and the MFN rate is free. The products covered in this assessment represent approximately 30 percent of U.S. exports to Korea in the GTAP "vegetables, fruit, nuts" and less than 1 percent of the "food products n.e.c." sectors, and represent less than 1 percent of U.S. imports from Korea in the GTAP "food products n.e.c." sector, for 2006.

The U.S.-Korea FTA would immediately eliminate Korean duties of 8 and 30 percent on raw almonds and pistachios, respectively, imported from the United States. The FTA would phase out tariffs for raw walnuts as it would eliminate the current 30 percent tariff on shelled walnuts and 45 percent tariff on in-shell walnuts in equal annual stages over 6 and 15 year periods, respectively. It would also phase out Korea's 45 percent duty on processed tree nuts (e.g., roasted, salted, etc.) in equal annual stages over a 10-year period.

The U.S. tree nut industry is well-positioned to take advantage of duty-free treatment under the FTA. The U.S. tree nut industry exported \$2.9 billion in tree nuts to all countries in 2006, \$72 million of which was shipped to Korea, the eighth-largest market for U.S. exports of tree nuts. Strong demand for tree nuts in domestic and international markets, buoyed by consumer recognition of the health benefits associated with most tree nuts, has kept tree nut prices high and has influenced U.S. production increases. As a result, U.S. exports of tree nuts are an important component of the U.S. industry's revenues. In recent years, approximately 50 percent of U.S. production of walnuts and pistachios and 70 percent of U.S. production of almonds have been exported. While other countries produce more of certain varieties of tree nuts than the United States, such as China (walnuts) and Iran (pistachios), nuts produced in those countries are typically of lower quality than U.S. nuts.<sup>205</sup>

The United States is the largest global producer and exporter of almonds. U.S. production, at almost 500,000 mt in crop year 2006/07 (marketing year) dwarfs the world's second-largest producer, Spain, which produced 62,000 mt in marketing year 2006/07.<sup>206</sup> The United States supplied over 97 percent of Korean imports of almonds during 2001–06 and faces little competition in the Korean market. The duty elimination in the FTA will likely lower the U.S. price for almonds in the Korean market, likely increasing demand and enabling U.S. producers to export larger volumes of almonds to Korea.

The elimination of the 30 percent import tariff on U.S. pistachios would likely make U.S. pistachios more price competitive in the Korean market vis-à-vis those of other sources. The United States is the second-largest global producer of pistachios after Iran. Products of both countries typically compete in similar markets, although in recent years, Iranian quality problems related to high levels of aflatoxin have led to a loss of half its market share in the EU.<sup>207</sup> Iran's difficulty in exporting pistachios to the EU contributed to increased competition for pistachios in other global markets, such as Korea. The United States provided 43 percent of Korean imports of pistachios in 2006, down from 90 percent in 2001. Iran has increasingly supplied the Korean market and, in 2006, supplied 56 percent of the Korean import market for pistachio imports, up from 2 percent in 2002.<sup>208</sup> U.S. pistachio producers estimated that the Korean market could grow to \$6–7 million under the FTA, an increase from the \$2 million in 2006.<sup>209</sup>

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<sup>205</sup> A common quality issue for tree nuts is the presence of aflatoxin, a naturally produced carcinogen found in mold that can be exacerbated by poor orchard and handling practices.

<sup>206</sup> *Cracker, The*, "Estimated World Almond Production," April 2007, 54.

<sup>207</sup> Songer, "New research blames beetle for aflatoxin in U.S. pistachios," March 23, 2007, 5. Globally, individual country tolerance limits for aflatoxin in tree nuts are in the 10–20 parts per billion (ppb) range; however, the EU, traditionally a large tree nut importer, maintains a 4 ppb tolerance limit for aflatoxin in most tree nuts. As a result, some global suppliers, such as Iran, have been plagued by rejected shipments of their nuts into the EU.

<sup>208</sup> Iran exported no pistachios to Korea in 2001.

<sup>209</sup> Herman, testimony before the Trade Policy Staff Committee, Office of the USTR, March 14, 2006.

Similarly, the phase out of Korean tariffs on imports of U.S. walnuts would likely lead to increased price competitiveness of U.S. walnuts in Korea relative to other suppliers. Korea is not a significant producer of walnuts; Korean production averaged approximately 1,000 mt during the years 2001 to 2005.<sup>210</sup> U.S. exports of walnuts to Korea during the years 2001 to 2004 accounted for 70–90 percent of the Korean market. Since 2004, however, U.S. market share has fallen as Vietnam has increasingly supplied the Korean market. Vietnamese exports accounted for 33 percent of Korea’s imports of walnuts in 2006, up from 6 percent in 2001.

### *Views of Interested Parties*

In its report on the FTA, the Advisory Committee on Trade in Fruits and Vegetables expressed support for the U.S.-Korea FTA in view of the increased opportunities that duty-free treatment affords to U.S. exporters of tree nuts.<sup>211</sup> In a submission to the USTR in March 2006, Blue Diamond Growers said that the outcome of the FTA is consistent with the almond industry’s effort to obtain worldwide duty-free treatment for almonds.<sup>212</sup> Another industry representative said that the U.S. almond industry views Korea as a high-priority market for exports because of several factors, including the high degree of health-consciousness of Korean consumers and a high level of Internet awareness, which allows for cost-effective advertising by U.S. exporters. Another industry representative stated that U.S. almond exporters expect an increase of 50 percent or more in exports to Korea by 2010 compared with 2006.<sup>213</sup> Paramount Farms, a grower of pistachio nuts, reported in an April 2007 press release that pistachio producers welcome the immediate elimination of the 30 percent duty on U.S. nuts and view this development as an important step to increasing exports to Korea.<sup>214</sup>

## **Dairy Products<sup>215</sup>**

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### *Assessment*

The initial economic impact of the U.S.-Korea FTA on U.S. dairy exports<sup>216</sup> to Korea would likely be limited because the FTA includes long phaseout periods for most of the applicable tariffs and creates five dairy TRQs that initially would limit U.S. export volumes. Over the long term, however, as Korean import tariffs are phased out and all but one TRQ is eliminated, the FTA would likely provide significant additional access for U.S. dairy

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<sup>210</sup> UN FAO, “Core Production Data,” July 18, 2007.

<sup>211</sup> ATAC on Trade in Fruits and Vegetables, *Advisory Committee Report*, April 2007, 2.

<sup>212</sup> U.S. industry official, telephone interview by Commission staff, July 2, 2007.

<sup>213</sup> U.S. industry official, e-mail message to Commission staff, July 3, 2007.

<sup>214</sup> Paramount Farms, “U.S. Pistachio Growers Welcome Successful Conclusion of Korea-U.S. Free Trade Agreement (April 2007).”

<sup>215</sup> The products covered in this assessment represent 100 percent of U.S. exports to Korea in the GTAP “dairy” and less than 1 percent of the “food products n.e.c.” sectors, and 100 percent of U.S. imports from Korea in the GTAP “dairy” sector, for 2006.

<sup>216</sup> Dairy products covered in this section include the following HTS tariff lines: 0401.10, 0401.20, 0401.30, 0402.10, 0402.21, 0402.29, 0402.91, 0402.99, 0403.10, 0403.90, 0404.10, 0404.90, 0405.10, 0405.20, 0405.90, 0406.10, 0406.20, 0406.30, 0406.40, 0406.90, 1702.11, 1702.19, 1901.10, 2105.00, 3501.10, 3501.90, and 3502.20.



exports. Estimates from the Commission's economy-wide analysis of the long-term effects of tariff and TRQ liberalization indicate that full implementation of the agreement would increase U.S. dairy exports by \$175–336 million (249–478 percent).<sup>217</sup> Based on current U.S. exports and Korean protection levels, additional U.S. dairy exports to Korea would likely consist primarily of cheese, whey, lactose, and infant formula (also known as prepared dry milk). As a result of these estimated increases in exports to Korea, the economy-wide model estimates that output and employment in the dairy sector could increase by 0.2 percent to 0.5 percent.

The Korean dairy industry is currently unable to supply total Korean demand for dairy products. Fluid milk is supplied solely from the domestic dairy industry, but currently one-half of nonfluid consumption, which includes powdered milk, is supplied by imports.<sup>218</sup> Although the total number of dairy cows has expanded rapidly and production per cow has increased by 2 percent per year since the early 1990s (to 83 percent of the U.S. average), milk consumption has outstripped supply.<sup>219</sup> To meet this excess demand, the United States supplied 17 percent of Korean dairy imports in 2005 and 18 percent in 2006.<sup>220</sup> In 2006, the U.S. dairy industry accounted for 56 percent of Korean whey imports, 17 percent of cheese imports, and 5 percent of infant formula imports.

Under the Uruguay Round Agreement, Korea converted import quotas for most dairy products to TRQs, with relatively low in-quota tariff rates and very high, but in some cases not prohibitive, over-quota rates. During the 10-year implementation period for Uruguay Round reductions, Korea lowered over-quota rates but did not reduce in-quota rates.<sup>221</sup> Current tariffs for certain dairy exports to Korea are relatively high. For example, dairy spreads and ice cream are subject to an import duty rate of 8 percent ad valorem; lactose syrup, 20 percent duty rate; cheeses and infant formula, 36 percent import duty rate; and whey products (including whey powder and modified whey), 49.5 percent duty rate.

The U.S.-Korea FTA establishes a variety of tariff elimination periods on Korean dairy imports from the United States. The phase-in periods are generally lengthy, particularly for those goods that are likely to be competitive in the Korean market, thereby limiting the initial economic benefit of the agreement. Korea would phase out its current 36 percent duty on milk and cream and yogurt products over 10 years, its 49.5 percent duty on lactose (nonsyrup) over 5 years, and its 8 percent duty on ice cream over 7 years; its 20 percent duty on casein and caseinates over 7 years; and its 8 percent duty on milk albumin over 5 years. Only modified whey used for animal feed receives immediate duty-free treatment under the agreement.

The FTA contains five dairy TRQs, all of which provide immediate duty-free treatment for in-quota quantities and 3 percent annual growth rates of those quantities (table 3.10).<sup>222</sup> The

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<sup>217</sup> Impact relative to an estimated 2008 base. See chap. 2 of this report for additional information regarding the economy-wide analysis.

<sup>218</sup> Lee, Sumner, and Ahn, "Consequences of Further Opening of the Korean Dairy Market," 2006, 239.

<sup>219</sup> Ibid.

<sup>220</sup> California Farm Bureau Federation, "United States-South Korea Free Trade Agreement: What it Would Mean for California Agriculture," 14.

<sup>221</sup> Lee, Sumner, and Ahn, "Consequences of Further Opening of the Korean Dairy Market," 2006, 240.

<sup>222</sup> The dairy TRQs cover milk powder and evaporated milk, food whey, butter and other fats derived from milk, cheeses, and prepared dry milk. These TRQs are specific to the United States, although most of these products are currently subject to first-come, first-serve TRQs when exporting to Korea. All of the TRQs except the TRQ for milk powder and evaporated milk are eventually eliminated under the agreement, and at  
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TRQ for food whey,<sup>223</sup> based on current U.S. exports to Korea, would likely be somewhat restrictive in the short term. The butter and cheese TRQs match current U.S. export levels and would therefore also likely be restrictive initially. Despite the tariff eliminations and increases in the in-quota TRQ quantities, competition from Australia and New Zealand in the milk powder and “prepared dry milk and other” markets would likely hamper increased U.S. exports to Korea in the short term.

This assessment of the FTA’s likely impact on U.S. dairy exports is similar to findings from other economic analyses. For example, econometric modeling simulations done by Lee, Sumner, and Ahn<sup>224</sup> show that lowering trade barriers on all dairy imports would result in increases in Korean imports of dairy fats and nonfat skim milk from all sources, including the United States. Similar findings are discussed in papers by Peng and Cox<sup>225</sup> and Beghin.<sup>226</sup>

**Table 3.10** Selected Korean dairy TRQs on imports from the United States

Description	Initial annual quantity	Compounded annual growth rate	Elimination year	U.S. exports to Korea in 2006	Total Korean imports in 2006
	( <i>mt</i> )	( <i>percent</i> )			
Milk powders and evaporated milk	5,000	3	None	1,017	8,918
Food whey	3,000	3	10	2,665	34,336
Butter and other fats and oils derived from milk	200	3	10	197	2,087
Fresh, curd grated or powdered, processed, and all other cheeses	7,000	3	15	6,848	44,016
Prepared dry milk and other	700	3	10	210	20,808

Sources: USTR, “Final - United States - Korea FTA Texts,” 2007, Appendix 2-B-1; and Global Trade Information Services, World Trade Atlas Database.

### *View of Interested Parties*

The National Milk Producers Federation (NMPF), the U.S. Dairy Export Council (USDEC), and the International Dairy Foods Association (IDFA) support the FTA and agree that full implementation of the agreement will provide opportunities for increased U.S. dairy exports

<sup>222</sup> (...continued)

that stage, U.S. exports of those dairy products to Korea would receive duty-free treatment in unlimited quantities. The TRQ for milk powder and evaporated milk would be subject to a permanent 3 percent increase compounded annually.

<sup>223</sup> Feed whey is given immediate duty-free treatment.

<sup>224</sup> Lee, Sumner, and Ahn, “Consequences of Further Opening of the Korean Dairy Market,” 2006, 238–248.

<sup>225</sup> Peng and Cox, “An Economic Analysis of the Impacts of Trade Liberalization on Asian Dairy Market,” 2006, 249–259.

<sup>226</sup> Beghin, “Evolving Dairy Markets in Asia: Recent Findings and Implications,” 2006, 195–200.

to Korea.<sup>227</sup> An IDFA official testified at a recent hearing at the USTR that per capita consumption of dairy products is rising in Korea because young Koreans have a taste for Western fast foods, such as pizzas, cheeseburgers, and sandwiches.<sup>228</sup> He predicted that most of the increase in U.S. dairy exports to Korea will be in the form of cheese, as local cheese production is limited by capacity constraints.

## **Meat (Beef, Pork, and Poultry)<sup>229</sup>**

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### *Assessment*

The U.S.-Korea FTA would likely result in increased U.S. exports of meat<sup>230</sup> to Korea. U.S. meat exports would benefit from the removal of high tariffs upon implementation of the FTA. In addition, beef and pork imports are subject to safeguard measures,<sup>231</sup> rather than TRQs, which would simplify export procedures by negating the need for U.S. exporters to apply for import permits or licenses. Increased U.S. imports of beef, pork, and poultry from Korea as a result of the FTA would not be likely, as Korea does not have any establishments eligible to export beef, pork, or poultry to the United States and, given that Korea is a large net importer of meat products, is unlikely to establish export production capacity in the foreseeable future.<sup>232</sup>

The Commission's economy-wide analysis of the long-term effects of tariff and TRQ liberalization estimates that U.S. beef (bovine meat products) exports to Korea could increase by \$0.6–1.8 billion (58–165 percent) and exports of other meat products, which include pork and poultry, could increase by approximately \$456–763 million (151–254 percent).<sup>233</sup> As a result of these estimated increases in exports to Korea, the economy-wide model estimates that output and employment in the beef and other meats sectors could increase by 0.5 percent to 2.0 percent.<sup>234</sup> In addition, these estimates for U.S. meat exports to Korea are based on the assumption of full liberalization and normalization of trade in meat products.<sup>235</sup> This assumption allows for an estimate that measures the

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<sup>227</sup> IDFA, "Dairy Processors Welcome U.S.-Korea Trade Agreement," April 10, 2007; and USDEC and NMPF, "Dairy Groups Praise U.S. Negotiators' Perseverance in Reaching U.S./South Korea Free Trade Deal," April 2, 2007.

<sup>228</sup> Hough, written submission to the Trade Policy Staff Committee, Office of the USTR, March 14, 2006.

<sup>229</sup> The products covered in this assessment represent 100 percent of U.S. exports to Korea in the GTAP "bovine meat products" sector and approximately 95 percent of the "meat products" sector for 2006.

<sup>230</sup> This section covers meat, comprised of beef, beef-variety meats, pork, pork-variety meats, poultry, and poultry-variety meats classified in chapters 2, 5, and 16 of the HTS.

<sup>231</sup> These safeguard measures on beef and pork are based on quantity rather than price, and function similar to a TRQ except that they do not require U.S. exporters to obtain import licenses. Therefore, the safeguard measures afford the Korean domestic producers a degree of protection while they also offer a market-access mechanism to U.S. exporters that is less administratively burdensome than a TRQ.

<sup>232</sup> USDA, FSIS, "Eligible Foreign Establishments," June 5, 2007.

<sup>233</sup> This GTAP model sector, "meat products n.e.c.," includes both pork and poultry. Impact relative to an estimated 2008 base. To isolate the effect of FTA tariff reductions on beef trade from the effects of SPS issues, U.S.-Korea beef trade is based on 2003 data, the most recent year of normalized trade prior to the Korean ban on beef imports from the United States. See chap. 2 of this report for additional information regarding the economy-wide analysis.

<sup>234</sup> This increased output in the beef and other meats sectors is also estimated to increase output and employment in the upstream cattle, etc. and animal products sectors, ranging from 0.5 percent to 2.0 percent.

<sup>235</sup> Levels of U.S. beef and poultry exports to Korea are subject to exogenous factors concerning zoonotic diseases, bovine spongiform encephalopathy (BSE) and highly pathogenic avian influenza subtype H5N1 (bird flu) respectively, that may dampen the estimated increase in U.S. exports (commodity-specific SPS

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potential changes in trade based solely on the removal of tariffs resulting from implementation of the FTA, and assumes no significant SPS measures that would restrict access to the Korean market.<sup>236</sup>

Tariff elimination under the FTA should positively affect U.S. beef exports. U.S. beef exports to Korea currently face a 40 percent tariff, which the FTA would phase out in 15 equal annual stages.<sup>237</sup> The agreement also includes a safeguard measure that begins at 270 thousand mt and grows 2 percent compounded annually and is eliminated in year 16.<sup>238</sup> This initial safeguard quantity is approximately equal to the largest quantity exported by the United States to Korea, which occurred in 2003, the most recent year of normalized trade prior to the Korean ban on beef imports from the United States (box 3.1). At current import unit values, the quantity under the initial safeguard measure would be valued at approximately \$1.0 billion during the first year after implementation of the agreement. The safeguard measure, based on quantity, performs much like a TRQ, but is advantageous because it allows U.S. exporters to bypass import permits and licenses. U.S. beef exporters are globally competitive and well-positioned to take advantage of the tariff removal.

**Box 3.1** Key events in recent U.S.-Korea Beef Trade

- Prior to Korea's ban on imports of U.S. beef following the discovery BSE in a Canadian-born cow in the state of Washington in late 2003, Korea imported an average of 5,670 tons of U.S. beef—primarily “short ribs”—per month. Product primarily consisted of “short ribs.”
- In September 2006, Korea allowed U.S. shipments of boneless beef to resume, albeit with a “zero” tolerance policy for bone chips or other material considered “at risk.” In addition, Korea will not accept beef from animals over 30 months of age, which is a more stringent approach than international standards of the World Organization for Animal Health (also known as the OIE).
- In late May 2007, OIE classified the United States as a “Controlled Risk” region for BSE. Controlled Risk is the second highest safety rating.
- Korea rejected the first three shipments of U.S. beef after reopening its market in September 2006 upon finding bone fragments in several boxes. Typically beef is shipped in prepackaged boxes. U.S. beef is mechanically deboned, which invariably results in small bone fragments, although this is considered commercially acceptable in the industry. The entire shipment, instead of the individual boxes, was rejected.
- In June 2007, several boxes of ribs were found in a shipment to Korea resulting in a “stoppage” of U.S. shipments. After a USDA investigation it was determined that the shipment was safe and was meant for U.S. domestic sale and mistakenly sent to Korea. Korea is presently accepting U.S. boneless beef and has indicated that it will only return individual boxes instead of entire shipments.
- Negotiations are currently ongoing.

*Sources:* World Organization for Animal Health (OIE). Official Animal Health Status, “Bovine Spongiform Encephalopathy”; Industry officials, e-mail and telephone correspondence with Commission staff, Washington, DC, June 2007; Johnston, Tom. “South Korea Reopens to U.S. Beef Imports,” June 8, 2007; and USDA, FAS, “Korea Lifts Suspension of Six U.S. Meat Plants,” June 25, 2007.

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<sup>235</sup> (...continued)  
issues are not addressed in the FTA text).

<sup>236</sup> For additional analysis regarding SPS and other NTMs, see chap. 5 of this report.

<sup>237</sup> USTR, “Final - United States - Korea FTA Text,” 2007, Korean General Notes and Annex 2-B.

<sup>238</sup> Ibid., Annex 3-A.

Historically, Korea represents the third-largest export market for U.S. beef and beef variety meats. Korea accounted for nearly 19 percent of all U.S. beef exports by volume and 21 percent by value in 2003. U.S. beef, due to its marbling, is highly valued in the Korean market and is commonly prepared in the Korean dish *galbi*, which is made from beef short ribs. Beef short ribs have been one of the core beef products exported by the United States to Korea and represent a high-value product in the Korean market versus its U.S. domestic use as ground beef, which is worth one-third of the value.<sup>239</sup>

The baseline values used in the Commission's economy-wide estimate of increased beef exports assume the resumption of beef exports to Korea, which have been limited in recent years because of SPS measures.<sup>240</sup> Figure 3.1 indicates that increased imports from other foreign suppliers were unable to entirely fulfill Korea's 2003 import demand. Because of the small volume of domestic beef production relative to consumption in Korea, relatively high tariffs and other restrictions on imports, and the inability of suppliers to fully meet excess demand,<sup>241</sup> Korean consumers witnessed a steep increase in beef prices in the third quarter of 2004 (figure 3.2). Beef prices have remained high, and Korean consumers pay some of the highest prices for beef in the world.<sup>242</sup> The elimination of tariffs on beef under the FTA may also increase the price competitiveness of U.S. beef in the Korean market, potentially increasing demand for U.S. beef.<sup>243</sup>

The phaseout of tariffs under the FTA should positively affect U.S. pork and poultry exports to Korea. Current U.S. exports of pork and poultry face tariffs ranging from 18 percent to 30 percent (table 3.11). Despite the current high tariffs, Korea is the fourth-largest export market for U.S. pork. Moreover, U.S. exports increased by approximately 50 percent by value in 2006 over 2005. After implementation of the FTA most Korean tariffs on pork products, with the exception of fresh or chilled pork, would be phased out in equal annual stages, becoming duty-free in 2014.<sup>244</sup> Although tariffs on fresh and chilled pork products would be phased out in ten equal annual stages, they are subject to a safeguard measure similar to that for beef.<sup>245</sup> The initial safeguard trigger level is 8,250 mt and increases by 6 percent annually, reaching 13,853 mt by the ninth year, and is eliminated in year 10.

The increased market access would likely enhance the price competitiveness of U.S. pork in the Korean market, especially with respect to pork from Chile, which implemented an FTA with Korea in 2004 that gives Chile duty-free access to the Korean market beginning in 2014.<sup>246</sup> Chile is a major competitor with the United States in the Korean market for pork. Korea provides a market for many cuts that are less popular in the U.S. market. The tariff phaseout also provides U.S. producers with an opportunity to enhance sales of value-added products.<sup>247</sup>

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<sup>239</sup> Truitt, written submission to the USITC on behalf of the NCBA, June 20, 2007; and Truitt, testimony before the USITC on behalf of the NCBA, June 20, 2007.

<sup>240</sup> In addition, industry representative testimony indicated that industry resumption of 2003 export levels would not pose any difficulty. Truitt, testimony before the USITC on behalf of the NCBA, June 20, 2007.

<sup>241</sup> Truitt, written submission to the USITC on behalf of the NCBA, June 20, 2007.

<sup>242</sup> Truitt, testimony before the USITC on behalf of the NCBA, June 20, 2007.

<sup>243</sup> Johnston, "S. Korean Cattle Prices Fall as U.S. Beef Imports Rise," June 18, 2007; and Johnston, "South Korea Cattle Slaughter Surges," June 21, 2007.

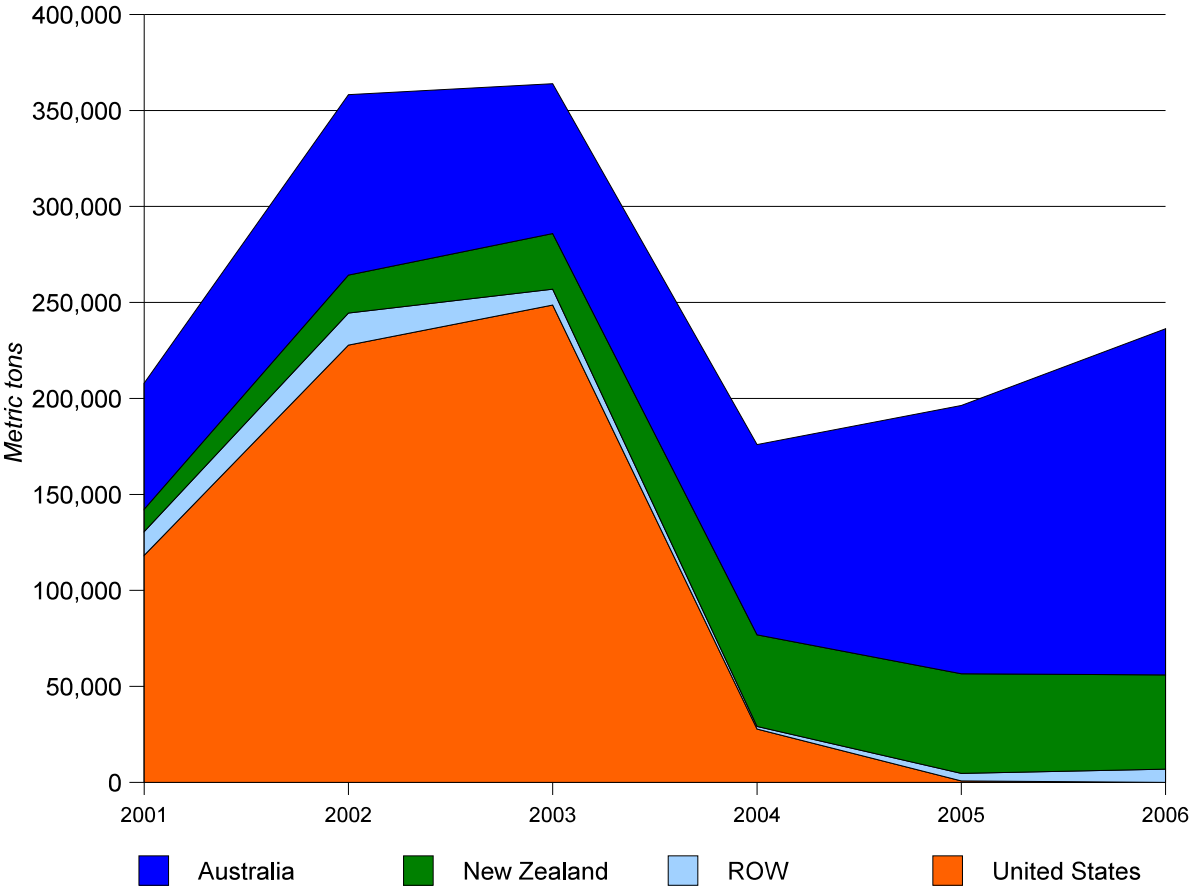
<sup>244</sup> USTR, "Final - United States - Korea FTA Text," 2007, Korean General Notes.

<sup>245</sup> Ibid., Annex 3-A.

<sup>246</sup> Hayes, "Impact of a U.S.-Korea Free Trade Agreement," written submission to the USITC, June 20, 2007.

<sup>247</sup> NPPC, written submission to the USITC, posthearing comments, June 27, 2007.

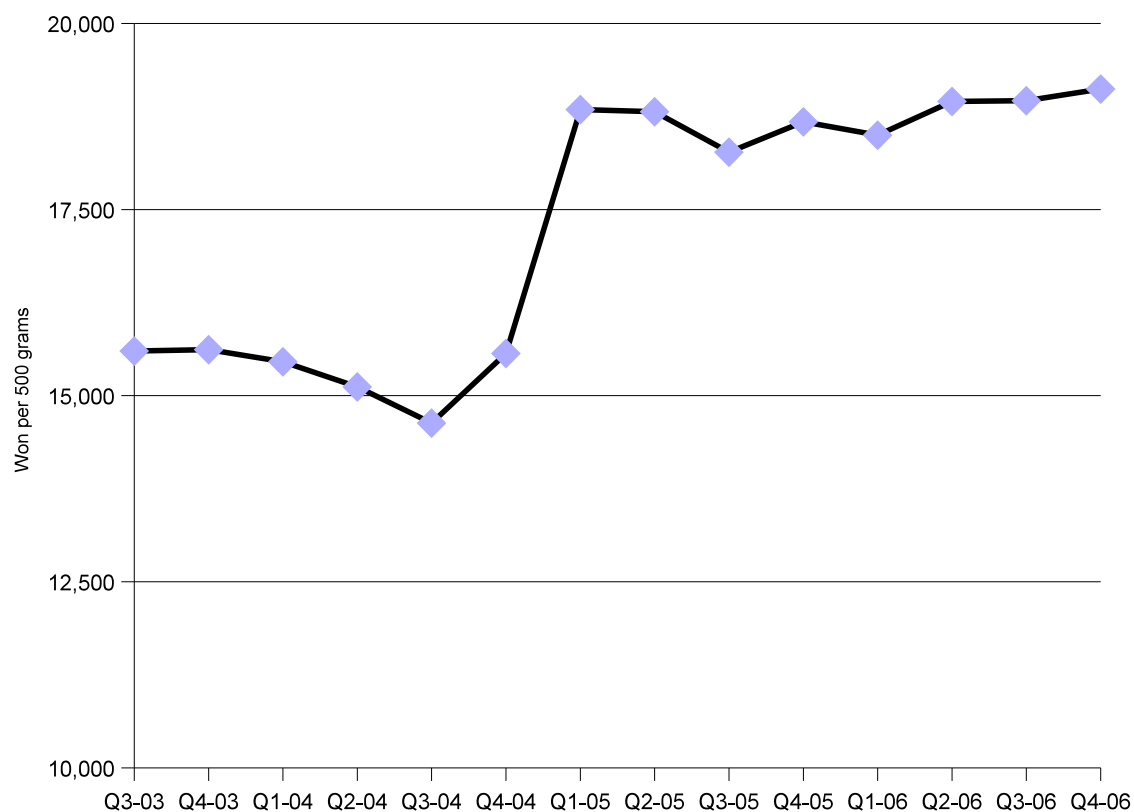
**Figure 3.1** Korea: Beef and variety beef imports, 2001–06



Source: Global Trade Information Services, World Trade Atlas Database.

ROW=Rest of World.

**Figure 3.2** Consumer prices for beef in Korea



Source: Compiled from monthly beef prices, Korea Meat trade Association.

**Table 3.11** Korea: Pork and poultry liberalization schedule

Product	Korea base tariff	FTA schedule	Safeguard measure
Pork bellies, fresh or chilled	22.5	10 equal annual stages	10 years
Shoulders and cuts of swine	30	Equal annual stages beginning on date agreement enters into force becoming duty-free on January 1, 2014	N/A
Pork (carcasses and half carcasses), frozen	25	Equal annual stages beginning on date agreement enters into force becoming duty-free on January 1, 2014	N/A
Chicken leg quarters, fresh or chilled	18	10 equal annual stages	N/A
Chicken leg quarters, frozen	20	10 equal annual stages	N/A
Chicken breast, frozen	20	12 equal annual stages	N/A
Chicken wing, frozen	20	12 equal annual stages	N/A

Source: USTR, "Final - United States - Korea FTA Texts," 2007, Agricultural Tariff Schedule for the Republic of Korea.

Note: "N/A" means not applicable.

## *Views of Interested Parties*

The increased market access would likely enhance the price competitiveness of U.S. pork in the Korean market, especially with respect to pork from Chile, which implemented an FTA with Korea in 2004 that gives Chile duty-free access to the Korean market beginning in 2014.<sup>248</sup> Chile is a major competitor with the United States in the Korean market for pork. Korea provides a market for many cuts that are less popular in the U.S. market. The tariff phaseout also provides U.S. producers with an opportunity to enhance sales of value-added products.<sup>249</sup>

U.S. poultry exports would likely increase, primarily as a result of tariff elimination under the FTA. Despite the current tariffs on U.S. poultry exports, the United States exported over 43,000 mt of poultry to Korea in 2006, accounting for a 55 percent market share. Under the FTA, Korea would phase out the 20 percent tariff on frozen chicken legs, the main chicken product exported by the United States (globally and to Korea) in ten equal annual stages. Korea would phase out tariffs on frozen chicken breasts and wings in 12 equal annual stages.

The National Pork Producers Council (NPPC) expressed strong support in a May 2007 press release for the U.S.-Korea FTA and, stating that the FTA “is the single most important trade agreement ever for the U.S. pork industry, and it will generate hundreds of millions of dollars in new export sales.”<sup>250</sup> The NPPC estimates that by the end of the FTA phase-in period, total U.S. pork exports to Korea will rise to nearly 600,000 mt, which represents about twice as much as the amount currently shipped to Japan, the largest export market for U.S. pork.

The National Chicken Council (NCC), in a written submission to the Commission, expressed support for the FTA and stated that the FTA will enhance the poultry trade by phasing out import duties on U.S. poultry. The NCC stated that the bilateral agreement concluded on SPS measures is equally important to the tariff reductions. NCC noted that Korea agreed to recognize the equivalency of the USDA’s poultry inspection system and to move toward less restrictive trade arrangements after a detection of highly pathogenic notifiable avian influenza in U.S. commercial poultry.<sup>251</sup>

The National Cattlemen’s Beef Association (NCBA), in a written submission to the Commission, stated that it would support the FTA if the following issues are resolved: the Korean market is reopened to U.S. beef, Korea agrees to eliminate tariffs on U.S. beef, and important SPS issues are resolved. NCBA noted that Korea historically has represented the third-largest export market for U.S. beef and beef-variety meat, and the prospects for future growth into Korea are tremendous when taking such factors as exchange rates, economic growth, and tariff reduction into consideration.<sup>252</sup>

In a statement posted to its Web site, the U.S. Meat Exporters Federation (USMEF) stated that the FTA would be beneficial for U.S. pork exports but that unresolved issues concerning

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<sup>248</sup> Hayes, “Impact of a U.S.-Korea Free Trade Agreement,” written submission to the USITC, June 20, 2007.

<sup>249</sup> NPPC, written submission to the USITC, posthearing comments, June 27, 2007.

<sup>250</sup> Appell, “U.S.-South Korea Trade Deal Best Ever For Pork,” May 25, 2007.

<sup>251</sup> National Chicken Council, written submission to the USITC, June 5, 2007.

<sup>252</sup> NCBA, “United States-Republic of Korea Free Trade Agreement, Testimony of the National Cattlemen's Beef Association,” written submission to the USITC, June 20, 2007.



beef remain a major obstacle. USMEF noted the importance of the Korean market to U.S. beef exporters prior to 2003 when SPS concerns effectively halted U.S. beef exports to Korea, and said that it expects that the United States can quickly regain its market share if full liberalization and normalization in beef trade resumed.<sup>253</sup>

In a statement posted in its Web site, the American Meat Institute (AMI) said that its support of an FTA with Korea is dependent upon Korea abiding by international science-based standards, which it said support full reopening of the Korean market to U.S. beef exports. AMI stated that once all SPS and normalization of beef trade issues are resolved, AMI and the beef industry will support the FTA.<sup>254</sup>

## Seafood<sup>255</sup>

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### *Assessment*

The U.S.-Korea FTA would likely result in increased U.S. seafood exports to Korea, although any positive impact on the U.S. industry as a whole would likely be small because of the limited size of the Korean import market relative to total U.S. seafood exports. Although a relatively high U.S. tariff on oil-packed tuna would be eliminated and a U.S. TRQ on water-packed tuna would be phased out, the FTA would likely result in only a small increase in U.S. seafood imports from Korea, given the low average tariffs currently applied to U.S. seafood imports.

The United States is a large producer, exporter, and importer of seafood. U.S. production of seafood reached an estimated \$6.4 billion in 2005, down slightly from \$6.6 billion the year before. The United States is the world's sixth largest producer of fish, the world's second largest importer, and the fourth largest exporter of seafood.<sup>256</sup> In 2006, Korea was the United States' third leading export market and twenty-seventh leading import source for seafood. Although an important global producer, exporter, and importer of seafood, Korea's fish industry is substantially smaller than the U.S. industry. Korea is the world's fifteenth largest producer and the seventeenth largest exporter of fish and seafood.<sup>257</sup> The United States was Korea's third leading export market and fifth leading import source.

The vast majority of Korean seafood imports are dutiable at either 10 percent or 20 percent. There are a few exceptions, with duties ranging from 5 percent to 63 percent. No imported seafood is duty-free. Popular seafood products in Korea, such as salmon (frozen fillets as well as roe), herring, and shellfish, are largely imported, but are subject to high tariff rates and (in the cases of flatfish, Alaska pollock, and croaker) TRQs. In addition, seafood imports

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<sup>253</sup> United States Meat Exporters Federation, "Strategic Market Profile: Korea—Beef."

<sup>254</sup> AMI, "AMI Encouraged by Partial Opening of South Korean Market to U.S. Beef, but Disappointed in Limited Access," January 13, 2006; and AMI officials, e-mail message to Commission staff, Washington, DC, May 30, 2007.

<sup>255</sup> The products covered here include articles classified in chap. 3 and headings 1604 and 1605 of the Harmonized Tariff Schedule. The products covered in this assessment represent approximately 96 percent of U.S. exports to Korea in the GTAP "fishing" and approximately 48 percent of the "food products n.e.c." sectors, and represent approximately 57 percent of U.S. exports to Korea in the GTAP "fishing" and approximately 27 percent of the "food products n.e.c." sectors, for 2006.

<sup>256</sup> USDOC, NOAA, NMFS, "Current Fisheries Statistics report No. 2005," February 2007, 40–41.

<sup>257</sup> *Ibid.*

are subject to the same food safety and health regulations applicable to imports of other types of food.

Most Korean tariffs on seafood imports from the United States (including products representing an estimated 95 percent of Korean imports from the United States in 2006) would be staged down to zero in equal annual increments over either 3 years or 10 years. Tariffs on some items would be eliminated immediately, and those on a few products would be eliminated over 5 years. The TRQs on flatfish and croaker are to be eliminated in 12 equal stages over 12 years; the TRQ on Alaska pollock is to be eliminated in 15 equal stages over 15 years.

Elimination of Korean duties on imports from the United States could provide export opportunities for a variety of frozen fish fillets (e.g., salmon, Pacific cod, halibut), fish roes, and shellfish products such as a number of Pacific crab species. Elimination of the TRQ on croaker is not likely to boost significantly U.S. exports, as U.S. croaker production is limited. More significant for increased export opportunities, however, would be the elimination of the TRQs on flatfish (flounders, halibut, etc.) and Alaska pollock (the source of surimi, used for seafood analogs such as artificial crabmeat), because the U.S. industry is a large producer and exporter of these products.

The Commission's economy-wide analysis of the long-term effects of tariff and TRQ liberalization estimates that the FTA could result in an increase in U.S. seafood (economy-wide model "fishing" sector) exports to Korea of \$5–20 million (22–83 percent).<sup>258</sup> Such exports are likely to be value-added products such as roe and frozen fillets, as well as high-value unprocessed products such as king or Dungeness crab. Because the Korean market is small relative to total U.S. exports to the world, total U.S. exports would only rise by an estimated 1 percent. The FTA would, nevertheless, likely be beneficial to the U.S. industry. The U.S. industry faces little competition from other suppliers to the Korean market for products such as North Pacific fish and shellfish, and it is likely that much of the gains from increased exports to the Korean market following tariff and TRQ elimination would accrue to U.S. exporters.

On the U.S. import side, U.S. tariffs on seafood currently average approximately 0.5 percent ad valorem, with the majority of products free of duty. Some products are dutiable at between 5 and 10 percent, including frozen blocks of fish meat, frozen swordfish and toothfish meat in containers under 6.8 kg, fresh or frozen crabmeat, canned salmon, breaded fish sticks and portions, boiled clams, and prepared meals containing fish or shellfish. Of these, only frozen swordfish and prepared meals are currently imported from Korea. Products dutiable at more than 10 percent include sturgeon livers and roe and caviar (15 percent), canned sardines in oil (15 to 20 percent), and canned tuna in oil (35 percent). Of these, only tuna in oil is currently imported from Korea. Canned tuna in water is the only seafood product subject to a TRQ: up to an annual aggregate quantity equal to 4.8 percent of the previous year's domestic production. The in-quota tariff is 6 percent, and the over-quota tariff is 12.5 percent. U.S. imports of seafood, like other food products, also are subject to FDA inspection and approval.<sup>259</sup> In general, U.S. tariffs on imports from Korea would be

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<sup>258</sup> Impact relative to an estimated 2008 base. See chap. 2 of this report for additional information regarding the economy-wide analysis.

<sup>259</sup> USHHS, FDA, "Seafood Information and Resources." See also, USDOC, NOAA, NMFS, "Seafood Inspection Program."

eliminated in ten equal increments over ten years.<sup>260</sup> The Commission's economy-wide analysis of the long-term effects of tariff and TRQ liberalization estimates that the FTA would increase seafood (economy-wide model "fishing" sector) imports by less than \$1 million (0.3–2.7 percent).<sup>261</sup> The elimination of U.S. tariffs on most seafood products would not likely result in a significant increase in U.S. imports of seafood from Korea, as Korea's tuna canning industry has been contracting in recent years.<sup>262</sup>

### *Views of Interested Parties*

Bumble Bee Foods,<sup>263</sup> a U.S. producer of canned tuna, among other foods, stated in a written submission to the Commission that it opposes any reductions in U.S. tariffs on tuna from Korea. It reported that it supports the current U.S. duty structure for canned tuna (consisting of an ad valorem tariff for tuna packed in oil and a tariff-rate quota for tuna packed in water). It noted that a rise in low-cost imports has led to the decline of the U.S. tuna processing industry (since 1979 at least ten canneries have closed, with a loss of 20,000 jobs). It stated that, compared with hourly labor rates of \$11.50 and \$7.50 in California and Puerto Rico, respectively, it cannot compete with foreign labor rates as low as \$1.75 per hour. Korea, according to Bumble Bee, has tuna canning operations and could easily divert additional shipments to the U.S. market should the proposed U.S.-Korea FTA lead to the elimination of the U.S. tariffs on canned tuna from Korea. Bumble Bee adds that any terms regarding canned tuna in the proposed agreement should include similar rules of origin as in the Andean Trade Preference Act, where tariff preferences were given only for tuna harvested by Andean- and/or U.S.-flag harvesting vessels (thereby offering increased market opportunities for the U.S. tuna fleet, now that most U.S. canneries have closed).<sup>264</sup>

## **Selected Processed Foods<sup>265</sup>**

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### *Assessment*

The U.S.-Korea FTA will likely result in significantly increased U.S. exports of selected processed foods to Korea in the medium-to-long term as tariffs on these products are progressively reduced and eliminated. Given its large urban population, rising affluence, and lifestyle changes, Korea has a growing market for processed foods and U.S. exporters should

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<sup>260</sup> Exceptions include tariffs on frozen blocks of fish meat and canned salmon (eliminated over 5 years); prepared meals containing fish or shellfish (eliminated over 3 years); canned tuna in oil (eliminated in increasing increments over 10 years), and the TRQ on canned tuna in water (both tariffs eliminated in increasing increments over 10 years).

<sup>261</sup> Impact relative to an estimated 2008 base. See chap. 2 of this report for additional information regarding the economy-wide analysis.

<sup>262</sup> UN FAO.

<sup>263</sup> Lischewski, "Written Comments Regarding Canned Tuna," written submission to the USITC, June 20, 2007.

<sup>264</sup> The FTA's rules of origin do not contain special provisions for tuna.

<sup>265</sup> Processed foods in this assessment are restricted to bread, pastry, malt extract, mixes and doughs, cookies, food preparations, soups and broths, sauces, and tomato ketchup. These products are found in HTS chaps. 19 and 21 and all were determined to be significant, as they each accounted for over \$2 million in U.S. exports to Korea in 2006. The products covered in this assessment represent approximately 18 percent of U.S. exports to Korea in the GTAP "food products n.e.c." sector, and represent approximately 37 percent of U.S. imports from Korea in the GTAP "food products n.e.c." sector, for 2006.

benefit under the provisions of this FTA as tariff reductions improve the U.S. competitiveness in the Korean market. The U.S. industry has noted, however, that several TBTs, such as restrictive food standards, numerous labeling requirements, and time-consuming customs procedures, have impeded U.S. exports to Korea for the past several years.<sup>266</sup> Interpretation and implementation of the SPS and TBT provisions of the FTA will likely be critical to fully realizing these market access gains.<sup>267</sup>

Despite the NTMs, exports to Korea of most of the processed foods included here have experienced continued strong growth for the past several years (table 3.12). The food consumption patterns of the Korean consumer have become very similar to those of U.S. consumers because of increasing per capita income, increasing participation of women in the workforce, and a younger, well-traveled generation that is familiar with U.S. brands.<sup>268</sup> The domestic processing industry has insufficient capacity to supply this increasing demand for processed foods, and imports are expected to increase. For products included in this assessment, the United States has been one of the leading suppliers to Korea during the years 2002 through 2006; China, the EU, and Japan represent the other major sources.<sup>269</sup> Korea's total imports of all of these products have shown consistent growth, and the United States has a significant market share for mixes and doughs, tomato ketchup, and food preparations (table 3.12).

**Table 3.12** Korean imports of selected processed foods

Product	Total			From the United States			U.S. share of Korean imports
	2002	2006	2002–06 change	2002	2006	2002–06 change	
	<i>Million dollars</i>		<i>Percent</i>	<i>Million dollars</i>		<i>Percent</i>	
Mixes and doughs	4.8	17.1	254	3.4	11.5	241	67
Malt extract	26.2	34.8	33	2.0	2.5	26	7
Cookies	2.6	3.0	16	0.0	0.0	N/A	0
Bread, pastry	54.1	99.5	84	16.4	25.2	54	25
Tomato ketchup	3.4	5.3	57	2.6	3.9	46	74
Sauces and condiments	64.8	92.9	43	7.9	9.8	23	11
Soups and broths	6.5	28.1	334	1.9	2.6	43	9
Food preps, nesoi	273.0	316.8	16	120.0	113.1	(6)	36

Source: Global Trade Information Services, World Trade Atlas Database.

Products in HS chapter 19 (preparations of cereals, flour, starch, or milk; bakers' wares) have MFN tariffs ranging from 8 to 36 percent ad valorem (mostly 8 percent), and products in HS

<sup>266</sup> Thorn, "Public Comments Regarding Proposed Free Trade Agreement with the Republic of Korea," written submission to the Trade Policy Staff Committee, Office of the USTR, March 17, 2006; USTR, "Korea," *2007 National Trade Estimate Report on Foreign Trade Barriers*, April 2, 2007, 359–61; and USDA, FAS, "Republic of Korea Exporter Guide Annual 2006," October 2, 7–11. For additional analysis regarding customs administration provisions of the FTA, see chap. 5 of this report.

<sup>267</sup> For additional analysis regarding TBTs, customs administration, and NTMs, see chap. 5 of this report.

<sup>268</sup> USDA, FAS, "Republic of Korea Exporter Guide Annual 2006," October 2, 2006, 3.

<sup>269</sup> Global Trade Information Services, World Trade Atlas Database.

chapter 21 (miscellaneous food) have MFN tariffs ranging from 5 to 754<sup>270</sup> percent (mostly 8 or 18 percent). These tariffs would be eliminated in 5 or 10 years under the FTA, and none is subject to TRQs or safeguards.<sup>271</sup> Consequently, the tariff eliminations of the FTA should improve the competitive position of the United States against China, the EU, and Japan once they are fully implemented. In addition, implementation of the FTA should support the U.S. processed food industry's ability to continue to capture some of the growing demand in Korea.

As shown in the Views of Interested Parties below, industry representatives have expressed concerns regarding the adverse effect of NTMs on U.S. exports to Korea. An analysis of international price and quantity data comparing Korean imports to comparable countries indicates that the potential effect of NTMs on Korean imports may be to restrict the quantity of imports or raise the price of imports for a variety of processed foods (box 3.2). Implementation of the TBT provisions of the FTA will likely be critical to fully realizing these gains in market access.

### *Views of Interested Parties*

In its report on the agreement, the ATAC for Trade in Processed Foods stated that it supports the FTA. It noted that more than one-half of the current U.S. food and agriculture exports to Korea will become immediately free of duty, including a wide variety of processed products, while many others are subject to a relatively short 5-year tariff phaseout period. The report notes that U.S. exporters of many processed food products could see the benefits of tariff removal under the FTA negated by continued TBTs not addressed in the negotiations. Specifically, the report mentioned that Korea does not allow the use of several food additives that are approved by the U.S. Food and Drug Administration and are commonly used in U.S. processed foods. Consequently, food products containing such additives would continue to be denied access to Korea, despite having their tariffs eliminated.<sup>272</sup>

A spokesperson for the Grocery Manufacturers Association and the Food Products Association (GMA-FPA), a trade association representing firms in the food, beverage, and consumer packaged goods industry, stated that the association is generally supportive of the FTA, as Korea is an important market for many of the producers it represents.<sup>273</sup> For tariffs, she noted that certain products of member companies will benefit greatly from Korea's rapid duty elimination in such products as frozen french fries, grape juice, and orange juice, while other products such as tomato ketchup, peanut butter, popcorn, and dairy products will benefit relatively less because of duty eliminations lasting several years. Prior to the negotiations, she stated that the association noted several NTMs for processed foods as hindering.<sup>274</sup> The association added that it is pleased that the U.S. emphasized the importance

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<sup>270</sup> Food preparations n.e.c. (red ginseng tea, HTS 2106.90.3021) has an MFN rate of 754 percent.

<sup>271</sup> USTR, "Final - United States - Korea FTA Texts," 2007.

<sup>272</sup> ATAC for Trade in Processed Foods, *Advisory Committee Report*, April 27, 2007.

<sup>273</sup> Peggy S. Rochette, senior director of International Policy, GMA-FPA, interview by Commission staff, Washington, DC, June 27, 2007.

<sup>274</sup> Rochette, "Public Comments Regarding Proposed Free Trade Agreement with the Republic of Korea," written submission to the Trade Policy Staff Committee, Office of the USTR, March 23, 2006.

**Box 3.2** Potential price and quantity effects of NTMs on selected processed foods

Firms seeking to export to Korea have identified several TBTs that may impede their access to the market for processed foods, including restrictive food standards, numerous labeling requirements, and time-consuming customs procedures (see text). These measures may restrict the quantity of imports into the Korean market, raise the price of imports, or both.

Unit values of Korean imports of U.S. processed foods selected for this assessment are in many cases significantly above unit values that U.S. exporters receive in other countries. In addition, Korean imports from the world of some of these same processed foods are substantially lower than imports of these products in most other comparable economies. Korea's MFN tariffs are 8 percent for tomato ketchup, bread, pastry, soups, and broths, and 18 or 45 percent for sauces and condiments. These tariffs appear in most cases to be too low to account by themselves for either the relatively high unit values of Korean imports or the relatively low import quantities. These relatively high unit values may be reflective of the effects of NTMs, but could also be influenced by such factors as market structure, product differentiation, and consumer preferences.

Korea's imports of tomato ketchup and other tomato sauces (HS 210320) are substantially lower than imports of the same products into most other comparable economies, relative to the size of the Korean economy. Korean imports of tomato ketchup and other tomato sauces were 6.1 kg per million \$ GDP, or 17.6 percent of the median for 64 comparable countries.

The table below compares Korean unit values on imports from the United States of certain U.S. processed foods with U.S. export unit values of the same products to the world. For example, the 57.0 premium on bread and pastry indicates that unit values on Korean imports from the United States, as reported in Korean trade data, are 57.0 percent higher than unit values on U.S. exports to the world, as reported in U.S. trade data.

Product	Unit value for Korean imports from the United States (\$/kg)	Unit value for U.S. exports to the world (\$/kg)	Implied unit value premium (percent)
Bread, pastry (HS 190591)	\$3.324	\$2.118	57.0
Tomato ketchup and other tomato sauces (HS 210320)	\$1.151	\$0.893	28.9
Sauces and condiments (HS 210390)	\$3.185	\$1.839	73.2
Soups and broths (HS 210410)	\$2.791	\$2.324	20.1

A portion of these higher prices is the result of transportation costs and insurance, since Korean import prices are on a cost, insurance, and freight (c.i.f.) basis and the U.S. export prices are on a free-on-board (f.o.b.) basis. In most of these cases, however, the price difference is still relatively large enough to imply the potential impact of NTMs in restricting trade in these goods. The TBT chapter and the committee established by the SPS chapter of the FTA are intended to address some of these NTMs (see chapter 5 of this report for additional information on these provisions).

For further information on the calculation and interpretation of the quantity and unit-value information reported above, see appendix J.

*Source:* See app. J for data sources; USITC staff analysis.

of these NTMs during the FTA negotiations. She stated that GMA-FPA views the SPS and TBT chapters of the FTA as “a step in the right direction,” as they establish a forum for discussing NTMs, but noted that GMA-FPA remains concerned about Korea’s current food regulatory system with respect to labeling, food standards, customs procedures, notification of regulation changes, and transparency of regulations. She added that it “remains to be seen” whether the SPS and TBT chapters will be able to fully address these concerns.

A spokesperson for the Campbell Soup Company, the world’s largest producer of soups and a major manufacturer of branded cookies, snack foods, mixed vegetable juices, and sauces, stated that the company is pleased with the FTA as it will phase out tariffs on most of its products over 5 years.<sup>275</sup> He noted that this eventual duty-free access would provide a significant competitive advantage for U.S. exports over comparable products manufactured in the EU and Japan.

The California Tomato Growers Association, a farmer-owned cooperative for growers of processing tomatoes, stated that it supports the elimination of tariffs on processed tomato products, including tomato ketchup, in the FTA.<sup>276</sup> The association reported that this elimination of tariffs could result in an estimated annual sales increase of up to \$15 million for the California processed tomato industry. It noted, however, that Korea’s labeling requirements and import clearance process can still affect trade despite the tariff eliminations; the association underscored that enforcement of the TBT and SPS provisions of the FTA will be necessary for the full benefits to increased exports to be realized.

## **Nonalcoholic Beverage Products<sup>277</sup>**

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### ***Assessment***

The U.S.-Korea FTA provisions for nonalcoholic beverage products would likely have a significant impact on U.S. exports. Exports of a number of U.S. beverage products, including grape juice and orange juice (including frozen concentrated orange juice [FCOJ]), would enter Korea free of duty upon FTA implementation. Tariffs on other products, such as vegetable juices, would be phased out over 5 years.<sup>278</sup>

The current Korean MFN rate for FCOJ is 54 percent, while single-strength orange juice is currently dutiable at 30 percent. For most other fruit juices, the applied MFN rate is

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<sup>275</sup> Kelly Johnston, Vice President, Government Affairs, Campbell Soup Company, e-mail messages to Commission staff, June 26, 2007.

<sup>276</sup> California Tomato Growers Assoc., “Public Comments,” written submission to the Trade Policy Staff Committee, Office of the USTR, n.d.

<sup>277</sup> Nonalcoholic beverages include beverage products are found in HTS chaps. 20, 21, and 22, with the exception of beverage products containing alcohol. Fruit juices are found in chap. 20, with the exception of juice products with added vitamins or other nutrients, which are found in chap. 21, and fruit drinks that are fruit juices with less than 100 percent juice, which are found in chap. 22. Bottled water and carbonated beverages, including those sweetened with artificial sweeteners are found in chap. 22, as are sports drinks, ice teas, milk-containing drinks, and “functional” beverages. The products covered in this assessment represent approximately 33 percent of U.S. exports to Korea in the GTAP “beverages and tobacco products” and approximately 4 percent of U.S. exports to Korea in the GTAP “food products n.e.c.” sectors, and represent approximately 33 percent of U.S. imports from Korea in the GTAP “beverages and tobacco products” and less than 1 percent of U.S. imports from Korea in the GTAP “food products n.e.c.” sectors, for 2006.

<sup>278</sup> ATAC for Trade in Processed Foods, *Advisory Committee Report*, April 27, 2007.

50 percent, while the vegetable juices rate is 30 percent. Grape juice and apple juice have 45 percent tariff rates. Korean tariffs on vegetable juices would be phased out over 5 years.<sup>279</sup> Beverages in HS chapter 22 such as bottled water, carbonated soft drinks, sports drinks, functional beverages, and iced tea are subject to an 8 percent tariff, while fruit juice drinks (less than 100 percent juice) are subject to a 26.2 percent tariff. These tariffs would be removed upon FTA implementation and should increase the competitiveness of U.S. exports into the Korean market and increase market share.

The Korean nonalcoholic beverage market was estimated at \$3.8 billion in 2005.<sup>280</sup> The total value of imported nonalcoholic beverages was about \$62 million in 2004, representing about 2 percent of the overall market. Carbonated beverages and fruit and vegetable juices each represent about one-third of the Korean nonalcoholic beverage market. The remaining third is made up of mineral water, sports beverages, canned coffee, functional beverages, traditional Korean drinks, and flavored water. In 2006, the total value of U.S. exports of beverage products to Korea was about \$44 million. Leading export items, in order of value, were carbonated soft drinks, mixtures of fruit juices, grape juice, and orange juice.

U.S. orange juice competes with Brazilian juice in the Korean market, while U.S. grape juice competes with exports from Argentina, Brazil, Chile, and Spain. In 2004, Brazil had about a 77 percent share of the Korean orange juice market, while U.S. juice accounted for about 21 percent.<sup>281</sup> In recent years, Brazil has captured an increasing share of Korea's orange juice market. The FTA could help the U.S. industry to recapture some of this market share from suppliers in Argentina and Brazil. The largest percentage increase is expected for grape juice and orange juice because the tariff reductions are the greatest, as high as 50 percent. Other beverage exports, such as carbonated soft drinks and bottled waters, would be likely to increase modestly from the liberalization of the 8 percent tariff rate on these beverages.

Concerns about safe drinking water have spurred sales of bottled waters in Korea. The Korean shelf life for bottled water is 6 months from the date of manufacture. While Korea had agreed to phase out government-mandated expiration dates on many food products and allow manufacturers to set their own "use-by" dates, Korea continues to maintain government-mandated shelf-life requirements for sterilized milk products and bottled water.<sup>282</sup> This period is shorter than the shelf life in the United States and many other countries, and in the past has been cited by exporters as a nontariff barrier.<sup>283</sup> In addition to establishing a standing committee, the SPS chapter of the agreement reconfirms the commitment of both parties to use sound science in the application of SPS measures and generally refers to the WTO SPS Agreement as establishing the means by which such measures would be applied.<sup>284</sup> Implementation of the FTA's SPS chapter provisions may, consequently, facilitate increased exports of beverages, such as bottled water, that face relatively low tariff barriers in comparison to NTMs.

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<sup>279</sup> Ibid.

<sup>280</sup> USDA, FAS, "Korea Product Brief, Non-Alcoholic Beverages 2005," August 26, 2005.

<sup>281</sup> Korean Customs Service, Republic of Korea.

<sup>282</sup> USDA, ERS, "Briefing Room on South Korea—Issues and Analysis," April 19, 2006.

<sup>283</sup> USTR, National Trade Estimate Report on Foreign Trade Barriers.

<sup>284</sup> For additional analysis regarding SPS and other NTMs, see chap. 5 of this report.



## *Views of Interested Parties*

Welch Foods Inc., a Cooperative (Welch's), in a written submission to the Commission, expressed support for the provisions of the FTA regarding grape juice. Welch's expects the agreement to have a positive economic effect for Welch's, other U.S. grape producers, and Korean consumers by immediately eliminating the 45 percent duty on U.S. grape juice exports. Welch's said that the main trade barrier to selling more grape juice in Korea has been Korea's 45 percent tariff on grape juice concentrate.<sup>285</sup> Welch's noted that, in 2002 and 2003, total U.S. exports of grape juice to Korea were valued at over \$9 million, but then fell to \$6.5 million in 2006 as Argentinian grape juice took a larger share of the Korean grape juice market.

The Wine Institute and the California Association of Winegrape Growers, in a written submission to the Commission, reported that it "applauds" the FTA, noting the benefit of immediate duty-free market access for grape juice concentrates.<sup>286</sup> It added that the FTA "will greatly enhance the competitive position" of the industry, especially with respect to Chile, which it noted had substantially increased exports of grape juice concentrates to Korea after implementation of the Chile-Korea FTA in 2004.

Florida Citrus Mutual, a Florida cooperative representing nearly 10,000 Florida citrus growers and processors, stated in a media release that it supports the FTA. The release said that the agreement would phase out the 30 to 54 percent tariff on U.S. orange juice, and would be beneficial to the Florida citrus industry.<sup>287</sup>

In its report, the ATAC for Trade in Processed Foods stated that it takes no position on the agreement. The committee noted in its report, however, that it strongly endorses the fundamental U.S. goal of opening markets, and since being formed in 2003, has firmly supported all comprehensive free trade agreements and trade promotion agreements. The committee also expressed concern that benefits from tariff reductions could be nullified by continuing TBTs not addressed in the FTA.

## **Textiles and Apparel<sup>288</sup>**

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### *Assessment*

The U.S.-Korea FTA would likely result in a significant increase in bilateral U.S.-Korea trade in textiles and apparel, particularly U.S. imports from Korea.<sup>289</sup> The expected increase in imports from Korea will likely be concentrated in goods for which Korea is a competitive,

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<sup>285</sup> Walther (counsel), "U.S.-Korea Free Trade Agreement: Potential Economy-Wide and Selected Sectoral Effects," written submission to the USITC on behalf of Welch Foods, June 14, 2007.

<sup>286</sup> Clawson and Gore, "Comments to the U.S. International Trade Commission," written submission to the USITC on behalf of the Wine Institute and the California Assoc. of Winegrape Growers, June 27, 2007.

<sup>287</sup> Florida Citrus Mutual, "U.S.-Korea Free Trade Agreement Could Prove Beneficial for Florida Citrus (April 9, 2007)."

<sup>288</sup> The products covered in this assessment represent 100 percent of U.S. exports to Korea in the GTAP "textiles" and "wearing apparel" sectors, and represent 100 percent of U.S. imports from Korea in the GTAP "textiles" and "wearing apparel" sectors, for 2006.

<sup>289</sup> A trade report also noted that experts in the Korean textile and apparel industry agree that the Korean industry would benefit substantially under the FTA. KOFOTI, "Forecast: Impact of FTA," March 2007, 46.

and major supplier, and U.S. tariffs are high, such as man-made fibers, yarns, fabrics, and hosiery, and will likely displace domestic production of such goods and especially imports of such goods from other sources.

The average U.S. tariff on imports from Korea is 11.0 percent for textiles and 16.5 percent for apparel, while the average Korean tariff on imports from the United States is 8.3 percent for textiles and 12.4 percent for apparel.<sup>290</sup> The FTA would eliminate tariffs on textiles and apparel that meet the FTA rules of origin (“originating goods”) either immediately upon its implementation or within 10 years.<sup>291</sup> The FTA would eliminate U.S. tariffs immediately on 52 percent of the Korean goods (based on the level of U.S. imports of textiles and apparel from Korea in 2006) and phase out U.S. tariffs on the remainder over 5 years (21 percent of the total) or 10 years (27 percent). The FTA would remove Korean tariffs immediately on 77 percent of U.S. textile and apparel exports and phase out Korean tariffs on the remainder over 3 years (13 percent) or 5 years (10 percent).<sup>292</sup>

The FTA would apply a yarn-forward rule of origin found in other recent U.S. FTAs to most textiles and apparel,<sup>293</sup> for a garment to qualify for FTA preferences, production of the yarn and fabric used in the garment, as well as cutting and sewing, must occur in the FTA region.<sup>294</sup> The FTA contains provisions similar to those found in CAFTA-DR.<sup>295</sup> Unlike CAFTA-DR, the U.S.-Korea FTA would permit the use of nonoriginating sewing thread, narrow fabrics, and pocketing fabrics in qualifying apparel,<sup>296</sup> and the U.S.-Korea FTA does not contain tariff preference levels (TPLs) that would grant tariff preferences to specified quantities of textiles and apparel made from nonoriginating materials or a “cumulation”

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<sup>290</sup> The duties are based on trade in 2006.

<sup>291</sup> Data in the paragraph on the portion of trade that would be subject to immediate tariff elimination include goods subject to immediate tariff elimination (staging code “A”) and those already free of duty (staging code “K”).

<sup>292</sup> Data in the paragraph are in terms of goods covered by FTA chap. 4, which includes all textiles and apparel listed in the annex of the Agreement on Textiles and Clothing, which is contained in Annex 1A to the WTO Agreement. The products include, but are not limited to, textile and apparel articles in HS chapters 50–63 except raw cotton, wool, and certain other textile fibers; textile travel goods (e.g., luggage) in HS heading 4202; glass fibers, yarns, and fabrics in HS heading 7019; and comforters in HS subheading 9404.90. In 2006, U.S. imports from Korea totaled \$2.0 billion and Korean imports from the United States were an estimated \$220–250 million. Official statistics of the U.S. Department of Commerce; and Global Trade Information Services, World Trade Atlas Database.

<sup>293</sup> FTA chap. 4 sets out the rules of origin and other provisions specifically applicable to textiles and apparel, a summary of which appears in app. D of this report.

<sup>294</sup> The yarn-forward rule of origin applies only to the component that determines the tariff classification of the garment (i.e., the component that gives the garment its “essential character”), rather than to all fabric components of the garment.

<sup>295</sup> The FTA would apply a more flexible single transformation, or “cut and sew,” rule of origin but to fewer goods, and would require certain visible linings used in qualifying suits, coats, jackets, and skirts to originate in the FTA region. The cut and sew rule would permit the use of nonoriginating fabrics in certain goods as long as the goods are cut and sewn in the FTA region, including textile luggage, silk and linen apparel, certain knit cotton pajamas and underwear, women’s knit man-made fiber blazers, and men’s woven shirts of fine-count cotton and man-made fiber fabrics.

<sup>296</sup> U.S. textile companies expressed concern that the FTA would permit the use of nonoriginating sewing thread, narrow fabrics, and pocketing fabrics in FTA-qualifying goods, because these inputs are in “plentiful supply” in the FTA region. ITAC (13) on Textiles and Clothing, *Advisory Committee Report*, April 27, 2007. According to the United States Association of Importers of Textiles and Apparel (USA-ITA), the key and most beneficial components of the textile and apparel provisions of the FTA include the use of these nonoriginating inputs. Jones, written submission to the USITC, June 27, 2007, 2–3.

provision that would permit integration of inputs among U.S. FTA partners.<sup>297</sup> The FTA includes detailed Customs enforcement cooperation provisions to ensure accuracy of the claims of origin, to prevent circumvention of the agreement, and to enforce measures affecting trade in textiles and apparel.<sup>298</sup>

The Commission's economy-wide analysis of the long-term effects of tariff and TRQ liberalization estimates that U.S. imports from Korea could increase by slightly more than \$1.7–1.8 billion (86–94 percent) for textiles and by \$1.0–1.2 billion (145–175 percent) for apparel, of which approximately 85–90 percent is diverted from other import sources.<sup>299</sup> The analysis also estimates that U.S. exports to Korea could increase by \$130–140 million (85–92 percent) for textiles and by \$39–45 million (125–147 percent) for apparel. The economy-wide model also estimates that the FTA could result in declines in domestic output and employment in the textile and apparel sectors ranging from 0.4 percent to 0.8 percent, partly reflecting Korea's small share of total U.S. imports (2.1 percent) and U.S. exports (1.1 percent) of such goods, as well as the high import share in key domestic markets for textiles and apparel.<sup>300</sup>

Korea has experienced a significant decline in its global competitiveness in textiles and especially apparel, as evidenced by a 27 percent decrease in its textile and apparel exports to the world during the years 2000 to 2005; this reflected declines of 18 percent in textiles and 49 percent in apparel.<sup>301</sup> Total U.S. imports of textiles and apparel from Korea decreased by 46 percent during the years 2000 to 2006 to \$1.7 billion, reflecting declines of 60 percent in apparel, to \$913 million, and 7 percent in textiles, to \$753 million.<sup>302</sup> The decline in Korea's shipments occurred during a period in which the United States and other importing countries completed the phaseout of quotas on textiles and apparel on January 1, 2005,<sup>303</sup> which put Korea in direct competition with China and other lower-cost exporting countries in mid- to low-end goods.<sup>304</sup> In addition, Korean textile companies shifted production of low-value-added apparel to lower-cost exporting countries, contributing to the decline in direct Korean exports of apparel.<sup>305</sup> China is the main site for Korean overseas apparel production, accounting for 40 percent (\$1.5 billion) of the \$3.8 billion in Korean foreign investment in

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<sup>297</sup> CAFTA-DR permits qualifying goods to be made of nylon filament yarn produced in the United States or its FTA partners, Israel and Mexico. A trade source was of the opinion that the U.S.-Korea FTA should allow cumulation between Korea and CAFTA-DR countries because Korean firms are heavily invested in Central America, and many Central American apparel facilities source yarns and fabrics from Korea. Jones, written submission to the USITC, April 27, 2006, 3.

<sup>298</sup> For additional analysis regarding customs administration provisions of the FTA, see chap. 5 of this report.

<sup>299</sup> Impact relative to an estimated 2008 base. See chap. 2 of this report for additional information regarding the economy-wide analysis.

<sup>300</sup> The import and export shares represent "baseline data" used in the Commission's economy-wide analysis, as discussed in chap. 2 of this report. These GTAP sectors include almost all textiles and apparel covered by U.S.-Korea FTA chap. 4 ("Textiles and Apparel"); for example, the GTAP textile sector does not include textile luggage and glass fibers, yarns, and fabrics. Unlike FTA chap. 4, the GTAP apparel sector also includes leather and fur apparel. U.S. imports from Korea in 2006 totaled about \$2.0 billion each under FTA chap. 4 and the GTAP sectors for textiles and apparel.

<sup>301</sup> WTO, "International Trade Statistics 2006."

<sup>302</sup> U.S. imports of textiles and apparel from all countries rose by 30 percent during the years 2000 to 2006 to \$93 billion (International Trade Administration, Office of Textiles and Apparel).

<sup>303</sup> The WTO Agreement on Textiles and Clothing (ATC) obligated the United States, the EU, and Canada to phase out their quotas (established under the Multifiber Arrangement [MFA]) on textiles and apparel from WTO member countries, including Korea, in four stages over a 10-year transition period ending on January 1, 2005.

<sup>304</sup> Park, "The Effect of the US-China Textile Agreement on Korea," November 28, 2005, 5.

<sup>305</sup> Ibid.; and Mun, written submission to the USITC, May 4, 2006.

textiles and apparel through 2005.<sup>306</sup> Although Korean production of textiles and apparel declined by 28 percent during the years 2000–2005, the textile and apparel sector is still a key source of economic activity in Korea, generating 9.6 percent of manufacturing jobs (274,000), 4.4 percent of manufacturing output, 4.6 percent of exports (\$13 billion), and a trade surplus of \$7.2 billion in 2005.<sup>307</sup>

## U.S. Imports

The expected increase in U.S. imports of textiles and apparel from Korea under the FTA will likely be concentrated in man-made fibers and goods made of such fibers, for which Korea is a major world producer<sup>308</sup> and has a “proven advantage.”<sup>309</sup> U.S. tariffs range from 4.3 percent ad valorem for fibers to 8–8.8 percent for yarns, 12–14.9 percent for woven fabrics, 18.8 percent for socks, and 30 percent for sweaters. Korea was the seventh-largest supplier of U.S. imports of man-made fiber textiles and apparel in 2006 with an import share of 3.0 percent (\$1.0 billion), but the fourth-largest for man-made fiber textiles (excluding apparel) with an import share of 5.3 percent (\$611 million).<sup>310</sup>

Korea is a major producer of polyester fibers, especially polyester staple fibers (PSF) and filaments,<sup>311</sup> accounting for 5.6 percent of world output of polyester fibers in 2005.<sup>312</sup> The FTA would immediately eliminate the U.S. tariff on imports of PSF from Korea, although U.S. imports of certain PSF from Korea would still be subject to a U.S. antidumping order,<sup>313</sup> and phase out U.S. tariffs on most polyester-filament yarns from Korea over 10 years. Korea is the largest foreign supplier of these inputs, accounting for 37 percent (\$165 million) of U.S. imports of PSF and 24 percent (\$33 million) of U.S. imports of nontextured filament yarn, including nontextured polyester filament yarn. The expected increase in imports of PSF and polyester filaments from Korea will likely displace domestic production of U.S. fiber manufacturers, which posted declines in shipments during 2000–05 of 25 percent in PSF, 39 percent in polyester textile filament, and 15 percent in polyester industrial filament.

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<sup>306</sup> KOFOTI, *Textile and Fashion Korea*, March 2007.

<sup>307</sup> WTO, “International Trade Statistics 2006;” KOFOTI, *Textile and Fashion Korea*, March 2007; KOFOTI, “Industry Scoreboard,” March 2007; and USDOS, U.S. Embassy, Seoul, “2006 Updated Statistics for Korean Textiles and Apparel Sector (SEOUL 003613),” October 20, 2006.

<sup>308</sup> Korea’s Minister of Commerce, Industry and Energy in 1998 introduced the Milano Project, which “offers special supports to research and development in design and apparel as well as yarn, dyeing, fabrication, textile machinery and synthetic fabrics” for the textile industry in Daegu, which reportedly has the largest synthetic fabric production and export complex in the world. Daegu (Korea), City of. “Milano Project.”

<sup>309</sup> Korea reportedly has a proven advantage in melt spinning, a method of spinning filaments of manufactured fibers such as polyester. Mauretti, “The Outlook for Technical Textiles Worldwide,” July 13, 2006, 6.

<sup>310</sup> The largest sources of U.S. imports of man-made fiber textiles (excluding apparel) in 2006 were China (\$5.1 billion), Canada (\$1.2 billion), and Mexico (\$826 million). International Trade Administration, Office of Textiles and Apparel.

<sup>311</sup> The Harmonized System divides man-made fibers into filaments (chap. 54) and staple fibers (chap. 55): Filaments are fibers in continuous lengths (e.g., miles long), while staple fibers are made from filaments cut into shorter lengths, depending on end use (e.g., 2–3 inches in length for blending with cotton).

<sup>312</sup> The largest producers of polyester fibers in 2005 were China (51 percent of world output) and Taiwan (8.1 percent). The United States generated 5.5 percent of the world total. Fiber Economics Bureau, *Fiber Organon*, July 2006, 133.

<sup>313</sup> The U.S. tariff on PSF, classified in HTS subheading 5503.20.00 (polyester staple fibers, not carded, combed, or otherwise processed for spinning), is 4.3 percent ad valorem. The U.S. antidumping duty order covers imports from Korea of PSF measuring 3.3 decitex or more in diameter, cut into lengths of one inch to 5 inches, and used as fiberfill in furniture, pillows, comforters, cushions, sleeping bags, and ski jackets. USITC, *Certain Polyester Staple Fiber from Korea and Taiwan*, March 2006, 3.

Imports currently supply 41 percent of the U.S. market for PSF.<sup>314</sup> The import share of the U.S. market for polyester textile filament and polyester industrial filament in 2005 was 22 percent and 33 percent, respectively.<sup>315</sup>

In fabrics, the expected growth in U.S. imports from Korea will likely be concentrated in knit and woven industrial and specialty fabrics and will likely displace domestic production of such fabrics. Korea was the third-largest source of U.S. fabric imports in 2006 with 11 percent (\$953 million) of the total, reflecting significant positions in knit fabrics (27 percent import share or \$203 million) and specialty fabrics (13 percent or \$116 million). Korean producers reportedly are expanding output of industrial and specialty fabrics that use information technology and biotechnology for use in tire-cord fabrics and engineering, construction, and medical applications.<sup>316</sup> Industrial fabrics include high-strength reinforcements, textile reinforcements, and laminated sheet goods that use the textile reinforcements to make them stronger. The fabrics are used in awnings, tents and mobile shelters, signs and banners, tarpaulins, commercial roofing membranes, health-care mattress and seating covers, truck covers, conveyor belting fabrics for package handling and treadmills, and geotextiles for water-containment linings and erosion control.<sup>317</sup>

Regarding apparel, the FTA would give Korea immediate duty-free access to the U.S. market for tariff lines covering 60 percent of U.S. apparel imports from Korea and phase out tariffs on the remaining Korean goods over 5 years (20 percent of total) or 10 years (20 percent). Korea is a key supplier of U.S. imports of hosiery and man-made fiber gloves and shirts.<sup>318</sup> Imports supply approximately 75 percent of the U.S. apparel market by value, based on the landed duty-paid value. A trade source contends that apparel production still based in the United States tends to follow niche domestic markets, to respond to government procurement incentives (e.g., the Berry Amendment),<sup>319</sup> or to serve quick response needs of the domestic market.<sup>320</sup> The expected increase in imports of apparel from Korea under the FTA could displace domestic production slightly, as well as U.S. production-sharing trade with preferential free trade partners, where U.S. and other firms make apparel from U.S. yarns and fabrics and import the apparel into the United States free of duty under NAFTA and CAFTA-DR.<sup>321</sup>

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<sup>314</sup> Bermish, testimony before the USITC, June 20, 2007.

<sup>315</sup> Fiber Economics Bureau, *Fiber Organon*, February 2006, 29.

<sup>316</sup> KOFOTI, "Special Report: Korean Textile and Clothing Industry," March 2007. The "2015 vision plan" introduced by Korea's Ministry of Commerce, Industry and Energy in November 2005 features the development of advanced industrial textiles. KOFOTI, "Industry Scoreboard," March 2007.

<sup>317</sup> American Manufacturing Trade Action Coalition, written submission to the USITC, April 2006.

<sup>318</sup> The "2015 vision plan" introduced by Korea's Ministry of Commerce, Industry and Energy in November 2005 features the development of infrastructure for digital, intelligent fashion apparel technologies like "smart clothing" that will include state-of-the-art dyeing and processing technologies. KOFOTI, "Industry Scoreboard," March 2007.

<sup>319</sup> The Berry Amendment (10 U.S.C. 2533a) requires the Department of Defense to give preference in procurement to U.S.-made goods, including apparel, tents and tarpaulins, and fabrics, including all fibers and yarns used in them and goods made from them. CRS, "The Berry Amendment: Requiring Defense Procurement to Come from Domestic Sources," April 21, 2005.

<sup>320</sup> Burke, written submission to the USITC, March 24, 2006.

<sup>321</sup> One U.S. industry source stated that the FTA would grant Korea immediate duty-free access to the U.S. market for 60 percent of the textile product categories that it identifies as sensitive, including those covered by the U.S.-China Textile Bilateral Agreement, threatening both U.S. domestic sales and U.S. coproduction relationships in the NAFTA/CAFTA region. Tantillo, "U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects," written submission to the USITC, June 27, 2007.

## U.S. Exports

The impact of the FTA on U.S. exports of textiles and apparel to Korea, while large in percentage terms, would likely be small in absolute terms. The Commission's economy-wide analysis of the long-term effects of tariff and TRQ liberalization estimates that U.S. exports to Korea could increase by \$130–140 million (85–92 percent) for textiles and by \$39–45 million (125–147 percent) for apparel. These results partly reflect the small volume of U.S. exports of textiles and apparel to Korea (\$150 million in 2006) and Korea's small share of U.S. exports of textiles and apparel (1.1 percent).<sup>322</sup> In addition, U.S. exports of textiles and apparel to Korea face intense competition from China, which supplied 58 percent (\$3.7 billion) of Korean imports of textiles and apparel in 2005.<sup>323</sup> U.S. textile industry sources said they do not expect that the FTA would generate significant new export business with Korea because consumers there have limited ability “to purchase finished goods made in countries that pay high wages and have strong environmental, labor, and safety and health standards” and because the textile sector there has historically benefited from extensive support from its government.<sup>324</sup> The expected increase in U.S. exports of textiles and apparel to Korea under the FTA is likely to be concentrated in goods for which the U.S. industry is competitive, including certain man-made fiber filament yarns and tow; industrial and specialty fabrics, including nonwoven, coated, and knit fabrics; and popular brand-name apparel.

### *Views of Interested Parties*<sup>325</sup>

In its report, the Industry Trade Advisory Committee (ITAC) on Textiles and Clothing (ITAC 13) stated that its members did not make a unified statement in support of or in opposition to the U.S.-Korea FTA.<sup>326</sup> The report noted that the members representing textile firms generally support the rules of origin for textiles and apparel under the FTA because the rules would “ensure that the benefits of the agreement flow mainly to the signatory parties.” The report stated, however, that these members expressed concern about the immediate elimination of U.S. tariffs on numerous “sensitive” goods. The report added that the textile members expressed concern about the ability of Customs to properly enforce FTA provisions relating to transshipments, given Korea's proximity to China. The report stated that the members representing U.S. apparel firms that source and market globally expressed concern that the FTA does not grant immediate duty-free treatment to all textile and apparel articles and that the FTA rules of origin do not provide for sufficient flexibility to generate and sustain trade and investment with Korea.

Wellman, Inc., Fort Mill, SC, a producer of PSF, stated at the Commission's hearing that the immediate elimination of the U.S. tariff on PSF (4.3 percent ad valorem) under the FTA

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<sup>322</sup> U.S. exports to Korea in 2006 consisted mostly of textiles (\$99 million). U.S. apparel exports to Korea rose rapidly from a small base during 2000–06 to \$51 million; they included leather apparel, knit wool blazers, and woven cotton pants.

<sup>323</sup> Data on China's share of Korea's imports is from the WTO, “International Trade Statistics 2006.”

<sup>324</sup> Johnson, testimony before the USITC, June 20, 2007, 176; and Foody, testimony before the USITC, April 20, 2006, 35.

<sup>325</sup> The views of the Travel Goods Association on textile travel goods (e.g., luggage) are presented in the assessment for “leather goods and footwear” in this chapter of the Commission's report.

<sup>326</sup> ITAC (13) on Textiles and Clothing, *Advisory Committee Report*, April 27, 2007.

would “severely damage Wellman” and “the entire national base” of PSF producers.<sup>327</sup> It noted that this FTA action “disregards, and in effect obviates, a standing antidumping order” on imports of PSF from Korea and that it “disregards” the U.S. International Trade Commission’s 2006 sunset review finding on the industry’s continuing vulnerability.<sup>328</sup> Wellman indicated that the FTA would augment Korea’s targeting of the U.S. market for Korean producers’ excess PSF capacity, particularly because all other significant export markets maintain effective restraints against these Korean exports.<sup>329</sup> It stated that the FTA would create a tariff inversion that carries significantly negative, discriminatory effects for U.S. producers, whereby the FTA would immediately eliminate the U.S. tariff on PSF but phase out the 6.5 percent U.S. tariff on certain raw materials used in domestic production of PSF over 10 years; the FTA, however, would eliminate the 5.9 percent Korean tariff on these raw materials immediately upon its implementation.

The National Council of Textile Organizations (NCTO), a trade association representing U.S. producers of fibers, yarns, fabrics, and finished textiles, stated at the Commission’s hearing that the FTA would pose a real threat to the domestic industry, particularly in man-made fiber yarns and fabrics, knit fabrics, socks, sweaters, shirts, and trousers, and that it could significantly harm existing U.S. business and trade flows, particularly with CAFTA, NAFTA, and Andean regions.<sup>330</sup> It noted that the FTA is the first agreement since NAFTA where the FTA party has a large and developed vertically integrated textile sector that exports significant quantities of textile goods to the United States. NCTO expressed concern about the vulnerability of key U.S. textile sectors to dumped and undervalued goods from Korea, given the “overexpansion” of Korean textile manufacturing capacity, and to transshipments from China, where Korean textile firms have made significant investments.

NCTO expressed concern that the FTA would give Korea immediate duty-free access to the U.S. market for many sensitive goods, including sweaters, brassieres, swimwear, man-made fiber shirts and socks, certain man-made fiber filament and staple fiber yarns and fabrics, and carded cotton yarn. According to NCTO, while the FTA would provide longer phaseouts for most heavily traded rate lines providing for goods of a kind subject to U.S. safeguards on imports from China, 422 of these rate lines would receive immediate duty-free market access, thereby creating opportunities for Chinese transshipments in these sensitive goods.

NCTO noted that the FTA would include a strict yarn-forward rule of origin with no loopholes, as well as strong Customs enforcement language, which it said is an essential element in deterring illegal transshipments. NCTO expressed concern, however, over whether Customs management has the willingness and determination to properly enforce textile agreements. It noted that, while the U.S. government did not allow goods from the industrial zones in Kaesong, North Korea, to gain market access under the FTA, the agreement would allow for consultations with Korea on future access. NCTO stated that textile production is a major component of these industrial zones, where, according to Korean projections, more than 300,000 people will be working within 5 years of FTA

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<sup>327</sup> Bermish, testimony before the USITC, June 20, 2007.

<sup>328</sup> In March 2006, the Commission completed its sunset review of the antidumping order on certain PSF from Korea and Taiwan, finding that “the domestic industry is vulnerable to the continuation or recurrence of material injury were the orders to be revoked” (USITC, *Certain Polyester Staple Fiber from Korea and Taiwan*, March 2006).

<sup>329</sup> According to Wellman, Korea’s PSF is currently subject to antidumping duties of 6.0–13.5 percent in Japan; 5.7–10.6 percent in the EU; 3.4–32 percent in Mexico; and up to 34.7 percent in China. Bermish, testimony before the USITC, June 20, 2007, 169.

<sup>330</sup> Johnson, testimony before the USITC, June 20, 2007, 176.

passage. NCTO indicated that, even if these zones were never granted FTA status, the likelihood exists of significant transshipments from the zones to the United States.

The American Manufacturing Trade Action Coalition (AMTAC), a trade association representing a wide range of industrial sectors, including textiles and apparel, stated in a written submission to the Commission that, given Korea's current capabilities as a major producer and exporter of industrial goods, the FTA will be a "major blow" to the U.S. manufacturing base, especially for textiles and apparel.<sup>331</sup> It expressed concern over Korea's history of using unfair trading practices and questioned whether U.S. Customs would be able to monitor and enforce the FTA. According to AMTAC, given Korea's proximity to China, where production costs are much lower, China will have an enormous incentive to take advantage of Korea's zero-duty access to the U.S. market through illegal transshipments and false documentation. AMTAC noted that the FTA would present unique concerns beyond those associated with previous FTAs such as CAFTA-DR, where the free trade partners generally were apparel assemblers with limited textile capabilities. AMTAC stated that the FTA would grant Korea immediate duty-free access to the U.S. market for 60 percent of the textile product categories that it identifies as sensitive, including those covered by the U.S.-China Textile Bilateral Agreement, threatening both U.S. domestic sales and U.S. coproduction relationships in the NAFTA/CAFTA region. AMTAC indicated that the FTA tariff phaseout schedule would likely undermine the U.S.-China Textile Bilateral Agreement and create increased potential for illegal transshipments in the region. AMTAC also stated that Korea has limited ability to consume finished goods manufactured in the United States and that it expects to see a significant increase in the U.S. trade deficit and the loss of more textile and apparel jobs in the United States as a result of the FTA.

The American Apparel & Footwear Association (AAFA), a national association representing apparel and footwear companies and their suppliers, stated in a written submission to the Commission that it supports passage of the FTA but expressed concern that the "restrictive and cumbersome" rules of origin and "less-than-ambitious" tariff phaseout schedule for textiles and apparel would provide little incentive to further develop trade with Korea in textiles and apparel.<sup>332</sup> It noted that "well over one-half" of current U.S.-Korea apparel and textile trade would receive less than immediate and reciprocal duty-free treatment. AAFA expressed concern about the FTA short-supply provision, noting that there are currently no fibers, yarns, or fabrics designated as not commercially available in the FTA region or to include items already designated in short supply under other U.S. trade programs. AAFA also noted that the FTA would place quantitative limits on the volume of fabrics and apparel made of short-supply inputs that would be eligible for FTA preferences. AAFA also indicated that the absence of "cumulation" provisions that permit integration of inputs among U.S. FTA partners would limit opportunities to create new markets for U.S. textile and apparel exports that flow through FTA partners (such as garments made with U.S. fabric in Guatemala exported to Korea). AAFA viewed the apparel and textile provisions in CAFTA-DR as a model that would have worked well in the U.S.-Korea FTA because, according to AAFA, CAFTA-DR provisions are designed to create export opportunities for U.S. textile firms and provide the region with the tools it needs to effectively compete: cumulation, a "robust" short-supply list, a single transformation rule of origin for key goods, a yarn-

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<sup>331</sup> Tantillo, "U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects," written submission to the USITC, June 27, 2007.

<sup>332</sup> Lamar, "Re: U.S. International Trade Commission Inv. No. TA-2104-24 (May 7, 2007)—U.S.-Korea Free Trade Agreement," written submission to the USITC, June 27, 2007.



forward rule of origin based on the component that confers essential character, and immediate and reciprocal duty-free entry for all apparel and textiles.

The United States Association of Importers of Textiles and Apparel (USA-ITA),<sup>333</sup> whose members include U.S. producers, distributors, retailers, importers, and related service providers, stated in a written submission to the Commission that it supports the concept of an FTA between the United States and Korea, but is “very disappointed” with many of the terms in the FTA as negotiated because those terms would limit the potential for expanding business with Korea and for broader liberalization that would benefit manufacturers, traders, and consumers in both countries and in other countries with which the United States has negotiated FTAs. It reported that the complex rules of origin for textiles and apparel are different in the U.S.-Korea FTA than in other recent U.S. FTAs, adding up to increased compliance costs for firms seeking to do business under the FTA. It stated that the key and most beneficial components of the textile and apparel provisions of the FTA are that a few goods would be subject to a single transformation rule of origin rather than the “onerous” yarn-forward origin rule and that there are no restrictions on the use of nonoriginating pocketing fabrics, sewing thread, or narrow fabrics in qualifying apparel.

USA-ITA stated that certain textile and apparel provisions are more restrictive in the U.S.-Korea FTA than in other U.S. FTAs. It indicated that while the U.S.-Korea FTA would grant immediate duty-free treatment to some originating goods, it would phase out U.S. tariffs on other originating apparel most likely to be purchased by its member companies and their customers over either 5 years (man-made fiber pants, shorts, socks, and knit shirts) or 10 years (cotton pants, shorts, knit shirts, and cotton and man-made fiber T-shirts and tank tops). It noted that the 7 percent de minimis foreign content rule in the FTA (that is, up to 7 percent of the total weight of the component that determines the tariff classification of the good could consist of nonoriginating fibers or yarns) is less than the 10 percent de minimis foreign content rule found in other recent U.S. FTAs and preference programs. According to USA-ITA, the FTA would establish a new short-supply process for yarns and fabrics not available in commercial quantities in a timely manner, but it has yet to designate any such inputs in short supply and, unlike CAFTA-DR, would set limits on the quantity of fabrics and apparel made in the FTA region from such inputs and eligible for tariff preferences.

USA-ITA stated that, for the first time ever, the customs cooperation provisions of the FTA would require Korea to obtain and update annually information concerning each entity engaged in the production of textiles and apparel in Korea and to submit that information to the United States annually, with the first submission due within one year of entry into force of the FTA. According to USA-ITA, this provision would create the possibility that the failure of Korea to provide complete information or to update it would result in entries from some suppliers being delayed or denied altogether. USA-ITA also expressed concern that the FTA, unlike other recent U.S. FTAs and preference programs, does not contain a “cumulation” provision that would permit integration of inputs among U.S. FTA partners, including a provision that would permit the use of Israeli or Mexican nylon filament yarn in qualifying goods. According to USA-ITA, given that Korea is an important supplier of yarns and fabrics to the United States, as well as to apparel-exporting countries with which the United States already has FTAs, the absence of cumulation in the U.S.-Korea FTA would limit opportunities to promote integration of all U.S. FTAs and for firms to integrate their operations globally.

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<sup>333</sup> Jones, written submission to the USITC, June 27, 2007.

In its report, the ITAC on Distribution Services for Trade Policy Matters (ITAC 5) stated that the U.S.-Korea FTA contains “a serious deficiency with respect to the rules of origin for textiles and apparel.”<sup>334</sup> The report stated that the committee opposes the yarn-forward rule of origin in the agreement, stating that a yarn-forward rule “retards rather than promotes textile and apparel trade” with U.S. FTA partners. The report added that the FTA contains no additional flexibility such as a cumulation provision permitting the use of nonoriginating inputs in the production of qualifying apparel and that the FTA contains a 10-year duty phaseout for many key apparel categories. The report noted that the United States should abandon “counterproductive” and “flawed” rules governing trade in textiles and apparel that hinder trade and investment while doing nothing to improve the competitiveness of the U.S. textile industry.

The Korea International Trade Association (KITA) in a written submission to the Commission stated that there is no basis to claims made by the U.S. textile industry that Korea would sell textiles and apparel in the U.S. market at below-market value following implementation of the FTA.<sup>335</sup> KITA said Korea’s textile and apparel industry has shifted from producing low-value, low-quality goods to producing high-end, high-technology, and high-value-added goods. KITA also said the Korean government has taken steps to ensure that transshipments of textiles and apparel from China or any other country do not become a problem for any potential FTA partner. It stated that Korea has in place an advanced customs administration system to prevent such acts, and is willing to work with the U.S. government to prevent illegal transshipments under the FTA. In addition, KITA stated that, upon implementation of the FTA, Korea’s textile exports will not compete directly with U.S. goods, but with products from third-country markets.

## **Leather Goods and Footwear<sup>336</sup>**

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### *Assessment*

The U.S.-Korea FTA would likely result in a significant increase in bilateral U.S.-Korea trade in leather goods and footwear (“leather goods”),<sup>337</sup> but likely have little effect on total U.S. trade or production of such goods. The average U.S. tariff on Korean leather goods is 8.8 percent, while the average Korean tariff on U.S. leather goods is 6.2 percent.<sup>338</sup> The FTA

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<sup>334</sup> ITAC (5) on Distribution Services for Trade Policy Matters, *Advisory Committee Report*, April 25, 2007.

<sup>335</sup> Mun, written submission to the USITC, May 4, 2006.

<sup>336</sup> The products covered in this assessment represent 100 percent of U.S. exports to Korea in the GTAP “leather products” sector and 100 percent of U.S. imports from Korea in the GTAP “leather products” sector for 2006.

<sup>337</sup> Includes leather and leather goods, as well as footwear, travel goods (e.g., luggage, handbags, purses, wallets, duffel bags, and briefcases), and other articles characteristic of the leather trade but also made from materials such as textiles and plastics. Included are tanned hides and skins, leather, and composition leather (HS headings 4104–4115); saddlery and harness (4201); travel goods (4202); articles of leather or composition leather for industrial and technical uses (4204) or other uses (4205); footwear (HS chap. 64); watch straps of nonmetallic materials (HS subheading 9113.90); and personal travel sets (9605.00). Excludes leather apparel (4203), which is included with textiles and apparel.

<sup>338</sup> Korea has a uniform “base rate” of duty of 5 percent for tanned hides and skins, leather, and composition leather of HS headings 4104–4114; 8 percent for travel goods of heading 4202, leather articles of headings 4201, 4204, and 4205, and waterproof footwear of heading 6401; and 13 percent for all other footwear of HS chap. 64.

would grant immediate and reciprocal duty-free market access for tariff lines covering all leather goods, except for 17 U.S. tariff lines covering “sensitive” rubber footwear from Korea.<sup>339</sup> U.S. tariffs on the sensitive footwear, which range from 20 percent to 64 percent AVE (based on 2006 trade), would receive a nonlinear phaseout over 12 years.<sup>340</sup>

The FTA rule of origin for the sensitive rubber footwear would, as in other U.S. FTAs, be similar to that under NAFTA, requiring a good to have a regional value content of not less than 55 percent of the appraised value of the article, which would effectively limit the use of nonoriginating uppers because of the high labor content associated with stitching. All other footwear would receive a more flexible rule of origin based on assembly also found in other recent U.S. FTAs, in which qualifying footwear could contain nonoriginating uppers and other materials as long as it is assembled in the FTA parties. A flexible process-based origin rule would apply to textile and nontextile travel goods,<sup>341</sup> requiring that the goods be cut or knit to shape, or both, and sewn or otherwise assembled in the FTA parties.<sup>342</sup> A trade report notes that more than 80 percent of all travel goods sold in the United States in 2006 were textile travel goods.<sup>343</sup>

The Commission’s economy-wide analysis of the long-term effects of tariff and TRQ liberalization estimates that the FTA would likely result in an increase of \$81–104 million (104–133 percent) for U.S. imports of leather goods from Korea and approximately \$60–71 million (53–63 percent) for U.S. exports of leather goods to Korea.<sup>344</sup> The results largely reflect Korea’s small and greatly diminished share of U.S. imports of leather goods, as well as the high import share in key domestic markets for leather goods.<sup>345</sup> Once a major world exporter of leather goods, Korea supplied just 0.2 percent (\$54 million) of total U.S. imports of leather goods in 2006.<sup>346</sup> U.S. imports of leather goods come mostly from China, which supplied 71 percent (\$19 billion) of the total in 2006. Imports now supply 98 percent

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<sup>339</sup> The 17 tariff lines (20 lines in the 2007 HTS) cover rubber or plastic protective footwear and certain athletic and other footwear with rubber or plastic soles and fabric uppers (HTS subheadings 6401.10.00, 6401.91.00, 6401.92.90, 6401.99.30, 6401.99.60, 6401.99.90, 6402.30.50, 6402.30.70, 6402.30.80, 6402.91.50, 6402.91.80, 6402.91.90, 6402.99.20, 6402.99.80, 6402.99.90, 6404.11.90, and 6404.19.20).

<sup>340</sup> The tariffs would remain unchanged during years one through eight, and then be reduced in four equal annual stages, becoming free at the beginning of year 12. U.S. imports from Korea of rubber footwear covered by the 17 U.S. rate lines fell by 98 percent from \$145.8 million in 1996 to \$2.8 million in 2006. Official statistics of the U.S. Department of Commerce.

<sup>341</sup> Textile travel goods are covered in FTA chap. 4, which contains the rules of origin and other provisions specifically applicable to textiles and apparel. A summary of these provisions appears in app. D of this report.

<sup>342</sup> Many recent U.S. FTAs apply a more restrictive “fabric-forward” rule of origin to textile travel goods, whereby imports of such goods from the FTA party must be made from inputs produced in the FTA region from the fabric stage forward to qualify for tariff preferences. For a textile travel good to qualify for FTA preferences under a fabric-forward rule, the production of the fabric used in the travel good, as well as cutting and sewing, must occur in the FTA parties. A representative of the U.S. travel goods industry contends that a fabric-forward rule “essentially renders the agreement useless for U.S. travel goods firms.” Pittenger, written submission to the Commission.

<sup>343</sup> Pittenger, written submission to the USITC, June 27, 2007.

<sup>344</sup> Impact relative to an estimated 2008 base. See chap. 2 of this report for additional information regarding the economy-wide analysis.

<sup>345</sup> U.S. imports of leather goods from the world in 2006 totaled \$27.1 billion, of which \$19.0 billion (70 percent of the total) consisted of footwear and \$6.8 billion (25 percent) consisted of travel goods. Official statistics of the U.S. Department of Commerce.

<sup>346</sup> U.S. leather goods imports from Korea declined by 90 percent from \$546 million in 1996 to \$54 million in 2006.

of the U.S. footwear market, with China accounting for 85 percent of the import volume.<sup>347</sup> Imports supply more than 95 percent of the U.S. travel goods market,<sup>348</sup> as the domestic industry has “transitioned from one of domestic manufacturing to one of primarily importing, warehousing, and distribution companies.”<sup>349</sup> The small volume of U.S. production of footwear and travel goods tends to serve niche and high-end domestic markets; the U.S. Armed Forces, as governed by the Berry Amendment,<sup>350</sup> or quick response requirements of the domestic market.<sup>351</sup>

The impact of the FTA on U.S. imports and production of leather goods would likely be further limited by the general erosion of Korea’s global competitiveness in leather goods.<sup>352</sup> A trade source noted that manufacturing costs in Korea are too high for it to compete successfully in the global footwear market, which has led to a relocation of its footwear production to China and other lower-cost exporting countries<sup>353</sup> as well as to a 40 percent decline in Korean production of leather goods during 2000–06.<sup>354</sup> The trade source stated, however, that Korea is still a center for “very vigorous product development,” manufacturing technology, and production of components for footwear.<sup>355</sup>

The impact of the FTA on U.S. exports of leather goods to Korea will likely be small in absolute value and quantity terms, given the relatively small volume of U.S. leather goods exports to Korea. Korea was the seventh-largest export market for U.S. leather goods with 4.9 percent (\$107 million) of total U.S. leather goods exports in 2006; most of the U.S. exports to Korea consisted of tanned leather rather than higher unit-valued finished goods. Nevertheless, the elimination of Korean tariffs under the FTA on U.S. leather goods will likely spur U.S. exports of leather and possibly finished leather goods to Korea, a major world market for leather goods with imports of almost \$1.9 billion in 2006.<sup>356</sup> A trade source

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<sup>347</sup> ITAC (13) on Textiles and Clothing, *Advisory Committee Report*, April 27, 2007, 5.

<sup>348</sup> A trade source estimates that U.S. consumers spent a record \$20.7 billion on travel goods in 2006. TGA, “U.S. Travel Goods Sales Hit Record in 2006,” May 8, 2007.

<sup>349</sup> ITAC (13) on Textiles and Clothing, *Advisory Committee Report*, April 27, 2007, 6; Pittenger, written submission to the USITC, June 27, 2007; and U.S. industry representative, telephone interview by Commission staff, July 11, 2007.

<sup>350</sup> The Berry Amendment (10 U.S.C. 2533a) requires the Department of Defense to give preference in procurement to U.S.-made goods, including apparel, tents and tarpaulins, and fabrics, including all fibers and yarns used in them and goods made from them (e.g., backpacks, hiking packs, duffle bags, and related textile travel goods). According to Robert Panichelle, chief, Field Clothing Division, Defense Supply Center Philadelphia, the Berry Amendment has been “construed as being applicable to footwear.” CRS, “The Berry Amendment: Requiring Defense Procurement to Come from Domestic Sources,” April 21, 2005; Pittenger, written submission to the USITC, June 27, 2007; U.S. industry representative, telephone interview by Commission staff, July 11, 2007; and Panichelle, telephone interview by Commission staff, August 2, 2007.

<sup>351</sup> Burke, written submission to the USITC, March 24, 2006; Pittenger, written submission to the USITC, June 27, 2007; and U.S. industry representative, telephone interview by Commission staff, July 11, 2007.

<sup>352</sup> A representative of U.S. rubber footwear producers states that, “given the fact that Korean wage rates are significantly higher than those of other Far Eastern rubber footwear competitors, the [domestic] industry is satisfied that the extended and nonlinear phaseout set forth in [the FTA for sensitive rubber footwear] will not pose a threat to the continued operation of domestic manufacturing.” Cooper (counsel), written submission to the USITC on behalf of the Rubber and Plastic Footwear Manufacturers Assoc., May 23, 2007.

<sup>353</sup> U.S. industry representative, telephone interview by Commission staff, June 14, 2007.

<sup>354</sup> Data on Korean production applies to the “tanning and dressing of leather, luggage, and footwear.” National Statistical Office, Republic of Korea.

<sup>355</sup> U.S. industry representative, telephone interview by Commission staff, June 14, 2007.

<sup>356</sup> Korean imports of leather goods in 2006 were broken down as follows: \$472 million for tanned hides and skins, leather, and composition leather (HS headings 4104–4115); \$552 million for travel goods (4202) and other leather goods classified in HS chap. 42, except leather apparel (4203) and miscellaneous goods (4206); and \$836 million for footwear (HS chap. 64). Global Trade Information Services, World Trade Atlas

(continued...)

said Korea is one of the fastest-growing import markets for travel goods, with imports of such goods rising by 65 percent during the years 2004 to 2006 to \$545 million.<sup>357</sup>

### *Views of Interested Parties*

In its report, the ITAC on Textiles and Clothing (ITAC 13) stated that its members did not make a unified statement in support of or in opposition to the FTA.<sup>358</sup> The report stated that members of footwear companies support the FTA because the rules of origin reflect their priorities—the 17 sensitive rubber footwear articles receive a “NAFTA style” rule of origin and a long, nonlinear duty phaseout, while all other footwear articles receive much more flexible rules of origin and immediate duty-free treatment. The report noted that members of the travel goods companies support the FTA because the agreement provides immediate and reciprocal duty-free treatment and flexible rules of origin for all textile and nontextile travel goods.

The Travel Goods Association (TGA), a trade association representing manufacturers, distributors, retailers, promoters, sales representatives, and suppliers of luggage and other related products, stated in a written submission to the Commission that it supports the FTA because the agreement would grant immediate and reciprocal duty-free entry to both textile and nontextile travel goods under flexible rules of origin.<sup>359</sup> TGA added that incorporating these rules into an FTA with a major trading partner like Korea, one of the fastest-growing markets for imported travel goods, will make the FTA a “landmark agreement” for the U.S. travel goods industry and be of potential benefit to the domestic industry.

The American Apparel & Footwear Association (AAFA), the national association of the apparel and footwear industries and their suppliers, stated in a written submission to the Commission that the FTA’s flexible and forward-looking footwear and travel goods provisions should provide new opportunities to grow the once significant, but declining, footwear and travel goods trade between the United States and Korea.<sup>360</sup> AAFA noted that the FTA rules of origin will not only help stem the decline in footwear and travel goods trade between the United States and Korea, but also provide a mechanism to rebuild this vital relationship. AAFA added that the FTA will have a negligible impact on the individual sectors that it represents.

The Rubber and Plastic Footwear Manufacturers Association (RPFMA),<sup>361</sup> a trade association representing the principal domestic producers of protective footwear and rubber-sole, fabric-upper footwear, stated in a written submission to the Commission that it is “satisfied” with the phaseout schedule under the FTA for U.S. tariffs on the core products

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<sup>356</sup> (...continued)  
Database.

<sup>357</sup> Pittenger, written submission to the USITC, June 27, 2007; and Global Trade Information Services, World Trade Atlas Database.

<sup>358</sup> ITAC (13) on Textiles and Clothing, *Advisory Committee Report*, April 27, 2007.

<sup>359</sup> Pittenger, written submission to the USITC, June 27, 2007.

<sup>360</sup> Lamar, “Re: U.S. International Trade Commission Inv. No. TA-2104-24 (May 7, 2007)—U.S.-Korea Free Trade Agreement,” written submission to the USITC, June 27, 2007.

<sup>361</sup> Cooper (counsel), written submission to the USITC on behalf of the Rubber and Plastic Footwear Manufacturers Assoc., May 23, 2007.

of these producers.<sup>362</sup> RPFMA noted that, under the FTA, U.S. tariffs on the core products would receive a nonlinear phaseout over 12 years; that is, the tariffs would remain unchanged during years one through eight, followed by a succession of 25 percent duty cuts in each of the following 4 years, becoming free at the beginning of year 12. It said that, given that Korean wage rates are significantly higher than those of other Asian rubber footwear competitors, the domestic industry is satisfied that the extended and nonlinear phaseout of U.S. tariffs will not pose a threat to the continued operation of domestic production of the specified rubber footwear.

## Pharmaceuticals<sup>363</sup>

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### *Assessment*

U.S. pharmaceutical companies exporting products to Korea would likely benefit from the U.S.-Korea FTA. The agreement addresses three issues that the U.S. industry has identified as having hindered U.S. pharmaceutical exports in the past: lack of intellectual property protections for pharmaceutical products, lack of transparency in Korea's national health-care system, and unethical business practices. The reduction of Korean tariffs for pharmaceutical products may also provide a small positive effect for U.S. exports. The FTA is unlikely to have any effect on U.S. imports because U.S. pharmaceutical imports are currently free of duty on an MFN basis<sup>364</sup> and U.S. intellectual property protections already meet or exceed the intellectual property standards included in the FTA.

The size of the Korean pharmaceuticals market makes it attractive for U.S. pharmaceuticals companies. Korea's pharmaceutical market is ranked among the world's top 12 pharmaceutical markets and is worth approximately \$8 billion annually.<sup>365</sup> Sustained growth in the market is expected as the Korean population ages.<sup>366</sup> Approximately 30 percent of Korea's health-care spending goes toward pharmaceuticals, which is higher than the average of 16 percent for OECD countries.<sup>367</sup> Foreign-based companies account for about 30 percent of the pharmaceuticals market in Korea, or an estimated \$2.4 billion.<sup>368</sup> U.S. exports of pharmaceutical products<sup>369</sup> to Korea were valued at \$351 million in 2006.<sup>370</sup> In that year, the United States accounted for 15.8 percent of Korea's imports of pharmaceutical products.<sup>371</sup> According to a representative of the Pharmaceutical Research and Manufacturers of America

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<sup>362</sup> RPFMA stated that all of its member companies do most of their manufacturing in the United States, but competitive circumstances have made it necessary for many of them to do a significant amount of importing. Cooper (counsel), written submission to the USITC on behalf of the Rubber and Plastic Footwear Manufacturers Assoc., May 23, 2007.

<sup>363</sup> The products covered in this assessment represent approximately 5 percent of U.S. exports to Korea in the GTAP "chemical, rubber, plastic products" sector, and less than 1 percent of U.S. imports from Korea in the GTAP "chemical, rubber, plastic products" sector, for 2006.

<sup>364</sup> Duties on U.S. pharmaceutical imports were eliminated in 1995 as a result of the Pharmaceutical Zero-for-Zero Initiative of the Uruguay Round Agreements.

<sup>365</sup> Ambassador Lee, testimony before the USITC, June 20, 2007; and EIU, "Industry Briefing, South Korea: Healthcare and Pharmaceuticals Forecast," January 5, 2007.

<sup>366</sup> EIU, "Industry Briefing, South Korea: Healthcare and Pharmaceuticals Forecast," January 5, 2007.

<sup>367</sup> Ibid.

<sup>368</sup> Ibid.

<sup>369</sup> Includes products in HS chap. 30 (i.e., HS headings 3001, 3002, 3003, 3004, 3005, and 3006).

<sup>370</sup> Global Trade Information Services, World Trade Atlas Database.

<sup>371</sup> Ibid.

(PhRMA), however, U.S. pharmaceutical companies currently have limited access to the Korean market due to nontariff market access barriers.<sup>372</sup>

According to the PhRMA, Korean government's current lack of strong intellectual property rights protection for pharmaceuticals reportedly discourages U.S. companies from marketing patented medicines in Korea.<sup>373</sup> The FTA would expand the intellectual property protections for pharmaceuticals in three important areas.<sup>374</sup> First, it would require the implementation of measures to prevent the marketing approval of a generic drug by drug regulators while the patent on the original drug is still in effect, a so-called "patent linkage" system.<sup>375</sup> Second, the data-exclusivity provisions would preclude third parties from relying on the safety or efficacy data submitted by the originator to obtain marketing approval for a pharmaceutical product for 5 years for a new product and 3 years for a previously approved chemical entity.<sup>376</sup> Third, the patent extension provision would allow companies to request an extension of the patent term for a pharmaceutical product as compensation for unreasonable delays in the patent or marketing approval processes.<sup>377</sup>

The USTR has previously recognized that the lack of transparency in the Korean health regulatory and reimbursement systems may be an impediment to U.S. companies.<sup>378</sup> The FTA would increase transparency for health-care programs administered by the central level of government in the two countries.<sup>379</sup> The provisions of the FTA chapter 5 aimed at increasing transparency in the marketing approval and pricing of pharmaceutical products are summarized in appendix D of this report. These provisions are expected to give stakeholders a meaningful opportunity to participate in the development of rules and regulations in the pharmaceutical sector.<sup>380</sup>

In 2006, the USTR found that Korea's complex distribution system for pharmaceuticals and lack of transparency in regulation and reimbursement may have contributed to unethical business practices that have harmed U.S. companies.<sup>381</sup> In testimony at the Commission's hearing, PhRMA said that the code of conduct that multinational pharmaceutical companies adhere to in their work with health-care professionals is not being applied and enforced in Korea's generic industry.<sup>382</sup> According to the USTR, the FTA would promote ethical business practices by requiring appropriate measures and enforcement in both countries "to

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<sup>372</sup> May, testimony before the USITC, June 20, 2007, 185.

<sup>373</sup> *Ibid.*, 186.

<sup>374</sup> For additional information on the intellectual property provisions of the FTA, see ch. 6 of this report.

<sup>375</sup> USTR, "Final - United States - Korea FTA Texts," 2007, Article 18.9.4.

<sup>376</sup> *Ibid.*, Articles 18.9.1-18.9.3.

<sup>377</sup> *Ibid.*, Article 18.8.6.

<sup>378</sup> USTR, "Korea," *2006 National Trade Estimate Report on Foreign Trade Barriers*, March 31, 2006, 415. See also Lee and Lee, "Feasibility and Economic Effects of a Korea-U.S. FTA," December 30, 2005, 66, and Schott, Bradford, and Moll, "Negotiating the Korea-United States Free Trade Agreement," June 2006, 10.

<sup>379</sup> The Korean central government provides universal health-care coverage through its National Health Insurance system, which covered 96 percent of Koreans in 1999, and the Medical Aid Program, which covers the remaining population. Most provision of health care, however, is performed by private health-care institutions. See EIU, "Industry Briefing, South Korea: Healthcare and Pharmaceuticals Profile," January 5, 2007. The Medicaid program in the United States is explicitly recognized as a regional health-care program, not a health-care program of the central level of government. See USTR, "Final - United States - Korea FTA Texts," 2007, ch. 5, footnote 3.

<sup>380</sup> May, testimony before the USITC, June 20, 2007, 189.

<sup>381</sup> USTR, "Korea," *2006 National Trade Estimate Report on Foreign Trade Barriers*, March 31, 2006, 416; and USKBC and the AMCHAM in Korea, U.S.-Korea Free Trade Agreement Position Paper, 2006, 20.

<sup>382</sup> May, testimony before the USITC, June 20, 2007, 287-8.

prohibit improper inducements by pharmaceutical or medical device manufacturers or suppliers to health-care professionals or institutions for the listing, purchasing, or prescribing of pharmaceutical or medical device products<sup>383</sup> eligible for reimbursement under health-care programs operated by its central level of government.<sup>384</sup> PhRMA expressed a similar view, indicating that the provisions of the FTA would help to ensure a level playing field for U.S. companies in terms of ethical business practices.<sup>385</sup>

Given the relatively low tariff rates applied by Korea on imports of pharmaceutical products, the phasing out of Korean tariffs on pharmaceuticals would likely have a small but positive impact on U.S. exports to Korea. Korean tariffs on pharmaceutical products (HS chapter 30) currently range from 0 to 8 percent ad valorem with 54 of 148 Korean tariff lines for pharmaceuticals having free MFN rates of duty. If the FTA is implemented, 68 additional tariff lines for U.S. pharmaceutical products would have duties eliminated immediately. Duties on the remaining 26 tariff lines would be phased out over a period of 3 years. The tariffs that would be phased out include the tariff provision with the highest level of Korean imports from the United States in 2006, “Medicaments in Measured Doses, Other,” which currently has a duty of 8 percent ad valorem. This category accounted for 32.0 percent of U.S. pharmaceutical exports to Korea in 2006.<sup>386</sup> Korean imports for all tariff lines subject to 3-year staging were 49.7 percent of imports from the United States in 2006.<sup>387</sup>

In addition to traditional pharmaceutical products, the Korean Food and Drug Administration also administers preapproval testing and registration requirements for the relatively new, “highly functional” cosmetic products.<sup>388</sup> These products, often called “cosmeceuticals,” include antiaging treatments, sunscreens, and other cosmetics that are marketed as having druglike benefits.<sup>389</sup> The ability of U.S. companies to compete in the Korean market for cosmeceuticals is currently impeded by burdensome requirements and a general lack of transparency in the regulatory system.<sup>390</sup> The FTA requirements for transparency in regulatory approval processes may provide U.S. cosmetic companies better access for their cosmeceutical products in the Korean market.

### *Views of Interested Parties*

The U.S. pharmaceuticals industry generally supports the FTA, especially the provisions addressing nontariff issues. According to hearing testimony, U.S. pharmaceuticals firms have faced a range of market access impediments in the Korean market.<sup>391</sup> Industry representatives specifically mentioned the importance of the strong protections provided by the intellectual property rights of the FTA.<sup>392</sup> In testimony before the Commission, a representative of PhRMA expressed support for the transparency provisions of the Pharmaceuticals and

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<sup>383</sup> An analysis of the effects of the FTA on the market for medical devices is presented in a separate section of chap. 3 of this report.

<sup>384</sup> USTR, “Final - United States - Korea FTA Texts,” 2007, Article 5.5.

<sup>385</sup> May, testimony before the USITC, June 20, 2007, 288.

<sup>386</sup> Global Trade Information Services, World Trade Atlas Database.

<sup>387</sup> Ibid.

<sup>388</sup> WTO, Trade Policy Review Body (TPRB), “TPR, Republic of Korea, Report by the Secretariat,” September 17, 2004.

<sup>389</sup> Sung, “Korea’s Cosmetic Market Brief,” September 2005, 2.

<sup>390</sup> USTR, “Korea,” 2007 *National Trade Estimate Report on Foreign Trade Barriers*, April 2, 2007, 359.

<sup>391</sup> May, testimony before the USITC, June 20, 2007, 185.

<sup>392</sup> PhRMA, “PhRMA Statement on the U.S.-Korea Free Trade Agreement (April 3, 2007).”



Medical Devices chapter because lack of transparency in Korea's reimbursement decisions has been a long-standing issue for U.S. companies.<sup>393</sup>

The ITAC on Chemicals, Pharmaceuticals, Health/Science Products and Services (ITAC 3) stated that it had encouraged provisions that increase the transparency of the Korea regulatory system and that a "more objective process for establishing the guidelines and conditions under which drugs can be reimbursed would improve access to innovative medical discoveries that are developed abroad and would benefit Korean patients significantly."<sup>394</sup> The Intergovernmental Policy Advisory Committee (IGPAC) stated that it commends the FTA for eliminating uncertainty about the Medicaid program by specifically classifying it as a regional health-care program excluded from the provisions of Chapter 5 of the FTA.<sup>395</sup>

Several observers criticized the intellectual property protections for pharmaceuticals in the FTA. Several contend that these provisions would delay the introduction of generic drugs to the Korean market and increase health-care costs in Korea.<sup>396</sup> A critic of the intellectual property provisions for pharmaceuticals notes that the Korean National Health Insurance Review Agency has a goal of reducing the percentage of health-care costs due to pharmaceuticals, relying on generic drugs to keep costs low, and claims that "because the proposed FTA is poised to result in greater restrictions on generic drugs through extending its patent expiration and limiting drug information, the FTA is likely to drive up the cost of health care in South Korea."<sup>397</sup> A pharmaceutical industry representative responding to this criticism said that if Korea, as well as other nations, adopts policies like the ones in this FTA "it would provide an incentive for even greater expansion of innovation in pharmaceuticals, the discovery of even more enhanced cures, and that, in the end, rebounds to the benefit of all patients, globally, in Korea and otherwise."<sup>398</sup>

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<sup>393</sup> May, testimony before the USITC, June 20, 2007, 186. For additional information on the summary of provisions for FTA chap. 5, see app. D of this report.

<sup>394</sup> ITAC (3) on Chemicals, Pharmaceuticals, Health/Science Products and Services, *Advisory Committee Report*, April 24, 2007, 7–8.

<sup>395</sup> IGPAC, *Advisory Committee Report*, April 24, 2007.

<sup>396</sup> Flynn and Palmedo, "Initial Response to the U.S.-Korean FTA Pharmaceuticals and IP Chapters," May 25, 2007; and KPI, "Policy Brief," February 7, 2007. A member of the ITAC 3 representing the Generic Pharmaceutical Association states that "this agreement blatantly excludes provisions to ensure affordable access to safe and effective generic medicines." ITAC (3) on Chemicals, Pharmaceuticals, Health/Science Products and Services, *Advisory Committee Report*, April 24, 2007, 16.

<sup>397</sup> KPI, "Policy Brief," February 7, 2007.

<sup>398</sup> May, testimony before the USITC, June 20, 2007, 248. In his testimony, Mr. May references in support of his statement the report USDOC, ITA, "Pharmaceutical Price Controls in OECD Countries," December 2004.

# Machinery, Electronics, and Transportation Equipment<sup>399</sup>

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## *Assessment*

The U.S.-Korea FTA would likely result in increased exports of U.S. machinery, electronics, and transportation equipment (machinery and equipment) to Korea. U.S. exports may benefit from the immediate or phased elimination of Korean tariffs ranging from 3 to 13 percent ad valorem on U.S. machinery and equipment, as well as from the implementation of nontariff market access provisions of the FTA. In the electronics sector, the majority of products, such as semiconductors, telecommunications equipment, and computer equipment already receive duty-free access to the Korean market under the WTO's Information Technology Agreement (ITA). Electronics products not covered by the ITA, such as consumer electronics (CE), generally face an 8 percent duty in Korea; a majority of CE products would receive duty-free access upon implementation of the FTA. There is also an 8 percent duty on many machinery products exported to Korea, and most of these products would receive immediate duty-free access upon implementation of the FTA. In terms of the transportation equipment sector (excluding passenger vehicles),<sup>400</sup> most U.S. products, such as civil aircraft, currently receive duty-free access to the Korean market. Certain transportation equipment, such as tugs and light vessels, currently face a 5 percent Korean duty, and the FTA would provide U.S. firms immediate duty-free access.

Machinery and equipment products were among the top U.S. exports to Korea in 2006.<sup>401</sup> Leading U.S. export groups under this category included semiconductors, aircraft, miscellaneous machinery, and certain machine tools (table 3.13). Leading U.S. imports from Korea were certain motor vehicles, certain transmission apparatus, semiconductors, and computer parts (table 3.14). A number of U.S. machinery and equipment sectors will likely benefit from expanded export opportunities in Korea as a result of trade liberalization under the FTA, including automotive parts; electronics, such as wireless broadband equipment and computer software; and various types of machinery, including machine tools, electrical power systems, and security products.<sup>402</sup>

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<sup>399</sup> This sector will provide an general overview of products covered in HTS chapters 84–90. Separate assessments of the medical goods sector and certain passenger vehicles are contained later in the chapter. The products covered in this assessment represent most of the U.S. exports to and imports from Korea in the GTAP “electronic equipment,” “transport equipment,” and “machinery and equipment n.e.c.” sectors, for 2006.

<sup>400</sup> See this chapter's section on passenger vehicles for additional information regarding the sector.

<sup>401</sup> Leading U.S. domestic exports to Korea in 2006 consisted of goods falling in HTS chapters 84–90. U.S. domestic exports of products under these HTS chapters were approximately \$18.2 billion.

<sup>402</sup> “Security products” covers a broad range of products, such as airport security equipment.

**Table 3.13** Leading U.S. exports of machinery and equipment to Korea 2004–06  
(1,000 dollars)

HTS	Description	2004	2005	2006
8542	Semiconductors and parts	3,936,539	4,098,851	4,256,170
8802	Aircraft	1,143,708	1,228,050	2,408,073
8479	Miscellaneous machinery	821,898	981,829	1,504,669
8803	Parts of aircraft	589,904	623,430	1,004,684
8456	Certain machine tools	364,986	631,854	691,842
8411	Turbojets, turbopropellers, and other gas turbines and parts	521,567	632,930	566,279
8543	Certain electrical machines and parts	466,434	470,444	511,785
8471	Computer equipment	432,024	392,503	442,937
8708	Parts for certain tractors, certain auto parts, and transportation equipment	358,593	432,251	436,686
9001	Optical fibers and optical fiber bundles	311,920	374,215	430,957
	Subtotal	8,947,573	9,866,357	12,254,081
	All other sector exports	4,822,048	5,408,474	5,927,183
	Total	13,769,621	15,274,832	18,181,264

Source: Compiled from official statistics of the U.S. Department of Commerce.

**Table 3.14** Leading U.S. imports of machinery and equipment from Korea, 2004–06  
(1,000 dollars)

HTS	Description	2004	2005	2006
8703	Certain motor vehicles	10,033,594	8,969,547	9,099,707
8525	Transmission apparatus for radio broadcasting or television; certain cameras	8,460,161	6,246,863	5,596,931
8542	Semiconductors and parts	3,787,615	2,903,298	2,851,934
8473	Parts and accessories of computer and office equipment	2,136,488	1,794,221	2,104,978
8708	Parts and accessories for certain tractors, certain auto parts, and transportation equipment	650,497	1,138,472	1,527,381
8471	Computer equipment	1,610,161	1,161,739	975,824
8429	Bulldozers and other self-propelled earth-moving machinery	385,069	445,463	530,969
8418	Certain machinery (refrigerators, freezers and other freezing equipment, heat pumps, and parts)	219,759	361,298	470,170
8528	Certain monitors and projectors	974,613	717,311	397,229
8529	Television, radio, and radar apparatus parts	501,821	454,965	346,781
	Subtotal	28,759,778	24,193,177	23,901,903
	All other sector imports	5,925,600	7,336,926	7,556,013
	Total	34,685,378	31,530,102	31,457,916

Source: Compiled from official statistics of the U.S. Department of Commerce.

U.S. exports of auto parts would be expected to increase with the implementation of the FTA as a result of the immediate elimination of Korea's 8 percent duty as well as provisions that ensure the equivalent treatment of remanufactured and used goods, such as auto parts.<sup>403</sup> However, such export growth would likely be mitigated, in part, by the strong relationships between Korean producers and their local supplier networks, the limited interchangeability of original equipment parts, and the relatively small role of U.S. automakers (and their U.S.-made vehicles) in the Korean market. Moreover, although the equivalent treatment of remanufactured goods may provide additional market access opportunities,<sup>404</sup> reused and remanufactured auto parts account for only 0.5 percent (\$250 million) of the estimated value (\$48 billion) of the total Korean auto parts market.<sup>405</sup>

U.S. suppliers of electronics would likely benefit from the FTA. The Commission's economy-wide analysis of the long-term effects of tariff and TRQ liberalization estimates that U.S. exports of electronic equipment to Korea would be likely to increase by \$212–231 million (3.8–4.2 percent).<sup>406</sup> Despite the fact that many electronics products are duty-free under the ITA, FTA provisions provide general duty-free access to non-ITA goods such as CE. CE are estimated to account for less than 5 percent of total U.S. exports of electronics and are expected to benefit from FTA tariff liberalizations. Nontariff provisions, such as those in the intellectual property and TBT chapters of the FTA, are expected to improve U.S. electronics firms' competitiveness in the Korea market.<sup>407</sup> For example, U.S. industry representatives express the view that the FTA provides strong protection for intellectual property rights.<sup>408</sup> Furthermore, U.S. manufacturers are leading suppliers of many electronics products, and the current Korean market demand for sector products such as wireless broadband equipment is expected to benefit U.S. firms.<sup>409</sup> Korea's high rate of Internet usage and broadband penetration—the U.S. Commercial Service estimated it to be approximately 90 percent of Korea's 15 million households in 2006—along with the development of new wireless Internet technologies, has provided opportunities for highly innovative and specialized U.S. telecommunications equipment firms.<sup>410</sup>

Wireless technological innovation and broadband access in Korea has also increased demand for computer software in the market. Because computer software currently receives duty-free access to the Korean market under the ITA, the sector is expected to benefit primarily from FTA provisions addressing NTMs. Industry groups, such as the International Intellectual Property Alliance (IIPA), indicate that the FTA's intellectual property provisions would have

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<sup>403</sup> Other industries that may benefit from Korea's agreement to accept remanufactured goods include machinery and medical goods. USTR fact sheet "Free Trade with Korea, Brief Summary of the Agreement." Korea currently allows imports of remanufactured goods, with requirements on certain goods, particularly medical devices. There is no known prohibition, however, on imported remanufactured goods. U.S. government official, e-mail message to Commission staff, July 5, 2007.

<sup>404</sup> The concept of remanufactured goods is relatively new in Korea. A law relating to domestically-remanufactured goods was enacted in December 2005 to foster environmentally friendly industries, including remanufactured goods. U.S. government official, e-mail message to Commission staff, July 13, 2007.

<sup>405</sup> U.S. government official, e-mail message to Commission staff, July 13, 2007.

<sup>406</sup> Impact relative to an estimated 2008 base. See chap. 2 of this report for additional information regarding the economy-wide analysis.

<sup>407</sup> For additional analysis regarding TBTs and other NTMs, see chap. 5 of this report.

<sup>408</sup> ITAC (15) on Intellectual Property Rights, *Advisory Committee Report*, April 27, 2007, 6; and ITAC (8) for Information and Communications Technologies, Services and Electronic Commerce, *Report*, April 27, 2007, 4.

<sup>409</sup> USFCS, "Doing Business in Korea: A Country Commercial Guide for U.S. Companies," 2007.

<sup>410</sup> *Ibid.*

a beneficial impact on copyright-based industries, such as computer software.<sup>411</sup> The FTA's intellectual property provisions and Korea's recent efforts to strengthen intellectual property rights protection through mechanisms such as the Computer Program and Protection Law are expected to assist U.S. firms and their position as principal suppliers of prepackaged software to Korea.<sup>412</sup>

U.S. suppliers of machinery products, a sector that comprises a wide variety of products, are generally expected to benefit from the FTA's reduction or elimination of tariffs. The Commission's economy-wide analysis of the long-term effects of tariff and TRQ liberalization under the FTA for this sector estimates that U.S. exports to Korea could increase by \$2.8–2.9 billion (36–38 percent).<sup>413</sup> Because current U.S.-Korea trade in this sector is relatively large in dollar terms, the elimination of duties on products in this sector would contribute to larger estimated effects in the modeling results. Currently, U.S. firms account for an estimated 15–20 percent of total Korean imports in this sector. Examples of sector products<sup>414</sup> likely to experience increased exports resulting from the FTA include computerized numerically controlled (CNC) cutting machine tools, electrical power systems, and security products. Currently, the United States is one of the leading Korean import sources for CNC machine tools.<sup>415</sup> Korean market demand for machine tools is primarily in sectors where major Korean manufacturing exists, such as the automotive sector, metal processing, electronics, and precision machine industries.<sup>416</sup> Korea currently has an 8 percent duty on most machine tools; the FTA would provide immediate duty-free access to many types of machine tools, while other machinery products would have staging periods ranging from 3 to 10 years.

U.S. exports of electrical-power generating equipment are currently assessed tariffs ranging from 0 to 8 percent and are expected to benefit from the immediate or phased elimination of duties. The United States is one of the leading suppliers of turbines, generators, and nuclear reactors to Korea. Korea currently plans to increase power-generating capacity in the country in anticipation of greater future electricity demand,<sup>417</sup> providing further opportunities for U.S. firms. U.S. suppliers of security products, with many facing 8 percent duties, are expected to benefit from immediate or phased reduction of duties along with increased demand of sector products, because of factors such as the replacement of airport and port security systems in Korea.<sup>418</sup>

Semiconductors and household appliances have traditionally been affected by NTMs, particularly standards and conformity assessment in the Korean market. While concerns regarding the Korean market remain for U.S. suppliers of these products, the FTA provisions will likely benefit these sectors. Semiconductors are one of the leading categories of U.S.

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<sup>411</sup> IIPA, "Re: Investigation No. TA 2104-24, U.S.-Korea Free Trade Agreement," written submission to the USITC, June 25, 2007, 2.

<sup>412</sup> USFCS, "Doing Business in Korea: A Country Commercial Guide for U.S. Companies," 2007.

<sup>413</sup> Machinery products are covered under the GTAP sector "machinery and equipment n.e.c." For additional information on the Commission's CGE results, see chap. 2 of this report. Impact relative to an estimated 2008 base. See chap. 2 of this report for additional information regarding the economy-wide analysis.

<sup>414</sup> The sector consists of a very broad range of products that cover an extremely large range of industries. The sectors highlighted in the assessment are provided as examples of products that may have some potential to benefit from the FTA.

<sup>415</sup> USFCS, "Doing Business in Korea: A Country Commercial Guide for U.S. Companies," 2007.

<sup>416</sup> Ibid.

<sup>417</sup> Ibid.

<sup>418</sup> Ibid.

imports from and exports to Korea. Although semiconductor products receive duty-free treatment through the ITA and the recently negotiated Multi-Chip Packaging (MCP) Agreement, concerns remain regarding other areas such as trade remedies and conformity assessment measures.<sup>419</sup> The semiconductor industry, through the WTO, has managed to resolve some issues relating to nontariff barriers prior to the FTA. The most recent WTO semiconductor case involved a dispute over alleged subsidies provided by the Government of Korea to a Korean manufacturer of dynamic random access memory (DRAM) semiconductors. The case was concluded in June, 2005, with the WTO Appellate Body ruling in favor of the United States.<sup>420</sup>

U.S. exports of household appliances within this sector generally are assessed an 8 percent Korean duty and are likely to benefit from the immediate elimination or phased reduction of tariffs. The potential benefits of the FTA's nontariff provisions, particularly standards and conformity assessment, would likely facilitate increased exports of household appliances.<sup>421</sup> One major U.S. household appliance company reported that exports to Korea continue to be encumbered by Korean government restrictions regarding certification, testing, and other standards related practices that have until recently stymied exports of these products.<sup>422</sup> The United States and Korea are currently engaged in informal discussions that address these issues, and any agreement reached may complement the U.S.-Korea FTA.

### ***Views of Interested Parties***

Various reports issued by several ITACs representing machinery and equipment sectors expressed their support for the FTA. The ITAC for Aerospace Equipment (ITAC 1) stated in its report that the FTA would be "WTO consistent" and a "high quality" agreement in terms of "coverage and liberalization levels." Further, ITAC 1 reported the FTA would lead to greater demand for products covered by their committee (aircraft and engines) by increasing GDP and trade between the two countries, which would result in greater air travel.<sup>423</sup> The ITAC on Consumer Goods (ITAC 4) expressed its support for provisions granting immediate duty-free access for products such as heavy motorcycles and provisions allowing trade in remanufactured goods.<sup>424</sup> Similarly, the ITAC for Information and Communications Technologies, Services, and Electronic Commerce (ITAC 8) expressed its support for the FTA regarding provisions that would improve market access for U.S. exports of information technology products and equipment.<sup>425</sup>

The ITAC on Automotive Equipment and Capital Goods (ITAC 2) was, however, divided in its support for the FTA. Industry representatives of capital goods manufacturers, such as U.S. manufacturers of electrical equipment, expressed support for the FTA; they indicated

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<sup>419</sup> SIA, "Comments Re: No. TA2104-24, U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects," written submission to the USITC, June 25, 2007. In SIA's written submission, SIA states that "MCP-like" devices do not receive duty free treatment under the FTA.

<sup>420</sup> USTR, "United States Wins WTO Semiconductor Case," June 27, 2005.

<sup>421</sup> See chap. 5 of the Commission's report for additional information regarding the FTA's TBT provisions.

<sup>422</sup> U.S. industry representative, telephone interview by Commission staff, August 7, 2007.

<sup>423</sup> ITAC (1) for Aerospace Equipment, *The Industry Trade Advisory Committee for Aerospace Equipment Report*, April 25, 2007, 2.

<sup>424</sup> ITAC (4) on Consumer Goods, *Report*, April 26, 2007, 3-4.

<sup>425</sup> ITAC (8) for Information and Communications Technologies, Services and Electronic Commerce, *Report*, April 27, 2007, 3.

that they would benefit from the tariff reductions and tariff eliminations gained from the FTA. U.S. automotive equipment representatives were divided, however, with some in support and others in opposition to the FTA.<sup>426</sup>

Several U.S. industry representatives of the information technology sector expressed support for the FTA. At the Commission's hearing, the Information Technology Industry Council (ITI) stated that the FTA would reduce tariff rates on U.S. goods and bolster the competitiveness of U.S. exports in Korea.<sup>427</sup> ITI further stated that the intellectual property rights chapter of the FTA is one of the strongest to be achieved in an FTA, and that it would support the ability of U.S. firms to innovate. ITI also noted that the FTA chapters on TBTs, government procurement, and competition policy would help promote market access and the competitiveness of U.S. sector exports.

The Semiconductor Industry Association, in a submission to the Commission, expressed support for the FTA and stated that it sees specific benefits for the semiconductor industry. SIA expressed reservations, however, about certain portions of the FTA, such as the trade remedies chapter, which it said might undercut the ability of U.S. firms to use the U.S. antidumping laws.<sup>428</sup>

Another industry trade group, the American Electronics Association (AeA), an association representing the technology industry, reported in a statement on its Web site that it supports the FTA.<sup>429</sup> AeA said that the high-tech industry will benefit from the elimination of tariff and nontariff barriers by "providing nondiscriminatory treatment for digital products, criminalizing end-user piracy, improving access to government contracts, enhancing regulatory transparency, and streamlining customs processes."<sup>430</sup>

The National Electrical Manufacturers Association (NEMA) stated that it supports the FTA and believes that it will provide benefits for its member firms through the elimination of duties, most immediately upon implementation, for products covered in their industry. NEMA reported, however, that it still has concerns about nontariff barriers and intellectual property rights in Korea.<sup>431</sup> In a statement provided to the Commission, the National Association of Manufacturers (NAM) expressed its support for the FTA and stated that the FTA would substantially reduce tariff and nontariff barriers in Korea and provide most U.S. industries with strong market access.<sup>432</sup> NAM said that, while it is a leading advocate of the FTA, the FTA is not perfect and noted the concerns expressed by U.S. automakers about the FTA's tariff and nontariff provisions and the questions raised by the U.S. steel industry about trade rules and other barriers.

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<sup>426</sup> ITAC (2) on Automotive Equipment and Capital Goods, *Advisory Committee Report*, April 27, 2007, 3. See this chapter's assessment of the passenger vehicles sector for additional information regarding the U.S. automotive industry's views on the FTA.

<sup>427</sup> Dawson, testimony before the USITC, June 20, 2007, 69–70.

<sup>428</sup> SIA, "Semiconductor Industry Association (SIA) Comments on the Korean US Free Trade Agreement (KORUS)," June 25, 2007.

<sup>429</sup> AeA, "The U.S.-South Korea Free Trade Agreement Will Improve Access for U.S. High Tech," June 19, 2007.

<sup>430</sup> *Ibid.*

<sup>431</sup> NEMA, "Issue Brief: US-South Korea Free Trade Agreement." For additional analysis regarding customs administration provisions of the FTA, see chap. 5 of this report.

<sup>432</sup> NAM, "National Association of Manufacturers Post-Hearing Statement," written submission to the USITC, June 27, 2007, 2.

## Passenger Vehicles<sup>433</sup>

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### *Assessment*

U.S. exports of passenger vehicles to Korea would likely experience a large percentage increase as a result of the FTA; however, given the current very small U.S. market share and regulatory measures in place, short- to medium-term increases would likely be small (by value). The long-term impact on U.S. exports of passenger vehicles to Korea depends on the implementation of FTA provisions addressing NTMs, including burdensome standards and certification requirements, taxes, and an opaque regulatory environment. Addressing nontariff issues could increase U.S. exports of passenger vehicles, whereas shortfalls in their elimination could reduce the estimated impact. The increase in U.S. imports of passenger vehicles from Korea will likely be small in percentage terms, because of the current relatively low U.S. tariff and the large pre-existing trade value of passenger vehicles in total U.S. imports from Korea, but large in value terms.

### **U.S. Exports<sup>434</sup>**

Elimination of Korea's 8 percent tariff on U.S. passenger cars and 10 percent tariff on U.S. light trucks would likely lead to increased U.S. passenger vehicle exports. Further, Korean commitments on TBTs and taxes would likely modestly enhance the potential for increased U.S. exports to Korea.<sup>435</sup>

### *Current Environment*

The passenger vehicle market in Korea is dominated by the domestic industry, which accounted for over 95 percent of the Korean market during the 2002–06 period (table 3.15). Penetration by foreign automakers was 4.2 percent in 2006. Passenger vehicles from Europe accounted for the largest share of total Korean passenger vehicle imports in 2006 (60 percent), imports from Japan accounted for 27 percent, and imports from the United States accounted for just 7 percent.<sup>436</sup> Observers note that the 1995 and 1998 memoranda of understanding (MOUs) between the United States and Korea, the stated goals of which were to increase market access and address nontariff barriers in the Korean market, did not result in increased sales of U.S.-built vehicles. Instead, as calculated by the Automotive Trade Policy Council, the U.S.-Korea automotive trade deficit increased from \$1.3 billion in 1995, to \$2.1 billion in 1998, and to \$11.1 billion in 2006.<sup>437</sup>

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<sup>433</sup> The quantitative analysis in this section is based on GTAP sector 38, Motor Vehicles and Parts. The qualitative analysis herein focuses on the subset of passenger cars and light trucks, or passenger vehicles. Other GTAP sector 38 products include automotive parts and engines, commercial trucks, buses, specialty vehicles, and certain containers and trailers.

<sup>434</sup> The products covered in this assessment represented approximately 21 percent of U.S. exports in the GTAP “motor vehicles and parts” sector in 2006.

<sup>435</sup> Korea's Ministry of Commerce, Industry, and Energy and the Korean Institute for Industrial Economics and Trade (KIET) both estimated that U.S. vehicle exports to Korea will increase by \$72 million. *Yonhap News*, “FTA to Boost S. Korea's Auto-related Surplus by US\$1 billion,” April 11, 2007; and *Yonhap News*, “Economic Effects of S. Korea-U.S. FTA May Differ From Early Estimates,” April 23, 2007.

<sup>436</sup> Commission staff estimates based on Global Trade Information Services, World Trade Atlas database.

<sup>437</sup> Biegun, written submission to the USITC, June 27, 2007.



**Table 3.15** Korean passenger vehicle market, unit registrations and market share, 2002–06

	2002	2003	2004	2005	2006
Total Korean new passenger vehicle registrations	1,241,310	1,021,374	881,322	944,451	976,211
Registrations of domestically built passenger cars in Korea	1,225,210	1,001,874	857,977	913,550	935,681
Market share (percent)	98.7	98.1	97.4	96.7	95.8
Total foreign automaker registrations in Korea	16,100	19,500	23,345	30,901	40,530
Market share (percent)	1.3	1.9	2.6	3.3	4.2
Total U.S. automaker registrations in Korea <sup>a</sup>	4,700	4,100	5,415	5,795	7,165
Market share (percent)	0.4	0.4	0.6	0.6	0.7
GM, Ford, and Chrysler registrations in Korea <sup>b</sup>	2,969	3,168	3,509	3,811	4,556
Market share (percent)	0.2	0.3	0.4	0.4	0.5

Source: Commission calculations based on data from Korean Automobile Manufacturers Association Web site and U.S. Department of Commerce.

<sup>a</sup>Includes registrations of GM, Ford, and Chrysler vehicles produced outside the United States, as well as foreign affiliate sales, i.e., Jaguar, Land Rover, and Volvo, are included for Ford, and Saab is included for GM. Not included are BMW and Mercedes-Benz vehicles produced in the United States for the Korean market; such registrations totaled 338 and 350 units, respectively, in 2006.

<sup>b</sup>Includes registrations of vehicles produced outside the United States, but excludes foreign affiliates. In 2006, GM's registrations are all Cadillac brand vehicles mostly made in the United States; Ford registrations include the EU-assembled Mondeo, which accounted for 23 percent of Ford's Korean sales in 2006; and less than half of Chrysler's 2006 registrations were of U.S.-built vehicles.

Market access for imported vehicles in Korea is affected generally by tariffs, taxes, and TBTs that typically take the form of safety and emissions standards. Many observers also assert that there is a persistent anti-import bias in Korea.<sup>438</sup> The Korean import tariff of 8 percent for passenger cars and 10 percent for light trucks is relatively high, and the Korean system of taxation for passenger vehicles has historically been based on engine size, assessing higher tax rates for cars with larger engines. Nearly all U.S. passenger vehicle exports to Korea have engines over 2,000 cc,<sup>439</sup> and are therefore subject to the higher tax rates.<sup>440</sup> Table 3.16 shows the composition of the Korean market based on engine size in 2005.

<sup>438</sup> USCIB, "USCIB Comments," 4; Levin, "Statement of Senator Carl Levin"; Levin, testimony before the USITC, June 20, 2007, 160-61; ATPC, "Statement of Stephen J. Collins"; Schott, "Autos and the KORUS FTA," 2006; Schott, Bradford, and Moll, "Negotiating the Korea-United States Free Trade Agreement," 9; UNEP, "Asia and Pacific Vehicle Standards and Fleets"; and VDA, *Auto Annual Report 2007*, 24.

<sup>439</sup> In 2006, 20 U.S.-built Dodge Calibers with engines smaller than 2,000 cc were sold in Korea.

<sup>440</sup> In 2006, nearly all Japanese imports sold in Korea were vehicles with engines larger than 2,000 cc, and 62 percent of European vehicles sold in Korea had engines over 2,000 cc. U.S. automakers' strength is in passenger vehicles with larger engines. A Ford representative stated that, for the Korean market, importers tend to import higher-cost vehicles into the Korean market because they bring a higher margin that can more easily bear the expenses that come from unique Korean designs, shipping costs, tariffs, and other costs. Additionally, Korean consumers of luxury vehicles are less price-sensitive. Biegun, testimony before the USITC, June 20, 2007, 233.

**Table 3.16** Korean passenger vehicle market by engine size, 2005

Engine category	Domestic		Import	
	Percent	No. of vehicles	Percent	No. of vehicles
1,000 cc and under	5	45,678	0	0
1,001 cc–1,600 cc	17	155,303	2	618
1,601 cc–2,000 cc	54	493,317	21	6,489
Over 2,000 cc	24	219,252	77	23,794
Total	100	913,550	100	30,901

*Source:* Commission staff calculations based on Korean Automobile Manufacturers Association and Automotive Trade Policy Council, as reported in Ford Motor Company posthearing statement.

*Note:* Data for engine categories 1,001–1,600 cc and 1,601–2,000 cc estimated by Automotive Trade Policy Council based on data for 1,001–1,500 cc and 1,501–2,000 cc.

A broad spectrum of taxes are assessed on all passenger vehicles, imports and domestically produced vehicles alike, and are assessed in a cascading manner, beginning with the import tariff (in the case of imports). Purchase taxes are applied next, and include the special consumption tax based on engine size, the educational tax that is a percentage of the special excise tax, value-added tax (VAT), registration tax, acquisition tax, and the subway bond; the bond is also based on engine size. Ownership taxes include an annual vehicle tax that is based on engine size and an annual educational tax that is based on the annual vehicle tax.

Aside from assessing certain taxes based on engine size—a disadvantage for U.S. exporters whose strength is in larger engine cars—the cascading method of application magnifies the effect for imports and for cars with larger engines. For example, a comparison of a Korean-built and an imported vehicle, both with engines over 2,000 cc and a price of \$30,000,<sup>441</sup> results in a total tax amount paid by the purchaser/consumer for the imported vehicle that is 20–25 percent higher than for the Korean-built vehicle.<sup>442</sup>

The extent to which safety and environmental standards affect market access is harder to assess in a quantifiable way. U.S. industry sources report that Korean standards “are unique to any other standards in the world,”<sup>443</sup> and characterize them as elaborately layered, ever-changing,<sup>444</sup> and “often nontransparent and out of sync with international standards.”<sup>445</sup> Although these standards apply to all vehicles sold in the Korean market, Korean automakers are able to amortize the cost of meeting such standards over a much broader sales base.<sup>446</sup> Moreover, standards are subject to revisions as new models are introduced.<sup>447</sup>

The effect of these NTMs may be to restrict the quantity of imports or raise the price of imports for passenger cars (box 3.3). According to Jeffrey Schott of the Peterson Institute for International Economics, “A large segment of the Korean market is taken by small engine vehicles, not the mainstay of major US producers...[t]hat said, the low import penetration of

<sup>441</sup> Ex factory + insurance and freight.

<sup>442</sup> Import, purchase, and first-year ownership, less insurance, freight, and dealer markup. Based on calculations of the U.S. Department of Commerce.

<sup>443</sup> Biegun, testimony before the USITC, June 20, 2007, 240.

<sup>444</sup> Ibid.

<sup>445</sup> Ibid.

<sup>446</sup> Ibid., 210–11.

<sup>447</sup> Meyer, testimony before the USITC, June 20, 2007, 238.

**Box 3.3.** Potential price and quantity effects of NTMs on passenger cars, 1,500–3,000 cc engine displacement (HS 870323)

Firms seeking to export passenger cars to Korea have identified TBTs, including burdensome standards, testing, and certification requirements; special taxes; and an opaque regulatory environment that may have impeded their access to the market for motor vehicles (see text). These measures may restrict the quantity of imports into the Korean market, raise the price of imports, or both.

Korean imports of passenger cars with engine displacement of 1,500–3,000 cc, in quantity terms, are substantially lower than imports of the same product into most other economies, relative to the size of the Korean economy. Moreover, Korea's import unit value for small passenger cars is substantially higher than the import unit value for most other countries. The existing tariff of 8 percent ad valorem appears to be too low to account by itself for either the relatively low quantity of imports or the relatively high price of imports. This relatively high price of imports may be reflective of the effects of NTMs, but could also be influenced by such factors as market structure, product differentiation, and consumer preferences.

Korean imports of smaller displacement passenger cars (1,500–3,000 cc engine) in 2003–05 were 0.02 vehicles per million \$ GDP, as compared to the median for 56 comparable countries of 0.45 vehicles per million \$ GDP. Korea ranks fifty-fifth out of the 56 countries in imports of these passenger vehicles relative to the size of its economy, with only India ranking lower. The Korean average import price from the world in 2004–06 was \$27,160 per vehicle, which is 96.9 percent above the world average import price of \$13,794; the average import price from the United States was \$19,754, which is 20 percent higher than the U.S. export price to the world of \$16,842.

Various provisions of the FTA are intended to address some of the NTMs affecting Korea's market for passenger cars, including provisions in Chapter 2 on National Treatment and Market Access for Goods, Chapter 9 on Technical Barriers to Trade, the confirmation letter on specific-autos regulatory issues, and Annex 22-B of the chapter on Institutional Provisions and Dispute Settlement, concerning alternative procedures for disputes concerning automotive products (see box 3.4 and chapter 5 of this report for additional information on some of these provisions).

For further information on the calculation and interpretation of the quantity and unit-value information reported above, see appendix J.

*Source:* See app. J for data sources; USITC staff analysis.

larger vehicles is still notable. The explanation is at least partly due to Korean tax and regulatory policies, the residual effects of prior anti-import campaigns, and technical standards.”<sup>448</sup>

Industry observers state that anti-import bias also plays a role in the low import penetration in the Korean market.<sup>449</sup> Despite a commitment in the 1998 MOU between the United States and Korea to improve the perception of foreign motor vehicles in Korea, to address instances of anti-import activity against foreign motor vehicles, to end the use of tax audits and other measures to discourage the purchase of motor vehicles, and to promote the benefits of free and open competition between foreign and domestic products, U.S. industry reports that anti-

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<sup>448</sup> Schott, “Autos and the KORUS FTA,” 2006.

<sup>449</sup> USCIB, “USCIB Comments,” 4; Levin, “Statement of Senator Carl Levin”; Levin, testimony before the USITC, June 20, 2007, 160-61; ATPC, “Statement of Stephen J. Collins”; Schott, “Autos and the KORUS FTA,” 2006; Schott, Bradford, and Moll, “Negotiating the Korea-United States Free Trade Agreement,” 9; UNEP, “Asia and Pacific Vehicle Standards and Fleets”; and VDA, *Auto Annual Report 2007*, 24.

import activities have continued “in a more subtle and indirect manner” and “continue to have a strong residual effect on consumers today.”<sup>450</sup>

#### *FTA Provisions*

The FTA addresses certain tax and TBT issues as described above, and also prescribes a system for consultation and dispute settlement.<sup>451</sup> The provisions of the agreement that relate to the passenger vehicle sector are described in box 3.4.

#### *Effect of FTA Provisions*

Removal of the 8 percent tariff on passenger cars and the 10 percent tariff on light trucks would likely have a positive effect on U.S. exports, potentially enabling U.S. exporters to lower their prices because of the tariff savings; further, the overall tax burden on the Korean consumer who purchases an imported vehicle would be reduced, more or less equalizing the total taxes paid on imported and domestic vehicles. Of particular interest is the treatment of hybrid vehicles. For hybrid vehicles in which the gas- or diesel-powered engine “provides the vehicle’s power system its essential character,” the 8 percent tariff would be immediately removed.<sup>452</sup> There are a number of hybrid vehicles currently produced or slated to be produced in the United States in the coming model years, and U.S. officials assert that all of the U.S.-built hybrids currently on the market would benefit from the immediate elimination of the 8 percent Korean tariff.<sup>453</sup> Consequently, the removal of this tariff could increase the competitiveness of U.S.-produced hybrid vehicles in the Korean market, particularly in light of the fact that there are currently no Korean-built hybrid vehicles.

The FTA provisions on market access and national treatment address Korea’s motor vehicle tax system. The reduction of the special consumption tax and the annual vehicle tax, and the restructuring of the vehicle classifications of those taxes, make the taxes less discriminatory against U.S. exports; the systems, however, continue to be based on engine size, and the overall effect is expected to be positive but likely minimal. As noted by Schott, Bradford, and Moll (2006), “[e]ven if the tariffs disappear on bilateral trade under an FTA, foreign automakers fear that the structure of domestic taxes will continue to depress demand in the Korean market for large-engine cars relative to small cars.”<sup>454</sup> Moreover, the FTA commitments on taxes would be applied on a multilateral basis, meaning that U.S. exports would not benefit from preferential taxation treatment. As can be discerned from the data in table 3.16, 95 percent of all vehicles sold in Korea in 2005—imports and domestically produced—were vehicles with engines over 1,000 cc and would therefore be assessed the reduced special consumption tax rate of 5 percent at full implementation. Regarding the annual vehicle tax, 79 percent of all vehicles sold in Korea have engines over 1,600 cc; the

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<sup>450</sup> Biegun, “Responses to Commissioners’ Questions to Mr. Stephen Biegun,” written submission to the USITC, June 27, 2007.

<sup>451</sup> For additional analysis regarding TBTs and other NTMs, see chap. 5 of this report.

<sup>452</sup> For hybrid vehicles in which the gas- or diesel-powered engine “does not give the vehicle’s power system its essential character,” the 8 percent tariff would be phased out over 10 years.

<sup>453</sup> U.S. government official, interview by Commission staff, Washington, DC, June 11, 2007.

<sup>454</sup> Schott, Bradford, and Moll, “Negotiating the Korea-United States Free Trade Agreement,” June 2006.

**Box 3.4 Automotive-related FTA Provisions**

**Tariff Liberalization**

Korea would immediately eliminate its 8 percent tariff on U.S.-built passenger cars and its 10 percent tariff on pickup trucks. The 8 percent tariff on two eight-digit tariff rate lines in the Korean tariff schedule would be phased out in ten equal annual stages.

The United States would immediately eliminate its 2.5 percent duty on passenger vehicles with gasoline-powered engines up to and including 3,000 cc, and would phase out over 3 years the 2.5 percent duty on passenger vehicles with gasoline-powered engines over 3,000 cc, and all diesel-powered passenger vehicles. The 2.5 percent tariff on passenger vehicles other than gasoline- or diesel-powered, and the 25 percent tariff on pickup trucks, would be phased out in equal stages over 10 years.

**National Treatment and Market Access for Goods (Chapter 2)**

- Korea commits to reducing the special consumption tax and annual vehicle tax, and restructuring the vehicle classifications (see table below).
- Korea would not impose any new taxes based on engine displacement.
- Korea commits to publicizing the availability of an 80 percent refund of the subway/regional bond for purchasers of new automobiles; 80 percent of the bond is immediately redeemable, or the bond is fully redeemable when it reaches maturity.

**Korean Automobile Taxes Addressed in the FTA**

<b>Purchase Tax</b>	<b>Current</b>	<b>FTA Commitment</b>
Special Consumption Tax	Below 800 cc—Exempted 801–2,000 cc—5 percent Over 2,000 cc—10 percent	Over 2,000 cc is immediately reduced to 8 percent, and further reduced to 5 percent over 3 years. After 3 years, tiers are restructured to below 1,000 cc, which would not be taxed, and over 1,000 cc, which would be taxed at 5 percent.

<b>Ownership Tax</b>	<b>Current</b>	<b>FTA Commitment</b>
Annual Vehicle Tax	Below 800 cc—80 won/cc 801–1,000 cc—100 won/cc 1,001–1,600 cc—140 won/cc 1,601–2,000 cc—200 won/cc Over 2,000 cc—220 won/cc	Below 1,000 cc—80 won/cc 1,001–1,600 cc—140 won/cc Over 1,600 cc—200 won/cc

**Box 3.4 Automotive-related FTA Provisions—Continued**

**Technical Barriers to Trade (Chapter 9) and Confirmation Letter (Specific Autos Regulatory Issues)**

- **K-ULEV:** With respect to Korea's Ultra Low Emission Vehicle standard, Korea has agreed that it would apply emissions standards no more stringent than those applicable in California. Korea has also agreed to use a low-volume (<4,500 vehicles) seller exemption equivalent to California's, a special midvolume (4,500–10,000 vehicles) rate used in California, and to use the California Fleet Averaging System methodology to determine whether a manufacturer meets the standard.
- **OBD II:** With respect to testing of onboard diagnostic equipment designed to confirm compliance with emissions standards, the FTA provides a grace period until December 31, 2008, for manufacturers that sell 10,000 or fewer units per year in Korea.
- **Self-certification:** With respect to self-certification of safety requirements, the FTA provides a 2-year grace period for imported vehicles to meet Korean safety standards and requires proof of meeting regulations only if the import is subject to a government-mandated recall. In addition, any manufacturer selling 6,500 or fewer units in Korea would be deemed to be in compliance if it meets U.S. Federal Motor Vehicle Safety Standards.
- **New technical regulations:** Korea agreed not to adopt technical regulations that create unnecessary barriers to trade and to cooperate to harmonize standards.
- **Autos Working Group:** The FTA includes a provision to create an Autos Working Group, made up of U.S. and Korean government representatives that may include or consult with other stakeholders and experts as the parties deem necessary and appropriate. Korea would be required to provide information on new regulatory measures to the group as soon as that information is provided to stakeholders. The group would analyze potential new regulations and provide views to the Korean government.

**Institutional Provisions and Dispute Settlement (Chapter 22)—Annex 22-B, Alternative Procedures for Disputes Concerning Automotive Products**

The FTA sets up a special dispute settlement mechanism for provisions pertaining to motor vehicles. Constitution of the panel would result from a meeting of the parties whereby they select by lot from a prescribed list, one national of each party to serve as panelists and one person who is not a national of either party to serve as chair of the panel.

Specifically, a party would be able to bring a complaint to a special dispute panel if it believes that the other party has violated an FTA commitment on autos or otherwise nullified or impaired expected benefits under that commitment. If the panel finds that (1) the relevant FTA provision has been violated or expected benefits have been nullified or impaired, and (2) the infringement has caused material injury, the panel can permit the injured party to return or "snap back" the tariff from zero to the HS 8703 MFN tariff of 2.5 percent in the United States and 8 percent in Korea.

If, after 10 years from the date of entry into force, a panel established under Annex 22-B has not determined that a party has failed to conform with its obligations under the FTA or that a party's measure has caused nullification or impairment, Annex 22-B would terminate.

Source: USTR, "Final - United States - Korea FTA Texts," 2007.

vehicles that receive a tax break in the agreement are those over 2,000 cc, as the new rate to be applied at implementation does not change for vehicles with engines between 1,601 and 2,000 cc. (The small percentage of vehicles between 801 and 1,000 cc also receive a tax cut, but there are no imports in this category.) The FTA does not reduce or restructure the subway bond, which is also based on engine size.

The effect on U.S. exports of passenger vehicles of Korea's commitments on TBTs is also expected to be positive but likely minimal. These commitments are also applied on an MFN basis. The FTA addresses the Korean standards that were identified by U.S. automakers as priority issues (ultralow emission vehicle standards, onboard diagnostic standards, and self-certification), and Ford conceded that "there is some convergence to the U.S. standards."<sup>455</sup> The overall Korean system, however, remains unique and continues to combine U.S. and European safety and emission standards.<sup>456</sup> On the priority issues, U.S. industry believes that the trade-distorting effect of the K-ULEV regulation is removed in the FTA.<sup>457</sup> The FTA did not eliminate the Korean OBD II regulation, but instead offers a short-term exemption from meeting the standard for low-volume importers. Additionally, as it stands, the OBD II regulation, although consistent with California regulations, may require U.S. automakers to incur significant additional costs in terms of vehicle prototypes, documentation, and other demonstration requirements.<sup>458</sup> Finally, on self-certification,<sup>459</sup> U.S. officials assert that, for U.S. manufacturers exporting no more than 6,500 vehicles, U.S. safety-certified vehicles would be accepted as meeting all Korean safety regulations.<sup>460</sup> As elaborated on in the Views of Interested Parties section, because of the highly technical nature of the TBTs, U.S. industry believes that the FTA text still requires clarification.

Further, the low-volume seller exemptions established for two TBTs in the FTA may act as a disincentive for U.S. automakers to pursue vehicle sales above these levels.<sup>461</sup> According to an official with Ford, to build a vehicle to a uniquely Korean emission standard would require sales in the tens of thousands to make sense from a business perspective.<sup>462</sup> If automakers manufacturing in the United States did reach and limit their exports to the lowest low-volume seller exemption threshold, which is the exemption from K-ULEV for importers selling up to 4,500 vehicles in Korea, it could represent a significant increase in the volume of U.S. exports to Korea; the agreement, however, does not specify how a "manufacturer" is defined; e.g., whether foreign affiliates are included in a parent company's total. Nonetheless, U.S. exports would still likely account for a very small portion of total Korean sales.

Additionally, the FTA states that Korea would not adopt new technical regulations that "create unnecessary barriers to trade" and to work with the United States on harmonizing standards. As noted earlier, however, the introduction of each new model of vehicle can create a situation in which subjective decisions are made that can result in loss of market

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<sup>455</sup> Biegun, testimony before the USITC, June 20, 2007, 239.

<sup>456</sup> ITAC (2) on Automotive Equipment and Capital Goods, *Advisory Committee Report*, April 27, 2007.

<sup>457</sup> *Ibid.*

<sup>458</sup> *Ibid.*

<sup>459</sup> Self-certification is the way by which the manufacturer certifies that each product put on the market conforms to given regulations; the competent administrative authorities may verify by random sampling on the market that the self-certified products comply with the requirements of given regulations.

<sup>460</sup> ITAC (2) on Automotive Equipment and Capital Goods, *Advisory Committee Report*, April 27, 2007.

<sup>461</sup> Congressman Levin, "Testimony as Prepared for Delivery," written submission to the USITC, June 20, 2007; and Biegun, "United States International Trade Commission's Hearing" written submission to the USITC, June 20, 2007.

<sup>462</sup> Biegun, testimony before the USITC, June 20, 2007, 241.

access. The FTA affirms the parties' rights under the WTO, which includes the following from the WTO Agreement on Technical Barriers to Trade: ". . . no country should be prevented from taking measures necessary . . . for the protection of human . . . life or health, or the environment . . . at the levels it considers appropriate, subject to the requirement that they are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail or a disguised restriction on international trade, and are otherwise in accordance with the provisions of this Agreement."

An ancillary factor in the potential effect of the FTA is the dispute settlement mechanism. While the USTR asserts that the agreement's innovative process for settling auto-related disputes would serve as a powerful deterrent against any violations of FTA commitments,<sup>463</sup> those in opposition to the agreement express disappointment that the burden of proof lies with U.S. exporters.<sup>464</sup> The dispute settlement provisions restrict the snapback penalty on light trucks, which in the United States are assessed a duty of 25 percent, to the rate for passenger cars, 2.5 percent.

## U.S. Imports

The Commission's economic simulation estimates that U.S. imports from Korea of the broader motor vehicles and parts sector are expected to increase by \$1.3–1.7 billion (9–12 percent).<sup>465</sup> However, according to the simulation analysis in chapter 2, 55 to 57 percent of this estimated increase in U.S. imports from Korea would be diverted from other import sources. U.S. imports of passenger vehicles from Korea accounted for 84 percent of U.S. motor vehicle and parts imports from Korea in 2006.<sup>466</sup> Given the relatively large overlap of the products covered in this assessment with those of the economy-wide model sector, this estimated impact on the broader sector reflects to a large degree the potential effect of the FTA on the passenger vehicle subsector.

The expected increase in U.S. imports of passenger vehicles from Korea as a result of the FTA would likely be the result of U.S. tariff reductions that would make Korean-built cars more competitive in the U.S. market,<sup>467</sup> and, in the longer term, provide preferential market access to Korean-built light trucks.<sup>468</sup> According to one industry analyst, the elimination of the 2.5 percent tariff on U.S. imports of Korean passenger vehicles would "make Korean cars

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<sup>463</sup> USTR, "Q&As on U.S.-Korean FTA," April 13, 2007.

<sup>464</sup> ITAC (2) on Automotive Equipment and Capital Goods, *Advisory Committee Report*, April 27, 2007.

<sup>465</sup> Impact relative to an estimated 2008 base. See chap. 2 of this report for additional information regarding the economy-wide analysis.

<sup>466</sup> As defined by GTAP sector 38. See chap. 2 for additional information.

<sup>467</sup> On average, the removal of a 2.5 percent tariff on a Korean-built passenger car can result in an approximate \$250 savings per vehicle. Korean press reports indicate that Hyundai and Kia believe that the removal of the 2.5 percent U.S. tariff would provide "minimal benefits" in light of the appreciation of the won and other considerations, and that the tariff savings would result in the price of an imported Korean car in the United States being reduced by \$150. Seo, "Republic of Korea Daily: Abolition of Car Tariffs Will Help U.S. More," March 30, 2007.

<sup>468</sup> Korean estimates of the likely increase in U.S. passenger vehicle imports from Korea vary within a narrow range; for example, KIET estimated that Korean exports of passenger vehicles will likely increase by \$813 million over the 10 year implementation period of the agreement, the Ministry of Commerce, Industry and Energy estimated that Korean exports may increase by \$810 million, and the Korean Institute for International Economic Policy (KIEP) estimated that Korean vehicle exports will likely increase by \$860 million in the first year of the agreement. *Yonhap News*, "Economic Effects of S. Korea-U.S. FTA May Differ From Early Estimates," April 23, 2007; and *Yonhap News*, "FTA to Boost S. Korea's Auto-related Surplus by US\$1 billion," April 11, 2007.



cheaper in the US market, helping offset recent pricing pressure from currency appreciation.”<sup>469</sup>

Two product areas that are addressed in the FTA, but for which there is currently no Korean production, are hybrid vehicles and pickup trucks. The United States committed to eliminating immediately the 2.5 percent tariff on the current generation of hybrid vehicles.<sup>470</sup> Hyundai announced in April 2007 that it plans to start mass production of hybrid cars in 2009 and build up to a capacity of 300,000 units per year by 2015.<sup>471</sup> More recently, a KIET report stated that mass production is unlikely before 2010, but that production could reach 500,000 vehicles by 2015, and 1.8 million by 2020.<sup>472</sup> These vehicles are expected to benefit from an immediate removal of the 2.5 percent tariff, which would increase the competitiveness of such products in the U.S. market.

An increase in U.S. imports of pickup trucks from Korea would not be likely in the initial years of the agreement because of the 10-year phaseout of the 25 percent tariff, and because Korean automakers do not presently have a model ready for the U.S. market. The Korean press reported that Korea’s chief negotiator predicts that Korean pickups would be selling in the United States in about 5 years.<sup>473</sup> Hyundai announced in early April that it would begin a feasibility study on moving into pickup truck assembly,<sup>474</sup> and according to a company spokesman, it would be at least 5 years until the company has a pickup truck ready for the U.S. market.<sup>475</sup> A recent report in the trade press, however, quotes a Kia official as stating that “neither Hyundai nor Kia is considering a pickup truck. A truck is absolutely off the radar screen.”<sup>476</sup> Kia introduced a U.S.-styled-concept pickup truck in 2004 that it continues to evaluate; Ssangyong,<sup>477</sup> which manufactures in Korea and exports to Europe and Australia a pickup truck called Actyon Sports, reportedly may consider introducing the truck to the U.S. market in 2011.<sup>478</sup> Although some observers note that other foreign automakers could locate motor vehicle—and in particular, pickup truck—production in Korea to take advantage of the elimination of U.S. tariffs,<sup>479</sup> U.S. industry officials state that such investment would be more likely to take the form of a joint venture or acquisition of a Korean automaker, rather than a greenfield investment.<sup>480</sup>

Current trends that will likely bear upon the level of U.S. passenger vehicle imports from Korea in the short to medium term include the forecast for Korean brand vehicles to continue

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<sup>469</sup> Lam, “Korea: Opening Up for Growth,” April 3, 2007. Additionally, Jeffrey Schott notes that “Korean exporters have had to price aggressively in the U.S. market to compete with Japanese-made cars to compensate for currency movements...while the swing in the won/dollar and yen/dollar rates swamps the impact of tariff reforms, the immediate 2.5 percent tariff reduction does provide a small cushion for Korean exporters in a highly competitive market.” Schott, “The Korea-US Free Trade Agreement,” August 2007, 4.

<sup>470</sup> Those in which the gas- or diesel-powered engine gives “the vehicle’s power system its essential character.” The 2.5 percent tariff on future hybrid vehicles—those in which the spark-ignition internal-combustion reciprocating piston engine or compression-ignition internal-combustion piston engine does not give the vehicle’s power system its essential character, and other alternatively powered vehicles, would be phased out over 10 years.

<sup>471</sup> Yahoo! Asia News, “FTA to Help Boost Competitiveness of US-Built Japanese Cars,” April 4, 2007.

<sup>472</sup> Jin, “Korea Urged to Invest More in Hybrid Cars.”

<sup>473</sup> Thorpe, “Will Koreans Ship Cheap Pickups Here?” April 9, 2007, 1.

<sup>474</sup> Associated Press, “Automakers hopeful on South Korea-US FTA,” April 8, 2007.

<sup>475</sup> Thorpe, “Will Koreans Ship Cheap Pickups Here?” April 9, 2007, 1.

<sup>476</sup> Jackson, “Hyundai Goes UpMarket,” August 13, 2007.

<sup>477</sup> Ssangyong is 51 percent owned by Shanghai Automotive Industry Corp. of China.

<sup>478</sup> Thorpe, “Will Koreans Ship Cheap Pickups Here?,” April 9, 2007, 1.

<sup>479</sup> Reuther, “Statement by Alan Reuther, . . . on the Subject of The United States-Korea Free Trade Negotiations Before the Subcommittee on Trade, CWM, U.S. House of Representatives,” March 20, 2007.

<sup>480</sup> Biegun, testimony before the USITC, June 20, 2007, 250.

gaining U.S. market share regardless of the FTA, and Korean passenger vehicle assembly in the United States, which has been increasing since Hyundai began U.S. assembly operations in 2005. Hyundai's Alabama facility has the capacity to produce 300,000 units per year, and the Kia plant under construction in Georgia is expected to be operational in 2009, with capacity to produce 300,000 cars per year. The combined U.S. sales of all Hyundai and Kia passenger vehicles, regardless of whether the vehicles are assembled in Korea or the United States, are forecast to reach 1,007,328 vehicles in 2011, up from 749,822 vehicles in 2006 (table 3.17).<sup>481</sup> Korean passenger vehicles in the U.S. market have been viewed by rating groups and in the trade press as having improved both in terms of quality and value.<sup>482</sup>

**Table 3.17** Total U.S. light vehicle sales, Korean import share, and total Korean share, in units, 2002–06

	2002	2003	2004	2005	2006
Total U.S. sales	16,848,180	16,675,648	16,912,613	16,997,203	16,559,625
U.S. sales of Korean imports	612,464	645,969	782,982	805,183	690,802
Korean import market share (%)	3.6	3.9	4.6	4.7	4.2
U.S. sales of all Korean-brand vehicles (U.S.- and Korean-built)	612,464	645,969	782,982	848,753	858,947
Total Korean market share	3.6	3.9	4.6	5.0	5.2
U.S. sales of Hyundai imports	375,119	400,221	418,615	411,442	287,375
U.S. sales of U.S.-produced Hyundai	N/A	N/A	N/A	43,570	168,145
U.S. sales of Kia imports	237,345	237,471	270,055	275,851	294,302
U.S. sales of GM Daewoo imports <sup>a</sup>	N/A	8,277	94,312	117,890	109,125

Source: *Automotive News*, various issues.

<sup>a</sup>Includes Chevrolet Aveo and Suzuki Forenza/Reno and Verona.

N/A=not applicable.

Some observers note that the removal of the 2.5 percent U.S. tariff would eliminate the incentive for Korean automakers to expand their U.S. production capacity,<sup>483</sup> and Korean press reports indicate that the FTA is seen by some in Korea as a way to increase vehicle exports from Korea and “provide job security for workers in Korea,”<sup>484</sup> because the tariff

<sup>481</sup> *Automotive News, 2007 Global Market Data Book*, 19.

<sup>482</sup> For example, the 2007 Santa Fe, Tucson, Sonata, and Entourage earned “5-Star” crash ratings from the National Highway Traffic Safety Administration; the 2006 Sonata earned *MotorWeek*'s “Driver's Choice Award” for Best Family Sedan and Kiplinger's *Personal Finance* called it “Best New Car” in the \$18,000 to \$23,000 category; the 2006 Tucson earned J.D. Power and Associates' “Highest Ranked Compact Multi-Activity Vehicle in Initial Quality” in its 2006 Initial Quality Survey. Hyundai Motor America, “Awards and Accolades.”

<sup>483</sup> Congressman Levin, “Testimony as Prepared for Delivery,” written submission to the USITC, June 20, 2007; and Meyer, “The United States-Korea Free Trade Agreement (KORUS FTA),” written submission to the USITC, June 20, 2007.

<sup>484</sup> Choi, “FTA—A Stepping Stone for Korean Auto and Steel Makers,” April 11, 2007.

provisions would allow Korean automakers to reduce costs without relocating overseas.<sup>485</sup> The decision to locate or expand passenger vehicle production in foreign markets, however, is based on a number of factors other than preferential tariff rates on finished vehicles and vehicle parts, including the volume of sales in the foreign market, exchange rates, transport costs, the desire to design and produce vehicles locally to be more responsive to consumer preferences, availability of parts and components, and political considerations.

### *Views of Interested Parties*

In his testimony before the Commission, Mr. Stephen Biegun, vice president, International Government Affairs of Ford Motor Co. expressed Ford's opposition to the FTA. He noted that Ford has been operating in Korea since 1995, and despite 12 years of investment and effort, Ford currently has one remaining dealership in Korea and sells just 1,700 vehicles in Korea each year, compared to approximately 1,400 Hyundai and Kia dealers. Mr. Biegun stated that 96 percent of the vehicles sold in Korea are built in Korea, and that this "would be impossible to sustain without the active intervention of the Korean government."<sup>486</sup> Mr. Biegun stated that the 1995 and 1998 MOUs were intended to reduce NTBs and increase market access, but were not successful.<sup>487</sup>

With respect to safety and environmental regulations, Mr. Biegun stated that Korean regulations are "nontransparent and out of sync with international standards,"<sup>488</sup> and while noting that these regulations also bear a cost to Korean domestic automakers, said the cost is proportionately much higher for importers because they must amortize the cost across a much smaller amount of sales. According to Mr. Biegun, meeting new safety and environmental regulations "can be so costly as to destroy the business case to remain in the Korean market."<sup>489</sup> Mr. Biegun stated his company's disappointment that the burden of proof with respect to trade remedy will continue to lie with U.S. companies, and that the 25 percent U.S. truck tariff was not included as part of the snapback provisions. Mr. Biegun added that the agreement will merely provide temporary relief from current NTBs, and that new NTBs will arise in the future.<sup>490</sup> He noted that the U.S.-based exporters would, from a business case perspective, take the small volume exceptions that are specified for each of the NTBs.

At the Commission's hearing, Mr. Biegun expanded on a number of the issues brought out in his testimony. He noted that importers tend to import higher cost vehicles into the Korean market because they bring a higher margin that can more easily bear the expenses that come from unique Korean design requirements, shipping costs, tariffs, and other costs, and also because consumers of luxury vehicles are less price sensitive. On the subject of NTBs, Mr. Biegun said that two of the currently most onerous standards—OBD II and K-ULEV—were addressed, and said that "there is some convergence to the U.S. standards."<sup>491</sup> However, he noted that while the FTA addressed the current environment, this is an ever changing industry and that each new model of vehicle presents an "opportunity for decisions that can

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<sup>485</sup> Ibid.

<sup>486</sup> Biegun, testimony before the USITC, June 20, 2007, 209.

<sup>487</sup> Ibid., 210.

<sup>488</sup> Ibid.

<sup>489</sup> Ibid., 211.

<sup>490</sup> Biegun, "United States International Trade Commission's Hearing" written submission to the USITC, June 20, 2007.

<sup>491</sup> Biegun, testimony before the USITC, June 20, 2007, 239.

keep the products out.”<sup>492</sup> Mr. Biegun stated that to build a vehicle to a uniquely Korean emission standard would require sales in the tens of thousands to make sense from a business perspective, and that the low volume exemption encourages foreign automakers to take “the bird in the hand, rather than make the huge expenditure to get into the bush and see what else is out there for you.”<sup>493</sup> Mr. Biegun added that the combination of the low volume exemption, the potential for future standards that are not addressed in the FTA, and the fact that the new tax structure will still place a higher burden on the vehicles that Ford sells in Korea will encourage U.S. automakers to prefer a low-volume strategy. Mr. Biegun also touched on the anti-import bias in Korea, stating that, while it has been curtailed, “the fact that this agreement had to explicitly enshrine a commitment from the Korean government that it would cease and desist from such activity indicates that it is still a very real concern.”<sup>494</sup> On dispute resolution, Mr. Biegun stated that it is “practically impossible” for the U.S. government to recommend a snap back of U.S. tariffs, because U.S. and Korean government officials will be influenced by “exogenous factors while they are making the decision.”<sup>495</sup>

As an attachment to the Automotive Equipment and Capital Goods (ITAC 2) report, Ford Motor Co. provided its assessment of the FTA, noting that it is disappointed that the recommendation of the U.S. auto companies that any U.S. “tariff reductions for Korean vehicles imported into the U.S. be conditional on measurable, significant, and sustained opening of the Korean auto market” was not accepted by the USTR.<sup>496</sup> Ford stated that U.S. tariff elimination will result in a lopsided, immediate benefit to the Korean auto industry. Ford stated that some progress was achieved in the FTA with respect to nontariff measures, but noted that the automotive dispute settlement provisions put the burden of proof with U.S. exporters. Ford asserted that, at best, the agreement may only result in small volume opportunities for U.S. exporters while completely opening the U.S. market to Korean vehicle exports. Specifically with respect to tariffs, Ford noted that Korean automakers will be the immediate beneficiaries of the FTA tariff provisions, with an immediate estimated cost savings of up to 40 times that of U.S. automakers exporting to Korea, based on 2006 bilateral vehicle trade levels. Ford also pointed out that there are 1,300 Hyundai and Kia dealers in the United States, compared to one Ford dealer in Korea.

On the consumption tax, Ford stated that the FTA provisions reduce, but not eliminate, discrimination based on engine size. On the annual vehicle tax, Ford stated that, although the FTA provisions bring some improvement in the system, nearly all U.S. vehicles fall in the category with the highest tax category, and that the ultimate effect will be minimal. On the subway bond, Ford pointed out that the FTA merely caps the tax at the current level and continues to be applied based on engine size. On TBTs, Ford stated that the Korean system will continue to use a mix of U.S. and European safety and emission standards; the K-ULEV requirement was not eliminated (but, pending clarification, Ford believes that the trade-distorting effect of K-ULEV was removed); the OBD requirement was not eliminated but rather, a small volume exemption was permitted; and clarification is needed as to whether U.S. safety certified vehicles will be accepted as meeting all Korean safety regulations.

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<sup>492</sup> Ibid.

<sup>493</sup> Ibid., 241.

<sup>494</sup> Ibid., 243.

<sup>495</sup> Ibid., 291.

<sup>496</sup> ITAC (2) on Automotive Equipment and Capital Goods, *Advisory Committee Report*, April 27, 2007.

On the accelerated dispute settlement, Ford stated that the 2.5 percent auto tariff and the 25 percent light truck tariff should have been included in the snapback provisions, and that it has concerns with the requirements for bringing a case to dispute settlement. On rules of origin, Ford noted that, although its recommendation was not followed, it finds the three methods contained in the FTA acceptable. Finally, Ford requested that the U.S. government confirm in writing that content from Kaesong will not qualify as South Korean content, and that the 1995 and 1998 MOUs will remain in force.

In testimony before the Commission, Douglas Meyer of the United Auto Workers (UAW) stated that the UAW opposed the agreement. He reported that Korea, the fifth-largest vehicle producer and the third-largest vehicle exporter, has the lowest level of import penetration of any major automotive producing country in the world. He stated that the 1995 and 1998 MOUs were ineffective in opening the Korean market to imported vehicles, and that the U.S. automotive trade deficit with Korea grew particularly quickly after the 1998 MOU, even while the U.S. government was engaged in regular consultations with the Korean government. Mr. Meyer stated that the FTA will result in a surge of imports from Korea, large loss of automotive jobs in the United States, and an abandoning of Korean automaker plans for future manufacturing expansion in the United States. Mr. Meyer noted that Korean automakers have one manufacturing plant in the United States and one under construction, and said that these two plants will not be able to satisfy most of their sales in the U.S. market.

Specifically with respect to the FTA provisions, Mr. Meyer stated that the Koreans will be able “to continue the discriminatory taxes and other non-tariff barriers that it has used to keep its market closed. In addition, the special auto dispute resolution process is structured in a manner that would make it extremely difficult for the U.S. to prevail in any case against Korean non-tariff barriers.” Mr. Meyer noted that, in the agreement’s side letter on autos, Korea agreed to delay the application of selected non-tariff barriers and to allow limited volume exemptions for others. However, he said the agreement does not require Korea to eliminate all current NTBs, nor does it establish effective and enforceable mechanisms for addressing future NTBs. Mr. Meyer stated that the Automotive Working Group created in the agreement has no enforcement power to address barriers, and that the dispute resolution procedures would do little more than “expedite slightly the usual joint committee review and arbitration process.” Moreover, Mr. Meyer stated that, with respect to dispute resolution, “the burden should be on the Korean government to prove that its discriminatory taxes and other non-tariff barriers are not responsible for keeping out our products” and that the snapback remedy provision, which does not apply to the 25 percent truck tariff, is “toothless” and will do nothing to provide redress to the automakers and their employees.<sup>497</sup> At the Commission’s hearing, Mr. Meyer also said that the FTA allows Korea to maintain its own emission standards that are “essentially equivalent” to U.S. standards in certain instances, calling into question the effectiveness with which a dispute could be resolved.<sup>498</sup>

The report of the ITAC on Automotive Equipment and Capital Goods (ITAC 2)<sup>499</sup> stated that the committee is divided on its assessment of the FTA, and noted that separate reports from Ford Motor Co. and General Motors Corp. (GM) were attached to the committee report. The committee noted that in 2006, Korea exported over 700,000 cars, vans, and sport utility vehicles (SUVs) to the United States, while the United States exported just over 4,000 of

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<sup>497</sup> Meyer, “The United States-Korea Free Trade Agreement (KORUS FTA),” written submission to the USITC, June 20, 2007.

<sup>498</sup> Meyer, testimony before the USITC, June 20, 2007, 237.

<sup>499</sup> ITAC (2) on Automotive Equipment and Capital Goods, *Advisory Committee Report*, April 27, 2007.

these vehicles to Korea. The committee said that its recommendation that the agreement “precondition the phase-out of U.S. automotive tariffs on the demonstration of Korean automotive market openness in terms of improved import penetration that is on par with that of other OECD countries” did not result in a “performance metric approach.” The committee report said that written confirmation from the U.S. government is needed to confirm that 1) changes to the K-ULEV regulation make it identical to the California nonmethane organic gas (NMOG) requirement, and 2) the outcome with respect to self-certification ensures that, up to 6,500 vehicles per manufacturer, that U.S.-certified vehicles will be accepted as meeting Korean safety regulations.

In its separate statement attached to the ITAC 2 report, GM states that it is neutral on the FTA; GM noted that it believes that the agreement addresses the U.S. auto industry’s concerns, and that the dispute settlement mechanism provides a deterrent to future Korean NTMs. However, GM added that, given the current imbalance in bilateral trade, “the benefits will skew, for the near term, to Korea.” GM stated that the elimination of Korea’s 8 percent tariff will provide savings in and of itself, but also provide savings in the calculation of cascading vehicles taxes. With respect to taxes, GM remarked that Korea is “reducing its dependence on engine displacement as the basis for taxation and has reduced the overall tax burden on the auto sector.” GM adds that the tax provisions of the FTA “eliminate discrimination against imports.” Regarding TBTs, GM states that the K-ULEV requirements are sufficiently harmonized with California Low Emission Vehicle (LEV) II program, thus eliminating GM’s concern with OBD II. GM also notes that it is satisfied with the self-certification outcome. GM states that the snapback provisions are innovative and have the potential to discourage imposition of new NTMs or the reinstatement of old ones. GM is satisfied with the rules of origin, and requests written confirmation that the 1995 and 1998 MOUs remain in effect.

In its advisory report, the Labor Advisory Committee (LAC)<sup>500</sup> stated that FTA’s automotive provisions were disappointing. It notes that the United States had a \$13.4 billion trade deficit with Korea in 2006, \$11.7 billion of which was in autos and auto parts. LAC states that a five-point proposal submitted to the USTR and crafted jointly by labor, industry, and members of Congress, including a 15-year phaseout of U.S. tariffs, exclusion of the 25 percent truck tariff, tariff reduction incentives for opening the Korean market, enhanced safeguards, elimination of NTMs and suggestions for how to address future NTMs, was not accepted by negotiators. LAC asserts that the FTA’s automotive-related provisions “are unlikely to open the door for more than a handful of vehicles from U.S. auto companies.”

With respect to tariffs, LAC opposes any immediate reduction in U.S. tariffs, but rather supports making tariff reduction contingent on “verifiable and significant opening of the Korean auto market.” The truck tariff, LAC noted, should only be addressed in multilateral forums. LAC added that the FTA’s tariff provisions will lead to significant new imports of vehicles from Korea, as Korean automakers can easily ramp up production.

Regarding discriminatory taxes, LAC noted that the FTA does not eliminate the engine displacement-based tax system, and this would allow for discrimination between vehicles with engines below and above 1,000 cc. Regarding TBTs, LAC stated that the Automotive Working Group set up by the FTA does not appear to function differently from what

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<sup>500</sup> LAC for Trade Negotiations and Trade Policy, *Report*, April 27, 2007.

currently exists in the context of the WP-29,<sup>501</sup> and that labor unions do not have a role in the process. LAC noted that neither the negotiated confirmation letter nor the auto provisions will stop the Korean government from using technical standards to discriminate against imports.

Regarding dispute resolution, LAC noted the following concerns: (1) there is no allowance for participation by nongovernmental interested parties; (2) the threshold for stating an actionable claim is higher than for nonautomotive disputes; (3) the dispute panel does not utilize panelists with automotive knowledge and experience; (4) the provision for reimposition of U.S. tariffs would do nothing to open the Korean market and prevents the collection of duties that would offset the value of the damage to U.S. exports caused by Korean barriers; (5) only the 2.5 percent tariff can be applied if an actionable violation has occurred, and not the 25 percent light truck tariff; and (6) it is not clear how long safeguards may remain in place. LAC remarked that the safeguard provisions for autos are “practically useless,” because the snapback provision only allows reimposition of the 2.5 percent U.S. passenger vehicle tariff, which, to date, has posed no barrier to Korean vehicles.

In his written testimony to the Commission, U.S. Congressman Sander Levin of Michigan stated that he opposes the FTA. He said that Korea maintains an “economic iron curtain against all imported autos, using a powerful and extremely effective combination of tariffs, prohibitive and discriminatory taxes, and regulations designed specifically for the purpose of keeping imports out,” and that “the FTA as currently negotiated will simply lock in a structure of one-way trade . . . and allow the Korean auto industry to continue an export driven strategy using the profits from their protected home market to fund R&D and broader incursions into the US and other major markets.”

Regarding discriminatory taxes, Congressman Levin added that the FTA would merely require reductions in two of them and leave the third intact. Regarding existing nontariff barriers, he noted that four such barriers were identified by U.S. industry during the negotiations. Congressman Levin characterized the outcome as “delay of one onerous discriminatory regulation, delay of another with an exemption dependent on a low volume of sales, an artificial resolution of the third and no handling of the fourth.” Specifically with respect to the low-volume sales exemption, Congressman Levin stated that this is a “self-defeating” concession.

On the FTA’s special dispute-settlement provisions, Congressman Levin noted that “the only thing ‘innovative’ about it might be that the expedited structure assures failure sooner,” and that it will be even more difficult for a U.S. automaker to win a case under the FTA provisions than to win a case under WTO dispute settlement rules. Congressman Levin also noted that the automotive working group created under the FTA is not mandated to meet. He estimated that tariff reductions would amount to a savings of \$217 million for Korean automakers exporting to the United States, but only \$12 million for U.S. automakers exporting to Korea.<sup>502</sup>

In a written statement to the Commission, U.S. Senator Sherrod Brown of Ohio stated that he does not support the U.S.-Korea FTA because it “creates unbalanced benefits for Korean automakers at the expense of U.S. auto workers and manufacturers.” In particular, Senator

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<sup>501</sup> WP-29 is the World Forum for Harmonization of Vehicle Regulations. For more information, see <http://www.unece.org/trans/main/wp29/wp29wgs/wp29gen/wp29pub/wp29pub2002e.pdf>.

<sup>502</sup> Congressman Levin, “Testimony as Prepared for Delivery,” written submission to the USITC, June 20, 2007.

Brown expressed concern about the rules of origin in the agreement and said that as they have a local content threshold that provides “an incentive for auto parts makers from elsewhere in the region to circumvent their duties and access the U.S. market, duty-free, through the FTA. Senator Brown added that the FTA does not guarantee that the market access provisions will be stringently enforced. He noted the Korean government’s estimate that Korean auto exports will increase by \$1 billion. He also noted the lack of increased market access arising from the 1995 and 1998 MOUs, and that he believes that “objective and verifiable benchmarks,” which were proposed by U.S. industry and labor, are a better way to achieve broader market access in Korea.<sup>503</sup>

Hyundai Motor Co. expressed support for the FTA in a submission to the Commission, stating that it believes “the benefits of vehicle tariff reduction under the KORUS FTA will be mutual and fair.” Hyundai stated that, as a result of tariff and nontariff provisions of the FTA, U.S. automakers should be able to improve their price competitiveness and market share in Korea. Hyundai reported that establishing manufacturing operations in major markets, including the United States, is part of its overall strategy to become one of the world’s leading automakers, in recognition of “the value of investing where we sell our vehicles.” Hyundai pointed out that it is engaged in the entire vehicle design, engineering, manufacturing, and testing process in the United States. Hyundai added that the FTA will create further opportunities for Hyundai to expand its market presence in the United States, to the benefit of the U.S. economy and the U.S. consumer. Hyundai noted that it will benefit from the U.S. duty savings negotiated in the FTA, stating that tariff and other provisions in the FTA will “allow Hyundai and its dealers to provide U.S. consumers with more choice, more competitive products and better service.” Hyundai noted, however, that many of the vehicles it sells in the United States are made locally.<sup>504</sup>

At the Commission’s hearing, Korean Ambassador to the United States Lee Tae-sik stated that the U.S. automobile sector will benefit immensely from the U.S.-Korea FTA. Ambassador Lee said that the FTA ensures that U.S. automobiles would have a fair opportunity to compete in the Korean market through the elimination of Korea’s 8 percent tariff on most U.S. cars, reforms to its taxation system, revisions to nontariff barriers such as emission and safety standards, and strengthening of dispute-settlement mechanisms, including the creation of snapback provisions. He addressed what he described as three misconceptions concerning the Korean automobile sector.

First, he said that the Korean market is open to foreign automobiles. Although he noted imported vehicles (by number of vehicles sold in 2006) accounted for 4.5 percent of the Korean market and are sold at relatively high prices, he said that the foreign-vehicle market share based on value rose to 14 percent in 2006. He also said that foreign-owned car manufacturers and imported cars together account for 30 percent of the total domestic market in Korea, compared to OECD member countries’ average rates of 40 percent. Second, he said that Korea is not the principal source of the U.S. automobile deficit, as it represented only \$8.5 billion of the deficit and ranked fourth behind the EU’s \$22.9 billion, Canada’s \$25.1 billion, and Japan’s \$43.2 billion in 2006. Third, Ambassador Lee stated that allegations that the Korean government fosters a campaign discouraging purchases of foreign automobiles are “groundless.” He noted that Korean automakers Kia and Hyundai have invested billions in high-tech manufacturing plants in Georgia and Alabama, respectively,

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<sup>503</sup> Senator Brown, “Re: U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects,” written submission to the USITC, June 20, 2007.

<sup>504</sup> Shin, “Statement of Hyundai Motor Company on the U.S.-Republic of Korea Free Trade Agreement,” written submission to the USITC, June 27, 2007.



and said that these investments, which have created thousands of new jobs and benefits for U.S. workers, exemplify highly successful economic cooperation in this sector. In conclusion, Ambassador Lee stated that the FTA will provide momentum to increase growth in the U.S. automobile industry in the near future.<sup>505</sup>

## Medical Devices<sup>506</sup>

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### *Assessment*

The U.S.-Korea FTA would likely result in increased exports of medical devices to Korea by reducing or eliminating a number of tariff and NTMs. U.S. exporters would benefit from the immediate or phased elimination of tariffs, improved transparency in the reimbursement process, less complex regulatory approval policies, and measures to counter unethical practices in the medical device and pharmaceutical sectors.

Korea is an important market for U.S. exporters of medical technology, with U.S. firms accounting for over \$600 million, or approximately one-third of Korea's imported medical devices, in 2006.<sup>507</sup> The \$2.5 billion market for medical devices in Korea is forecast to grow at an annual rate of 10–15 percent over the next several years, “driven by improved health insurance for South Koreans, an aging population, and funding for new equipment to improve the country's medical infrastructure.”<sup>508</sup> With continued economic growth, Korea is expected to demand an even higher level of health care,<sup>509</sup> which could generate greater export opportunities for U.S. medical device manufacturers.<sup>510</sup> By addressing the tariff and nontariff issues affecting the sales and trade of medical devices, the U.S.-Korea FTA should enable U.S. manufacturers of such products to benefit from these export opportunities.

The FTA would eliminate remaining tariffs for U.S. medical device exports—immediately for most products or phased in within 3 years for other products. Tariff reductions for a few selected products, however, such as medical magnetic resonance imaging apparatus and ultrasonic scanning apparatus, would be phased in over 10 years. Unlike the United States, Korea was not a party to the Uruguay Round “zero-for-zero” tariff elimination initiative for medical devices;<sup>511</sup> thus Korea maintains tariffs ranging from 6.5 to 13 percent in important export categories for U.S. medical device manufacturers. These categories include a broad range of products such as general hospital supplies; intraocular lenses and other ophthalmic

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<sup>505</sup> Ambassador Lee, testimony before the USITC, June 20, 2007, 9–23.

<sup>506</sup> The products covered in this assessment represent approximately 7 percent of U.S. exports to Korea in the GTAP “machinery and equipment n.e.c.” sector and less than 2 percent of three other GTAP sectors, and represent approximately 4 percent of U.S. imports from Korea in the GTAP “machinery and equipment n.e.c.” sector and less than 1 percent of three other GTAP sectors, for 2006.

<sup>507</sup> Espicom Business Intelligence, “The Medical Device Market: Korea,” November 30, 2006, 1; and official statistics of the U.S. Department of Commerce.

<sup>508</sup> Diller, “Healthcare: Products and Supplies: Asia,” March 2007, 11; Gross and Minot, “Medical Device Registration in Korea: An Overview,” January 2007, 1; and USFCS, “Medical Equipment and Devices,” 53.

<sup>509</sup> USDOC, “Mission Statement: U.S. Healthcare Technologies Trade Mission: Taiwan, Korea and The Philippines,” 1–4; and USFCS, “Doing Business in Korea: A Country Commercial Guide for U.S. Companies,” 2006.

<sup>510</sup> Business Wire, “Medical Devices Market in South Korea is Favourable,” 1–2.

<sup>511</sup> The FTA tariff provision is consistent with U.S. objectives in the Doha Development Agenda to have all WTO members eliminate tariffs on health-care products. Current signatories to the Uruguay Round “zero-for-zero” initiative for medical devices include the United States, Japan, the EU, Iceland, Liechtenstein, Norway, Switzerland, Canada, and Singapore. Trade Reports International Group, “Eliminating Medical Tariffs,” February 27, 2007, 1–2.

goods; and high-technology medical, surgical, and dental instruments and appliances.<sup>512</sup> By eliminating tariffs, the FTA should make U.S.-made medical devices more cost-competitive with those of Korean and foreign competitors.

The FTA contains a specific pharmaceuticals and medical devices chapter<sup>513</sup> that addresses NTMs in Korea such as reimbursement, regulatory,<sup>514</sup> and unethical business practices.<sup>515</sup> For instance, the chapter details the creation of an independent review mechanism<sup>516</sup> that would allow medical device manufacturers to challenge the Korean government's pricing and reimbursement decisions for medical devices.<sup>517</sup> Further, regulatory cooperation would be promoted by encouraging each party to recognize the results of certification and testing completed in the other party's territory.<sup>518</sup> Unethical practices by pharmaceutical and medical device manufacturers or suppliers are discouraged by prohibiting them from providing incentives to health-care professionals or health-care institutions<sup>519</sup> for listing, purchasing, or prescribing drugs or devices eligible for reimbursement by central government health-care programs.<sup>520</sup>

The FTA would establish a medicines and medical devices committee cosponsored by the health and trade officials of each party to monitor and support the implementation of the obligations in the chapter.<sup>521</sup> U.S. medical device manufacturers should also benefit from the provisions of the FTA's TBT chapter, which would reduce duplication, provide more transparency, and encourage the use of international standards in Korea's regulatory approval process.<sup>522</sup> By addressing all of these issues, the FTA would likely lead to a decrease in the price and an increase in the quantity of U.S.-made medical devices in Korea.

According to industry experts, Korea currently maintains nontransparent reimbursement and pricing policies<sup>523</sup> in its government-administered health-care insurance system that discriminate against U.S. and other foreign manufacturers of medical devices and insufficiently reward their innovation.<sup>524</sup> U.S. industry officials report that regulations issued

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<sup>512</sup> AdvaMed, testimony before the Trade Policy Staff Committee, Office of the USTR, March 14, 2006, 1–11.

<sup>513</sup> For additional information on a summary of the pharmaceuticals and medical devices chapter of the FTA, see chap. 2 of this report and the pharmaceuticals section of this chapter.

<sup>514</sup> USKBC and the AMCHAM in Korea, U.S.-Korea Free Trade Agreement Position Paper, 2006, 20.

<sup>515</sup> Inside Washington Publications, "U.S., Korea FTA Contains Strong PhARMA Text, Excludes Kaesong," April 3, 2007, 1.

<sup>516</sup> Ambassador Lee, testimony before the USITC, June 20, 2007, 17; and USTR, "Trade Facts: Free Trade with Korea Summary of the U.S.-Korean FTA." Washington, DC: USTR, April 2007, 5.

<sup>517</sup> May, testimony before the USITC, June 20, 2007, 288–289; Stangarone, "Anatomy of a Deal: The KORUS FTA," 1; and Inside Washington Publications, "U.S., Korea FTA Contains Strong PhARMA Text, Excludes Kaesong," April 3, 2007.

<sup>518</sup> USTR, "Final - United States - Korea FTA Texts," 2007, Article 5.6.

<sup>519</sup> Reis, testimony before the USITC, June 20, 2007, 28; and May, testimony before the USITC, June 20, 2007, 287.

<sup>520</sup> USTR, "Final - United States - Korea FTA Texts," 2007, Article 5.5.

<sup>521</sup> *Ibid.*, Article 5.7; Ambassador Lee, testimony before the USITC, June 20, 2007, 17; and May, testimony before the USITC, June 20, 2007, 189.

<sup>522</sup> For additional analysis regarding TBTs and other NTMs, see chap. 5 of this report.

<sup>523</sup> The Korean government sets prices even for services and products for which it does not provide reimbursement. Diller, "Healthcare: Products and Supplies: Asia," March 2007, 32.

<sup>524</sup> Diller, "Healthcare: Products and Supplies: Asia," March 2007, 23; Gross and Weintraub, "Medical Device Reimbursement in Korea," July 2005, 1; and AdvaMed, testimony before the Trade Policy Staff Committee, Office of the USTR, March 14, 2006, 1–11.

by the Ministry of Health and Welfare reportedly show a bias toward domestic products.<sup>525</sup> For instance, reimbursement prices for imported products are capped based on documented free on board (FOB) prices, while the reimbursement levels for domestic manufacturers and distributors are negotiated based on self-generated and often undocumented manufacturing cost data.<sup>526</sup> According to industry experts, the imposition of arbitrary price limits on medical technology constitutes a practice that does not adequately reflect the market costs of doing business in Korea, the high costs associated with research and development, or the medical and economic benefits of innovative medical technology.<sup>527</sup> The FTA would address these issues by increasing the transparency of the Korean National Health Insurance reimbursement system for medical devices. The program establishes prices for those products.

Medical devices also are reportedly subject to overly complex and costly certification, testing, inspection, and other regulatory approval requirements in Korea.<sup>528</sup> Many manufacturers claim that the Korea Food and Drug Administration (KFDA) rules, requiring them to submit detailed data on certain medical products, are excessive and delay market access.<sup>529</sup> Further, according to industry analysts, Korean regulatory authorities do not allow medical devices into the country that have not been approved in their country of manufacture,<sup>530</sup> a duplicative requirement not faced by Korean producers.<sup>531</sup>

KFDA also requires reregistration of all medical device production transferred to a manufacturing site outside of its original country of origin.<sup>532</sup> This reregistration is equivalent to a new registration. The U.S. industry would like Korea to expand existing licenses to cover dual sites and permit notification of the change to KFDA without the need for reregistration.<sup>533</sup> Eliminating the need for reregistration may be possible if Korea introduces and adopts a verifiable and enforceable Good Manufacturing Practices paradigm consistent with international standards, which the United States hopes would happen sometime in 2007.<sup>534</sup>

Widespread use of unethical business practices in the Korean health-care system continues to be a significant problem reported in the Korean market for some medical devices.<sup>535</sup> Major contributors to the problem are the complex distribution system and lack of transparency in the government decision-making process, which leads to improper practices by wholesalers and distributors.<sup>536</sup> By providing more transparency and predictability in Korea's medical

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<sup>525</sup> AdvaMed, testimony before the Trade Policy Staff Committee, Office of the USTR, March 14, 2006, 1–11.

<sup>526</sup> U.S. industry officials, interview by Commission staff, May 4, 2007.

<sup>527</sup> Gross and Weintraub, "Medical Device Reimbursement in Korea," July 2005, 1–2; and AdvaMed, testimony before the Trade Policy Staff Committee, Office of the USTR, March 14, 2006, 1–11.

<sup>528</sup> EIU, "Country Commerce: South Korea," July 2006, 106; and Gross and Minot, "Medical Device Registration in Korea: An Overview," January 2007, 1–4.

<sup>529</sup> WTO, Trade Policy Review Body (TPRB), "TPR, Republic of Korea, Report by the Secretariat," September 17, 2004, 59.

<sup>530</sup> Gross and Minot, "Medical Device Registration in Korea: An Overview," January 2007, 1.

<sup>531</sup> U.S. industry officials, telephone interviews by Commission staff, May 22–23, 2007.

<sup>532</sup> USTR, *2007 National Trade Estimate Report on Foreign Trade Barriers*, April 2007, 370.

<sup>533</sup> U.S. industry officials, telephone interviews by Commission staff, May 22–23, 2007; and USTR, *2007 National Trade Estimate Report on Foreign Trade Barriers*, April 2007, 370.

<sup>534</sup> USTR, *2007 National Trade Estimate Report on Foreign Trade Barriers*, April 2007, 370.

<sup>535</sup> *Ibid.*

<sup>536</sup> U.S. industry officials, telephone interviews by Commission staff, May 22–23, 2007.

device pricing, reimbursement, and regulatory policies, the FTA should lessen the opportunities and incentives for engaging in unethical business practices.<sup>537</sup>

An analysis of international price and quantity data comparing Korean imports to other comparable countries indicates that the potential effect of NTMs on Korean imports may be to restrict the quantity of imports or raise the price of imports for medical devices. As box 3.5 suggests, U.S. exports of ultrasound scanning apparatuses may be affected not only by tariffs, but by NTMs as well. Implementation of the NTM-related provisions of the FTA will likely be critical for U.S. exporters to fully realize the gains in market access for medical devices.

### ***Views of Interested Parties***

Three industry associations, the Advanced Medical Technology Association (AdvaMed), the Pharmaceutical Research Manufacturers of America (PhRMA), and the National Electrical Manufacturers Association (NEMA), each provided information regarding the U.S.-Korea Free Trade Agreement in various news releases and statements. In a news release, AdvaMed states that the FTA demonstrates Korea's commitment to increasing access for its citizens to innovative medical technologies and that it supports the establishment of the Medicines and Medical Devices Committee.<sup>538</sup> Further, AdvaMed added that Korea is an important market for U.S. medical technology companies, where U.S. manufacturers exported more than \$670 million worth of medical technology products to Korea.<sup>539</sup>

In addition, PhRMA, along with several U.S. industry officials, stated that, to achieve the FTA's goals, it recommends that the U.S. government closely monitor the full and effective implementation of Korea's FTA commitments and continue to work with Korea regarding its reimbursement system.<sup>540</sup> Lastly, in an issue brief, the National Electrical Manufacturers Association (NEMA), which represents medical imaging and other electrical manufacturers, reports that the FTA's market access provisions will improve sales opportunities in Korea for its members.<sup>541</sup>

In its report on the FTA, the ITAC for Chemicals, Pharmaceuticals, and Health/Science Products & Services (ITAC 3), which represents a wide range of U.S. health-care manufacturers, states that it is pleased that remaining tariffs will be removed on medical equipment.<sup>542</sup> The report states that committee members believe that the pharmaceuticals and medical devices chapter contains a number of important improvements to Korea's regulatory

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<sup>537</sup> Reis, testimony before the USITC, June 20, 2007, 28; and USTR, *2007 National Trade Estimate Report on Foreign Trade Barriers*, April 2007, 370.

<sup>538</sup> AdvaMed, "AdvaMed Welcomes U.S./Korea Free Trade Agreement (April 3, 2007)," 1.

<sup>539</sup> Ibid.

<sup>540</sup> U.S. industry officials, interview by Commission staff, May 16, 2007; and PhRMA, "PhRMA Statement on the U.S.-Korea Free Trade Agreement (April 3, 2007)," 1.

<sup>541</sup> NEMA, "Issue Brief: US-South Korea Free Trade Agreement," April 2007, 1.

<sup>542</sup> ITAC (3) on Chemicals, Pharmaceuticals, Health/Science Products and Services, *Advisory Committee Report*, April 24, 2007, 13.

**Box 3.5 Potential price and quantity effects of NTMs on ultrasound scanning apparatus (HS 901812)**

Firms seeking to export to Korea have identified a variety of NTMs that may have impeded their access to the market for medical equipment, including opaque pricing and reimbursement policies, overly complex and costly regulatory requirements, and unethical business practices (see text). These measures may restrict the quantity of imports into the Korean market, raise the price of imports, or both.

Korean imports of this product, in quantity terms, are substantially lower than imports of the same product into most other economies, relative to the size of the Korean economy. Korea's import unit value for imported ultrasonic scanning apparatus is substantially higher than the import unit value for most other countries. Existing tariffs of 8 percent ad valorem appear to be too low to account by themselves for either the relatively low quantity of imports or the relatively high price of imports. This relatively low quantity and relatively high price of imports may be reflective of the effects of NTMs, but could also be influenced by such factors as market structure, product differentiation, and consumer preferences.

Korean imports of ultrasonic scanning apparatus in 2003–05 were 0.0028 units per million \$ GDP, as compared to a median of 0.012 units among 23 comparable countries. Korea ranks twenty-second out of the 23 comparable countries in imports relative to the size of its economy, with only Thailand ranking lower. The number of comparison countries is limited because some countries measure imports in kilograms or other units.

The Korean average import price from the United States during 2004–06, was \$31,733 per ultrasonic scanner, which is 48 percent higher than the U.S. export price to the world of \$21,450. The Pharmaceuticals and Medical Devices and TBT chapters of the FTA are intended to address some of these NTMs (see chapter 5 of this report for additional information on TBT provisions and appendix D for a summary of the FTA chapter on Pharmaceuticals and Medical Devices).

For further information on the calculation and interpretation of the quantity and unit-value information reported above, see appendix J.

Source: See app. J for data sources; USITC staff analysis.

and reimbursement systems concerning access to innovation, imposition of an independent appeals process, increased transparency and accountability, and maintenance of ethical business practices to ensure a level playing field.<sup>543</sup> The report, however, says that the committee believes that substantial work remains to ensure full implementation of the FTA's provisions to address the challenges that innovative medical device and pharmaceutical firms face in gaining fair access to the Korean market.

In its report, the ITAC on Small and Minority Business (ITAC 11) states that it believes the chapter on pharmaceuticals and medical devices will expand opportunities for small businesses in the medical device industry.<sup>544</sup> Finally, the Intergovernmental Policy Advisory Committee noted that it is pleased that state-level Medicaid programs are excluded from coverage of the chapter on pharmaceuticals and medical devices, which applies only to central-level government health-care programs.<sup>545</sup>

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<sup>543</sup> Ibid., 16.

<sup>544</sup> ITAC (11) on Small and Minority Business, *Advisory Committee Report*, April 26, 2007, 4.

<sup>545</sup> IGPAC, *Advisory Committee Report*, April 24, 2007, 23.



# CHAPTER 4

## Impact of Market Access Provisions for Services

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This chapter assesses the potential effect of the U.S.-Korea FTA on the services sector and services trade. The analysis first focuses on cross-border trade in services<sup>1</sup> generally, and then discusses financial, telecommunications, professional, and audiovisual services specifically.

### FTA Chapter 12—Cross-Border Trade in Services

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#### *Assessment*

The trade-in-services provisions of the U.S.-Korea FTA would provide U.S. firms levels of market access, national treatment, and regulatory transparency that exceed those afforded both by Korea's commitments under the GATS, the first legally enforceable agreement on trade in services, and by de facto market conditions for U.S. services firms.<sup>2</sup> The effect of FTA disciplines on overall bilateral services trade would likely be greater than other recent FTAs, because Korea's services market is large (box 4.1). Restrictions in Korea pertaining to numerous services industries would, however, remain in place after the FTA enters into force.<sup>3</sup>

Overall, the Korean services market is less open to foreign services firms than the U.S. market.<sup>4</sup> Currently, the Korean market is relatively open to U.S. cross-border services exports but relatively closed to U.S. services firms operating on a commercial-presence basis; i.e. selling services through a U.S.-owned affiliate located in Korea. Direct measures of the competitive position of U.S. services firms relative to foreign country counterparts are not available, but indirect measures indicate that, on a commercial-presence basis, U.S. services firms are on roughly equal footing with EU services firms. Korea is the seventh-largest cross-border export market for U.S. services firms.<sup>5</sup> Relative to its GDP, Korea consumes a moderate amount of U.S. cross-border exports, importing more U.S. services

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<sup>1</sup> The term "cross-border trade," as used in this chapter, indicates that services, service suppliers, or service consumers have crossed national boundaries to affect trade. The term is intended to differentiate these modes of delivery from delivery through affiliates located in the country of the consumer.

<sup>2</sup> WTO, "General Agreement on Trade in Services, Republic of Korea, Schedule of Specific Commitments," April 15, 1994. Prior to the U.S.-Korea FTA, the GATS governed the rights and obligations that U.S. service providers had in Korea. The Commission, therefore, uses Korea's GATS commitments as a baseline from which to measure the benefits of the FTA.

<sup>3</sup> It is not possible to establish an overall quantitative measure of the effect of the U.S.-Korea FTA on trade in services because of the unavailability of necessary data. Using methodology developed by the Commission, however, a quantitative measure of impediments to banking services is presented in the financial services assessment in this chapter and in app. H of this report.

<sup>4</sup> Reis, testimony before the USITC, June 20, 2007.

<sup>5</sup> USDOC, BEA, "International Economic Accounts," July 16, 2007.

**Box 4.1** Profile of services industries in Korea and the United States

The Korean services industry is generally less developed, less productive, and less liberalized than the U.S. services industry. It is characterized by lower labor productivity in virtually all subsectors compared to counterparts in the United States and other advanced economies such as Germany, France, and Japan. A liberalization index constructed by Lee and Lee based on the GATS schedules of Korea and the United States indicates that the U.S. services sectors are more liberalized than Korean services sectors in virtually every area except for tourism, where the two countries are equally liberalized, and transport, where the Korean market is slightly more liberalized than the U.S. market.

The services sector in Korea accounted for 56 percent of the country's GDP and 65 percent of total employment in 2005, the latest year for which data are available. The largest service sectors in Korea are financial services, real estate and rental services, and wholesale and retail services respectively. Korea posted a services trade deficit in that year, as shown in the table below. Services accounted for 14 percent of Korea's overall exports, with the transportation sector predominating.

The U.S. services sector accounted for 77 percent of U.S. GDP in 2004 (latest year available from source consulted) and 78 percent of total employment in 2005.<sup>1</sup> The largest service sectors in the United States are real estate and rental and leasing services, wholesale and retail services, and financial services, respectively. The United States is the world's largest services exporter. Sales of services by foreign affiliates of U.S. parent firms, the value of which has exceeded that of U.S. cross-border services since 1996, totaled \$489.6 billion in 2004 (latest available). Such sales follow U.S. direct investment in foreign markets, and in part reflect the degree to which foreign markets are open to U.S. services firms.

Cross-border trade in services with all trading partners by the United States and Korea, 2005 (*million U.S. dollars*)

Service industry	United States			Korea		
	Exports	Imports	Trade balance	Exports	Imports	Trade balance
Total services	376,788	314,575	62,213	45,375	58,467	-13,092
Passenger transport	20,930	26,070	-5,140	2,488	1,517	971
Freight transport	17,340	44,160	-26,820	18,352	7,831	10,521
Other transport	24,910	17,950	6,960	3,043	10,619	-7,576
Travel and tourism	102,010	73,560	28,450	5,660	15,314	-9,654
Other services <sup>a</sup>	211,600	152,840	58,760	15,831	23,187	-7,356

Source: IMF, *Balance of Payments Statistics Yearbook*, 2006, part 1, 525, and 1,018.

Note: Because of the calculation routines used by the IMF, there may be rounding differences between an aggregate and the sum of its components.

<sup>a</sup>Included in "other services" are communications; construction; insurance; financial; computer and information; royalties and license fees; other business; personal, cultural, and recreational; and other government.

Sources: Lee and Lee, "Feasibility and Economic Effects of a Korea-U.S. FTA," December 30, 2005; World Bank, *World Development Indicators*; Bank of Korea, Republic of Korea, "National Accounts." ECOS—Economic Statistics System; USDOC, BEA, *Survey of Current Business*, October 2006; USDOC, BEA, "Gross Domestic Product by Industry Accounts"; and IMF, *Balance of Payments Statistics Yearbook*, 2006.

<sup>1</sup> World Bank data on services used here differ from services data reported by the U.S. Bureau of Economic Analysis (BEA) in that World Bank data include public sector figures, but do not include construction or utilities data, while BEA data exclude government data but include construction and utilities data.



relative to GDP than do China, Japan, France, and Germany but relatively less than the United Kingdom, Canada, Mexico, and Switzerland.<sup>6</sup>

On a commercial presence basis, the Korean services market is relatively closed. In a sample of nearly 5,000 mid-to large-sized services firms operating in Korea,<sup>7</sup> 98 percent are owned by Korean individuals or firms.<sup>8</sup> Of the 2 percent of services firms that are foreign owned, 35 firms are U.S.-owned, 31 are EU-owned, and 22 are owned by investors from other countries, primarily Japan and Switzerland. The provisions of the FTA may increase U.S. firms' competitiveness relative to other foreign services suppliers that have not yet entered into a trade agreement with Korea.<sup>9</sup>

Improvement in U.S. firms' access to the Korean market under the FTA is attributable in part to the use of a "negative list" approach in the agreement. Under this approach, all disciplines included in FTA chapter 12 would automatically cover all services industries and industry segments except for those specifically exempted in FTA Annexes I through III on nonconforming measures (NCMs) (see appendix tables I.1 and I.2), other FTA chapters, and side letters.<sup>10</sup> Use of the negative list approach extends the disciplines found in the services chapters of the FTA to a number of services for which Korea scheduled limited or no commitments under the GATS, including those yet to be offered commercially.<sup>11</sup> For instance, Korea elected to make no GATS commitments in sporting and other recreational services and limited GATS commitments in research and development services other than marine research, but did not exempt these services from FTA disciplines. Consequently, U.S. providers of such services would be entitled to unrestricted market access, nondiscriminatory regulatory treatment, and improved transparency under the terms of the FTA, compared to the situation under the GATS. Korea has highlighted improvements it made in the FTA over the GATS via the negative listing approach on research and development, travel, tourism, and several business services.<sup>12</sup> The trade liberalizing effect of negative listing is moderated only by the relatively large number of NCMs listed by Korea.

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<sup>6</sup> Ibid.; World Bank, "WDI and GDF Online"; and Commission staff calculations.

<sup>7</sup> Companies with at least 7 billion won (\$US 7.5 million) in total assets. Only firms with an identifiable ultimate owner controlling at least 25 percent of equity are included in this sample. Data were obtained from Orbis, a large international database that compiles financial and ownership information on public and private firms.

<sup>8</sup> By comparison, 18 percent of U.S. firms and 40 percent of UK firms were foreign in samples obtained using similar methodology.

<sup>9</sup> The EU and Korea commenced FTA negotiations in May 2007. The European Free Trade Association, of which Switzerland and three other non-EU European countries are members, entered into an FTA with Korea in September 2006. MOFAT, Republic of Korea, "Bilateral Trade Relations."

<sup>10</sup> NCMs are trade measures which do not conform to the disciplines of the agreement. The United States has specified six services industries for which it currently maintains cross-border NCMs, whereas Korea specified 44 services industries subject to cross-border NCMs. The Korean services sectors subject to NCMs are subject to equal or greater restrictions under the GATS, thus the impact on U.S. services exports resulting from these NCMs relative to current situation is likely to be small. Additionally, due to the openness of the U.S. market, the impact of these measures on U.S. imports is also likely to be small.

<sup>11</sup> The negative list approach tends to yield greater market access and transparency than the positive list approach employed in GATS, wherein market access and national treatment apply only to the provision of specifically listed services. Under a positive list approach, the extension of trade disciplines to newly created services would have to be negotiated individually.

<sup>12</sup> USTR, "Final - United States - Korea FTA Texts," 2007, Appendix II-A, 53-4, 2007.

## ***Summary of Provisions***<sup>13</sup>

Chapter 12 of the FTA covers measures of the parties that affect cross-border services other than financial services, air transport, and gambling and betting services.<sup>14</sup> The FTA would guarantee national and MFN treatment for providers of the covered services, and it includes measures adopted or maintained by all levels of government, as well as certain nongovernmental bodies. Commercial presence is not required, and regulation of services and qualification requirements may not be unduly burdensome. Chapter 12 also includes regulatory transparency provisions beyond those delineated in the transparency chapter,<sup>15</sup> which would lay out requirements for the publication of proposed regulations and the input of interested parties.<sup>16</sup> The parties would be permitted, but not required, to recognize education, experience, licenses, or certifications obtained in particular nonparty countries. As to market access, the chapter would bar measures that impose specific limitations, such as numerical limits on the number of suppliers of a service.

The parties would commit to permit unfettered transfers and payments relating to the cross-border supply of services, and must allow such transactions to occur in a freely usable currency at the prevailing exchange rate on the date of transfer, subject to explicit exceptions. The benefits of this chapter may be denied under limited circumstances if the service supplier is controlled by persons of a nonparty.

FTA chapter 12 includes specific language on express delivery services that defines the scope of coverage, confirms the desire to maintain market access no less favorable than that in effect when the FTA was signed, and delineates the relationship between covered services and each party's postal monopoly.<sup>17</sup> Additionally, two side letters express Korea's intention to reform its postal system to reduce the number of services, including international delivery, that may be provided solely by the Korean Postal Authority. The side letters also state that Korea would, over time, ensure independent regulation of the postal and express delivery systems.

Annex 12-C of the agreement would provide for consultations between the parties regarding NCMs maintained by regional levels of government. Finally, a side letter included would clarify that various regulations currently maintained by the parties are not inconsistent with the agreement. These regulations include the prohibition of holding more than one license to provide multiple services and various regulations governing educational institutions and rail transportation.

## ***Views of Interested Parties***

Overall, U.S. industry representatives expressed satisfaction with the FTA provisions on services and transparency. An industry representative views the FTA commitments regarding

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<sup>13</sup> For additional information on summary of provisions related to professional services and audiovisual services, see the "Professional Services" and "Audiovisual Services" sections.

<sup>14</sup> Gambling and betting services are excluded due to provisions included in a side letter. Air transportation is covered by a separate bilateral "open skies" agreement. See <http://www.state.gov/e/eeb/tra/c661.htm> for additional information.

<sup>15</sup> For additional information on the FTA chap. 21 covering transparency, see chap. 6 of this report.

<sup>16</sup> USTR, "Final - United States - Korea FTA Texts," 2007, Chapter 12 Article 12.8, 12-4.

<sup>17</sup> *Ibid.*, Chapter 12 Annex 12-B, 12-11.

services as a substantial improvement over Korea's GATS commitments or its offered commitments under the Doha Round.<sup>18</sup>

In its report, the Industry Trade Advisory Committee on Services and Finance Industries (ITAC 10) stated that the FTA will provide a favorable environment for cross-border services trade, opening many previously closed Korean sectors to U.S. services suppliers and investors.<sup>19</sup> The ITAC 10 report supports provisions that allow the U.S. to benefit from any trade concessions made to other countries with which Korea may negotiate FTAs and the strategic implications of the FTA on U.S. economic relations with other countries in the region.<sup>20</sup> On an industry-specific basis, the ITAC 10 report states that the FTA chapters on investment, government procurement, cross-border trade in services, and regulatory transparency provide a framework that can increase opportunities in Korea for U.S. energy services firms, despite the lack of domestic energy reserves and the stalling of privatization plans in the Korean gas distribution and electricity sectors.<sup>21</sup>

The Industry Trade Advisory Committee on Distribution Services for Trade Policy Matters (ITAC 5) said in its report that the FTA would generate new opportunities for U.S. distribution firms, but would continue to be hampered by tariff and nontariff barriers imposed on goods imported from their global supply networks.<sup>22</sup>

In particular, an industry representative stated that she is encouraged by the potential for substantial increases in U.S. cross-border exports and affiliate sales given the large size of Korea's economy and the relatively restricted nature of the Korean services sectors prior to the agreement.<sup>23</sup> An additional industry source said that Korea currently maintains an "intrusive and nontransparent regulatory regime."<sup>24</sup> This situation is of particular concern to services industries, which tend to be heavily regulated. The FTA seeks to address these concerns by providing for a more transparent regulatory system. The express delivery industry expressed support for the FTA at the Commission's public hearing.<sup>25</sup> The industry representative said that, although the industry has de facto market access rights, the FTA would provide legally enforceable market access and national treatment rights. He also noted that the FTA would provide a 4-hour customs clearing target, which he said would be superior to the 6-hour customs clearing target included in previous FTAs.

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<sup>18</sup> Goyer, testimony before the USITC, June 20, 2007. Goyer represented the U.S. Coalition of Service Industries, an advocacy organization representing the interests of approximately 40 large services firms.

<sup>19</sup> ITAC (10) on Services and Finance Industries, *Advisory Committee Report*, April 25, 2007. ITAC 10 represents approximately 30 service providers.

<sup>20</sup> Ibid.

<sup>21</sup> Ibid.

<sup>22</sup> ITAC (5) on Distribution Services for Trade Policy Matters, *Advisory Committee Report*, April 25, 2007.

<sup>23</sup> U.S. industry representative, telephone interview by Commission staff, May 31, 2007.

<sup>24</sup> Reis, testimony before the USITC, June 20, 2007. Reis represented the U.S.-Korea Business Council and the U.S. Chamber of Commerce.

<sup>25</sup> Min, testimony before the USITC, June 20, 2007. Min represented the Express Delivery and Logistics Association.

## FTA Chapter 13—Financial Services

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### *Assessment*

The financial services provisions of the U.S.-Korea FTA would likely lead to increased penetration of the Korean market by U.S. firms. Particularly important Korean liberalizations bound by the FTA enable cross-border provision of insurance and asset management services, full establishment rights for U.S. financial services firms, and the ability to transfer customer data into and out of Korea. Another important provision would permit U.S. portfolio managers to provide services to both mutual funds and pension funds in Korea. The negative list approach adopted in the FTA is also considered especially beneficial to U.S. financial services firms, as they tend to compete through introduction of innovative new products.<sup>26</sup> Industry representatives consider Korea to be a significant market for U.S. financial services firms,<sup>27</sup> and state that these sector liberalizations and resulting reforms bound by the Agreement would result in sizeable new cross-border exports of financial services and investment by U.S. firms. Significant new imports of financial services from Korea are not expected in the near term because the U.S. financial services market is already generally open.

### **Financial Services—Except Insurance**

The FTA would likely generate a substantial increase in U.S. exports of banking, securities, and asset management services to Korea. Although cross-border exports to Korea in 2005 accounted for just 1 percent (\$344 million) of total U.S. exports of financial services,<sup>28</sup> the anticipated absolute effect of the FTA would be significant due to the size of the Korean market and the country's expressed desire to become a regional financial hub (see box 4.2). Comparatively speaking, Mexico,<sup>29</sup> which has a comparable GDP, is also an OECD member, and already has an FTA with the United States, imported \$547 million of U.S. financial services in 2005.<sup>30</sup> The FTA text represents a significant improvement over Korea's current GATS bindings. The Commission estimates that the tariff equivalent (TE) of Korea's remaining nontariff impediments to banking services stands at 29 percent under the terms of the FTA, which is less than one-half of the estimated 76 percent TE consistent with Korea's GATS bindings. The TE decline reflects, among other things, the removal of certain restrictions on investment, cross-border supply, and product range (box 4.3 and appendix H).

The FTA would not likely have a significant effect on U.S. imports of financial services from Korea, as the market for U.S. financial services is already fairly open and highly competitive, and Korean banks currently have a small presence. As of December 2006, Korean banks in the United States held \$4.4 billion in assets, less than 1 percent of total

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<sup>26</sup> Reis, testimony before the USITC, June 20, 2007, 27.

<sup>27</sup> USKBC and the AMCHAM in Korea, U.S.-Korea Free Trade Agreement Position Paper, 2006.

<sup>28</sup> USDOC, BEA, *Survey of Current Business*, October 2006, 57.

<sup>29</sup> Mexico was chosen for comparative purposes because of the similar size of its GDP, and because the country already has an FTA with the United States, which may serve as an indicator for a potential increase in financial services trade. Geographic proximity is not as relevant to services trade as it is to trade in goods.

<sup>30</sup> USDOC, BEA, *Survey of Current Business*, October 2006, 57.

**Box 4.2** Financial services: Competitive conditions

The Korean banking industry was the world's nineteenth largest in 2005, with \$676 billion in assets, or less than 1 percent of the global total. By contrast, U.S. banks account for the largest share of world assets (15 percent) valued at \$59.7 trillion in 2005, and are very competitive in open markets. Since 2003, the Korean government has undertaken financial-sector reform measures toward the goal of turning Korea into a regional financial hub by 2020. As such, the financial sector has undergone consolidation and become more accessible to foreign firms. Foreign investors currently own an estimated 40 percent of Korea's banking sector, including two of the country's official national commercial banks, which are owned by Citigroup (U.S.) and Standard Chartered Bank (UK). In 2006, the top ten foreign banks operating in Korea, three of which were U.S. firms, controlled 25 percent of the commercial banking market. Despite the regulatory reforms, however, foreign firms still have difficulty achieving the same level of market penetration as their domestic counterparts, partly due to remaining regulatory hurdles, and partly due to cultural issues.

The insurance industry in Korea is the second largest in Asia, following Japan, in terms of premiums written. In 2006, life and non-life insurance premiums were valued at \$33.5 billion and \$14 billion, respectively. The life insurance sector is highly consolidated, with the top three firms accounting for 74 percent of the market. Foreign firms, the most prominent of which include Allianz First Life (Germany), ING (Netherlands), and Prudential (U.S.), hold an estimated 10 percent of market share. In the nonlife sector, the three largest firms hold 54 percent of the market, and foreign participation is minimal, at less than one percent.

*Sources:* EIU, "Country Finance: South Korea," February 2007; and EIU, "South Korea: Financial Services Profile," January 5, 2007.

**Box 4.3** The interpretation of tariff equivalents<sup>1</sup>

The Commission estimated the tariff equivalent (TE) for banking services consistent with Korea's current GATS commitments on banking to be 76 and its latest Doha Round GATS offer to be 59 percent. The Commission estimated that the TE associated with Korea's commitments in the FTA is reduced to 29 percent. Tariff equivalents are a measure of the percentage increase in prices due to trade impediments relative to the prices that would exist in the absence of trade restrictions. The decline in the TE represents both the lowering of barriers to entry and barriers to operation for U.S. firms in Korea and the lowering of the price of banking (intermediation) services.

Specifically, the decline in the TE from the GATS Uruguay Round commitments reflects decreased barriers to the acquisition of existing Korean firms, reduced residency requirements for senior executives, and the elimination of minimum investment restrictions for foreign direct investment. Further reductions in the TE from the GATS Doha Round offers to the FTA reflect the reduction of restrictions in the cross-border supply of certain financial information services, the elimination of Mode 2 restrictions on Koreans' consumption of banking services outside Korea, and the increased ability of foreign banks to offer a full range of financial products. The reduction in Korea's TE in the banking sector applies only to U.S.-based financial institutions. As such, U.S.-based financial institutions may realize a competitive advantage in the Korean market relative to financial institutions based in third-country markets.

The Commission estimated the price effects of trade barriers on net interest margins (NIMs), which are the spread between lending and deposit interest rates, using a two-stage econometric model. The first stage of the model-corrected NIMs for the effects of prudential regulations, which promote the stability of the financial system but increase the price of banking services. This first-stage model incorporated firm-level data from 1,400 banks in over 50 countries, including Korea. The second stage of the model isolated the effects of trade restrictions after controlling for a number of country-level market variables. The Commission used GATS schedules and the FTA text, including the annexes on nonconforming measures, to identify trade restrictions. The Commission assigned scores to market access and national treatment commitments on the seven activities defined as banking services in the GATS. The services included deposit taking and lending services, as well as fee-based services.

<sup>1</sup> The tariff equivalents estimated here are not directly comparable to the ad valorem equivalents used in the Commission's computable general equilibrium model described in chap. 2 of this report. A full description of the analysis and methodology used is presented in app. H.

assets held by foreign banks.<sup>31</sup> Total U.S. imports of banking and securities services registered \$12.3 billion in 2005, and sales of financial services by U.S. affiliates of foreign firms totaled \$23.8 billion in 2004 (latest available).<sup>32</sup> While precise figures on sales by U.S. affiliates of Korean firms do not exist, cross-border imports of financial services from Korea totaled \$125 million in 2005,<sup>33</sup> or approximately 1 percent of total U.S. banking and securities services imports. Such U.S. imports are most likely concentrated in the provision of trade financing to U.S. clients importing goods from Korea, and do not directly compete with U.S.-based banks. Near-term growth in imports will likely be a result of demand for trade finance services generated by increased trade in goods between the United States and Korea, rather than a direct result of financial sector liberalization.

## **Insurance**

The FTA would also be expected to generate a substantial increase in U.S. exports of insurance services to Korea. The Korean insurance market is the seventh-largest in the world in terms of premium volume, and the biggest to be included in a recent U.S. bilateral FTA. It has remained relatively closed to foreign firms, however. As such, the potential for cross-border U.S. exports or sales by foreign affiliates of U.S. firms in this sector likely is sizeable. Total U.S. cross-border exports of insurance in 2005 totaled \$6.8 billion, although exports to Korea amounted to just \$74 million, or 1 percent of the total.<sup>34</sup> Comparatively speaking, Mexico imported \$158 million of insurance services from the United States in 2005.<sup>35</sup> According to industry estimates, cost savings to the life insurance sector from removal of the restriction on data transfer could reach \$50 million, and potential gains from new market growth due to the FTA provisions could be \$5 billion in the long term.<sup>36</sup>

With respect to the potential for increased U.S. imports from Korea, the U.S. insurance market is already open to foreign firms, so market access gains for Korean firms would likely be marginal. In 2005, total U.S. cross-border imports of insurance services were \$28.5 billion, and insurance sales by U.S. affiliates of foreign firms totaled \$81.3 billion in 2004 (latest available).<sup>37</sup> Precise figures on sales by U.S. affiliates of Korean firms are not available, but cross-border imports totaled \$15 million in 2005,<sup>38</sup> or less than 0.1 percent of total U.S. imports of insurance services. Near-term growth in imports would likely result from demand for insurance generated by increased trade in goods between the United States and Korea, rather than as a direct result of insurance-sector liberalization. Korean insurance companies are unlikely to compete directly with more sophisticated U.S. insurers in the highly competitive U.S. market.

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<sup>31</sup> Federal Reserve Board, "Structure and Call Report Data for U.S. Offices of Foreign Entities by Country," December 31, 2006.

<sup>32</sup> USDOC, BEA, *Survey of Current Business*, October 2006, 74.

<sup>33</sup> *Ibid.*, 57.

<sup>34</sup> This figure represents the sum of reinsurance (\$207 million) and primary insurance (\$26 million) premiums received, minus losses paid (\$161 million). The figures do not total exactly because of rounding. USDOC, BEA, *Survey of Current Business*, October 2006, 60.

<sup>35</sup> USDOC, BEA, *Survey of Current Business*, October 2006, 60.

<sup>36</sup> Smith, testimony before the USITC, June 20, 2007, 64.

<sup>37</sup> USDOC, BEA, *Survey of Current Business*, October 2006, 60 and 74.

<sup>38</sup> *Ibid.*, 57.

## *Summary of Provisions*

Chapter 13 of the FTA would generally require each party to allow cross-border trade in financial services, accord national treatment and MFN treatment to investors of the other party, and provide market access without limitations on the number of financial institutions, value of transactions, number of service operations, or number of persons employed.

As in previous bilateral U.S. FTAs, cross-border trade would be limited to certain segments of the financial services industry, as outlined in Annex 13-A. For insurance, FTA coverage of cross-border trade would be limited to marine, aviation, and transit (MAT) insurance; reinsurance and retrocession;<sup>39</sup> services auxiliary to insurance, such as consultancy, risk assessment, actuarial and claim settlement services; and insurance intermediation services such as brokerage and agency services. For banking and securities, FTA coverage of cross-border trade would be limited to the provision and transfer of financial information and financial data processing, advisory, and other auxiliary financial services as defined in the text of the chapter. The provision regarding financial data processing, however, does not go into effect until two years following entry into force of the agreement. Cross-border intermediation services (i.e., deposit taking and lending) would be excluded from the agreement.

Each party would be required to permit a financial institution of the other party to provide new financial services on the same basis that it permits its own domestic institutions to provide, without additional legislative action. The chapter would not require either party to furnish or allow access to information related to individual customers or confidential information, the disclosure of which would impede law enforcement, be contrary to the public interest, or prejudice legitimate commercial concerns.

Under chapter 13, neither party could require financial institutions of the other party to hire individuals of a particular nationality as senior managers or other essential personnel, nor could a party require more than a minority of the board of directors to be nationals or residents of the party. The parties would agree that transparent regulations and policies are important, commit to publishing in advance all regulations of general application, and agree to maintain or establish mechanisms to respond to inquiries from interested persons. Where a party requires membership in a self-regulatory organization, the chapter would provide that such organizations will be subject to the national treatment and MFN obligations of this chapter.

The FTA would establish a Financial Services Committee to implement the provisions of chapter 13. Chapter 13 would also provide for consultations and dispute resolution, and includes cross references to the provisions covering dispute settlement procedures. Under the FTA, parties may retain specific financial services measures that do not conform to the FTA by including the measures in Annex III of the agreement. For example, Korea included

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<sup>39</sup> Retrocession is defined as risk accepted by a reinsurer, which is then transferred to another reinsurance company.

as an NCM a regulation<sup>40</sup> that requires a branch of a bank or securities company constituted under the laws of another country to bring and maintain operating funds within Korea.<sup>41</sup>

### *Views of Interested Parties*

U.S. financial services industry representatives widely regard the agreement as a catalyst for substantial new opportunities in the Korean market. In testimony before the Commission, Laura Lane, corporate co-chair of the U.S.-Korea FTA Business Coalition, stated that it is the best financial services chapter negotiated in a free trade agreement to date.<sup>42</sup> In the banking and securities sector, Korea is believed to have made significant progress in reforming its banking sector in recent years, but opportunities for U.S. banks have been limited.<sup>43</sup>

The ITAC on Services and Finance Industries (ITAC 10) report states that many elements of the FTA represent a marked improvement in the operating climate for U.S. firms doing business in Korea.<sup>44</sup> In particular, it states that the provisions on market access, national treatment, and transparency are critical to increased participation by U.S. firms in the Korean market, as well as furthering Korea's efforts to become a regional financial hub. Further, the ITAC 10 report highlights the importance of allowing the delegation of core functions to offices outside Korea, allowing firms to transfer customer data into and out of the country,<sup>45</sup> and allowing the cross-border provision of portfolio management services. The ITAC 10 report expressed disappointment about the absence of investor-state arbitration related to the prudential carve-out, as well the inclusion of provisions that would allow Korea to restrict certain capital flows as they relate to investment.<sup>46</sup>

In addition to creating new market opportunities for U.S. firms, one industry representative indicated that the agreement would send an important message to the region, where countries are reportedly wary of large U.S. banks that they believe, erroneously, to be interested in acquiring small domestic banks. If U.S. banks can successfully demonstrate their ability to bring healthy competition and innovative products to the commercial banking sector in Korea, perhaps the rest of the region would be more willing to allow those firms greater access to their markets.<sup>47</sup>

The ITAC 10 report also expressed support for the insurance provisions of the FTA, characterizing them as "commercially meaningful."<sup>48</sup> The report states that allowing greater market access to U.S. firms would help to strengthen the Korean insurance sector by introducing new products and positively influencing the way the industry operates.<sup>49</sup> Of particular importance to U.S. industry, the report stated, are the provisions for MFN and

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<sup>40</sup> This regulation is based on Korean legislation, namely The Banking Act and the Securities and Exchange Act.

<sup>41</sup> U.S. industry representatives contend that this requirement is reasonable. U.S. industry representative, telephone interview by Commission staff, June 1, 2007.

<sup>42</sup> Lane, testimony before the USITC, June 20, 2007, 106.

<sup>43</sup> U.S. industry representative, telephone interview by Commission staff, June 1, 2007.

<sup>44</sup> ITAC (10) on Services and Finance Industries, *Advisory Committee Report*, April 25, 2007.

<sup>45</sup> *Ibid.*

<sup>46</sup> *Ibid.*

<sup>47</sup> U.S. industry representative, telephone interview by Commission staff, June 1, 2007.

<sup>48</sup> ITAC (10) on Services and Finance Industries, *Advisory Committee Report*, April 25, 2007.

<sup>49</sup> *Ibid.*; and U.S. industry representative, telephone interview by Commission staff, June 1, 2007.



national treatment, full establishment rights, cross-border provision of services, data transfer, and transparency.

In addition, industry representatives support the requirement that the state-owned Korea Post and cooperative insurance providers be subject to the same regulatory requirements as private insurance firms.<sup>50</sup>

On a general note, one industry representative expressed support for the negative list approach used in negotiating the FTA, as it limits the number of services subject to restriction.<sup>51</sup> Also, this representative viewed Korea's commitment to accord to the United States any future trade liberalizations to which it agrees with a third-party country as particularly valuable to U.S. financial services firms, especially given Korea's pending negotiations with China and Japan.<sup>52</sup>

## FTA Chapter 14—Telecommunications

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### *Assessment*

The FTA would likely have minimal impact on U.S. cross-border exports<sup>53</sup> of telecommunication services, largely due to already high levels of price competition for voice telephone services between the United States and Korea. Price competition contributed to a 66 percent decline in U.S. carrier revenues for U.S. calls terminating in Korea during 2001 to 2005,<sup>54</sup> even as the volume of U.S. calls, measured in minutes, grew by 25 percent.<sup>55</sup> Efforts by the U.S. Federal Communications Commission (FCC) to reduce international accounting rates<sup>56</sup> may also have contributed to the decline in per minute prices and associated U.S. carrier revenues during the years 2001 to 2005.<sup>57</sup> Overall, U.S. cross-border exports of telecommunication services to Korea were relatively small, totaling \$150 million, or 3 percent of total telecommunications exports, in 2005.<sup>58</sup>

By contrast, the provisions of the FTA likely would facilitate the entry of U.S. firms into the Korean market, either through the establishment of a wholly owned subsidiary or through investment in existing telecommunication companies. Currently, Korea limits foreign direct

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<sup>50</sup> Smith, testimony before the USITC, June 20, 2007, 64.

<sup>51</sup> Goyer, testimony before the USITC, June 20, 2007, 46.

<sup>52</sup> *Ibid.*, 47.

<sup>53</sup> The traditional international telephone call is the primary means of cross-border trade in telecommunication services between the United States and Korea.

<sup>54</sup> U.S. carrier revenues derived from U.S.-originated calls terminating in Korea decreased from \$24.3 million in 2001 to \$15.8 million in 2005. U.S. Federal Communications Commission (USFCC), 2005 International Telecommunications Data, April 2007, 109–132.

<sup>55</sup> The volume of U.S.-originated calls to Korea, measured in minutes, increased from 258.4 million minutes in 2001 to 322.2 million minutes in 2005. USFCC, 2005 International Telecommunications Data, April 2007, 109–132.

<sup>56</sup> Under traditional settlement procedures, carriers negotiate bilateral accounting rates, or per-minute fees, for carrying and terminating international telephone traffic.

<sup>57</sup> FCC, Benchmark Order, 12 FCC Rcd 19,806 (1997). The Order established a 5-year time-frame during which settlement rates would be reduced to \$0.15 per minute for upper income countries, \$0.19 per minute for middle-income countries, and \$0.23 per minute for lower-income countries. Although the FCC's initial accounting rate goals were not met due to resistance from many countries, average U.S. accounting rates began to fall after the issuance of the Order.

<sup>58</sup> USDOC, BEA, *Survey of Current Business*, October, 2006.

investment (FDI) in facilities-based telecommunication-services firms to 49 percent of total voting shares.<sup>59</sup> The provisions of the FTA, however, remove this restriction, allowing 100 percent foreign ownership 2 years after the FTA enters into force.<sup>60</sup> Although high levels of competition, the maturation of important market segments (box 4.4), and FTA exclusions pertaining to mobile services<sup>61</sup> and nonfacilities-based service providers<sup>62</sup> may deter U.S. firms from entering the domestic Korean market and/or impair the ability of U.S. firms to offer telecommunication services to residential and/or corporate customers within Korea, the FTA's investment provisions would likely benefit U.S. firms seeking to offer international corporate data, virtual private network, and Internet Protocol-based corporate customers in Korea.

The telecommunication provisions of the U.S.-Korea FTA would likely have minimal impact on U.S. cross-border imports of telecommunication services, largely due to already high levels of price competition for voice telephone services between the United States and Korea. Efforts by the FCC to reduce accounting rates may have contributed to the decline in per minute prices during the years 2001 to 2005. Overall, U.S. imports of telecommunication services were relatively small, totaling \$74 million, or 2 percent of total telecommunications exports, in 2005.<sup>63</sup> The FTA would likely have minimal impact on the entry of Korean telecommunication firms into the U.S. market, or the sales of existing Korean subsidiaries in the United States, due largely to the existing regulatory openness of the U.S. telecommunication services market. For example, Korean operator SK Telecom currently offers wireless service in the United States via Helio, a mobile virtual network operator (MVNO)<sup>64</sup> established as a 50/50 joint venture with U.S. Internet firm Earthlink.<sup>65</sup> High levels of competition in the U.S. telecommunication services market and several FTA exclusions pertaining to mobile services operators<sup>66</sup> in the United States may deter additional market entry by Korean telecommunication services firms.

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<sup>59</sup> USFCS, "Doing Business in Korea: A Country Commercial Guide for U.S. Companies," 2005, 88; EIU, "Country Commerce: South Korea," July 2006, 117; and USTR, "Korea," *2007 National Trade Estimate Report on Foreign Trade Barriers*, April 2, 2007, 367.

<sup>60</sup> At the end of 2005, foreign ownership in Korea's major fixed-line telecommunication services firms included 5 percent in Dacom, 46 percent in KT, and 48 percent in Hanaro Telecom. In the wireless sector, foreign ownership stood at 22.5 percent in KT Freetel, 27 percent in LG Telecom, and 49 percent in SK Telecom. EIU, "Country Commerce: South Korea," July 2006, 118.

<sup>61</sup> In Korea, commercial mobile services are not subject to commitments related to major suppliers, services resale, network unbundling, leased circuits, colocation, and access to poles, ducts, conduits, and rights-of-way.

<sup>62</sup> In Korea, commitments related to network unbundling, interconnection, leased circuits, submarine cable access, colocation, and access to poles, ducts, conduits, and rights-of-way do not apply to non-facilities based providers.

<sup>63</sup> USDOC, BEA, *Survey of Current Business*, October 2006.

<sup>64</sup> MVNOs typically do not own spectrum allocation or telecommunication network facilities. As a result, MVNOs typically resell the wireless services of established mobile services providers. Helio, for example, leases network capacity from Verizon Wireless and Sprint Nextel.

<sup>65</sup> Krause, "Amp'd Mobile Bankruptcy Casts Shadow on MVNOs," June 6, 2007; Nam, "Helio's Losses To Widen This Year-SK Telecom," February 7, 2007; Kawaguchi, "Telecommunications: Wireless-Asia," April 2007, 12; and Tae-gyu, "Telecom Operators Set Eyes on Overseas Markets," July 29, 2007.

<sup>66</sup> In the United States, commercial mobile services are not subject to commitments related to dialing parity, major suppliers, services resale, and access to poles, ducts, conduits, and rights-of-way.

**Box 4.4** Competitive conditions in the Korean telecommunication services market

**Fixed-Line Services**

Fixed-line services are provided in Korea by the incumbent, KT Corp., and several new entrant firms, including DACOM, Hanaro Telecom, and Onse Telecom. Despite the introduction of competition in the 1990s, KT Corp. dominates the fixed-line market, controlling 93.2 percent of local fixed-line subscribers, 65 percent of leased lines, and 86 percent of domestic long distance services. By contrast, high levels of competition have reduced KT Corp.'s share of the international long distance service market to approximately 45 percent. Overall, revenues in the fixed-line market are slowly contracting, due to fixed-to-mobile substitution, increasing levels of competition, and the growing use of Voice-over-Internet Protocol (VoIP). In 2005, the Korea Fair Trade Commission issued corrective orders and levied fines against Korea's four fixed-line providers for price collusion in local, domestic long distance, international long distance, leased-line, and high-speed internet services.

**High-Speed Internet Services**

The main providers of high-speed Internet services in Korea are KT Corp., Hanaro Telecom, DACOM, Dreamline, Onse Telecom, and Powercomm. High-speed Internet services are primarily delivered over Asymmetric Digital Subscriber Line (ADSL) technologies, although access via wireless, satellite, and hybrid fibre-coaxial technologies are also available. In 2005, the broadband penetration rate in Korea stood at approximately 25 percent, one of the highest in the world. Overall, an increasingly saturated market and competition-induced price declines have resulted in slower growth in both subscriber numbers and revenues in Korea's high-speed Internet market. Licensed VoIP services were launched by resellers in mid-2005. Currently, VoIP services are provided in Korea by the main network operators, as well as smaller firms like Skype, Samsung Networks, and Anyuser Net.

**Mobile Services**

Mobile services in Korea are provided by SK Telecom, KTF Corp., and LG Telecom. Over the past few years, Korean government regulators have taken steps to stimulate competition in mobile services, including banning handset subsidies, actively regulating interconnection rates, and preventing large operators from offering discounted service bundles. After several years of strong growth, the Korean mobile services market is now entering the mature stage, characterized by high levels of mobile service penetration (82 percent) and intense competition among its three service providers. Korea is a global leader in the deployment of third generation (3G)<sup>1</sup> networks and services, with the first such network launched in September 2000. Currently, nearly 43 percent of Korea's mobile customers subscribe to 3G services. Such leadership is driven in part by the Ministry of Information and Communication (MIC), which actively controls licensing and monitors carrier commitments to invest in, and launch, 3G technologies and services. High levels of competition in mobile voice services, which have led to declining revenues, have also driven 3G product development to include not only messaging services but also advanced services such as mobile television, music and game downloads, and e-gift services.

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<sup>1</sup> Third generation (3G) technologies, which are based upon the International Telecommunication Union's International Mobile Telecommunications-2000 (IMT-2000) family of standards, offer substantially higher bandwidth than previous technological standards, enabling not only greater capacity for voice transmissions but also data transfer rates of up to 2 megabits per second (Mbps). Such high data transfer rates allow mobile services providers to offer an expanded range of value-added services, including text and multimedia messaging; Internet/e-mail access; downloadable music, ringtones, graphics, and audio/video clips; and mobile television.

*Sources:* Kawaguchi, "Telecommunications: Wireless-Asia," April 2007; Mergent, "The Asia-Pacific Telecommunications Sectors," January 2007; Datamonitor, "Fixed Line Telecoms in South Korea," June 2006; Datamonitor, "Internet Access in South Korea," July 2006; and Tae-gyu, "Telecom Operators Set Eyes on Overseas Markets," July 29, 2007; and Primetrica, "Korea," GlobalComms Database, April 2006.

## ***Summary of Provisions***

The provisions of Chapter 14 would require each party to ensure that enterprises of the other party have access to and use of any public telecommunication service offered in its territory and/or across its borders on reasonable and nondiscriminatory terms and conditions. Specifically, the chapter would obligate suppliers of public telecommunications services to provide network interconnection, number portability, and dialing parity to telecommunication service providers of the other party on reasonable and nondiscriminatory terms and conditions. In addition, major suppliers of one party would be required to offer telecommunication services to suppliers of the other party on terms and conditions no less favorable than those accorded to their own subsidiaries, affiliates, and nonaffiliated service suppliers, particularly regarding the availability, provisioning, rates, and quality of such services. Major suppliers would also be subject to specific additional obligations related to competitive safeguards, services resale, network unbundling, interconnection, leased circuits, colocation,<sup>67</sup> and access to rights-of-way and submarine cable systems.

Chapter 14 would commit the governments of the United States and Korea to ensure the independence of their respective telecommunications regulatory bodies and bestow such entities with the authority to enforce compliance with FTA obligations. The parties to the agreement also would be required to maintain transparent and nondiscriminatory procedures related to licensing, allocation and use of scarce resources, and dispute resolution. A variety of exclusions for mobile services providers, nonfacilities-based providers, and rural telecommunication services are contained in Annex 14-A and Annex 14-B, while Annex 1 to the FTA would establish several restrictions on foreign investment in Korea's telecommunications sector.<sup>68</sup>

## ***Views of Interested Parties***

Overall, U.S. industry representatives expressed support for the commitments detailed in the telecommunications chapter. The Information and Communications Technologies, Services and Electronic Commerce (ITAC 8) report, for example, stated that the U.S.-Korea FTA would foster a more open and liberalized telecommunications market in Korea. In particular, the ITAC 8 report expresses support for the removal of foreign investment restrictions 2 years after the FTA enters into force, although it notes that an investment ceiling remains in place for Korea's incumbent telecommunication services providers, KT and SK Telecom. The ITAC 8 report also supports commitments pertaining to submarine cable landing stations, stating that commitments on international circuits, backhaul facilities,<sup>69</sup> colocation,

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<sup>67</sup> Colocation is defined as physical access to space in order to install, maintain, and repair equipment at premises owned, controlled, or used by a supplier of public telecommunications services.

<sup>68</sup> Annex 1 to the FTA states that foreign ownership may not exceed 49 percent of the total voting shares of facilities-based suppliers of public telecommunications established in Korea. Similarly, a license for facilities-based telecommunication services will not be granted to entities in which foreign owners control more than 49 percent of total voting shares. In addition, foreign owners may not be the largest shareholder in Korea Telecom, unless foreign owners hold less than 5 percent of total voting shares. Two years after the FTA enters into force, Korea shall permit foreign ownership of 100 percent of the total voting shares of a facilities-based supplier of public telecommunication services (except for KT and SK Telecom), which in turn may hold a license for facilities-based public telecommunication services.

<sup>69</sup> Backhaul facilities are defined as transmission links between a submarine cable landing station and a point of access to the public telecommunications network.

and cross-connect links<sup>70</sup> are more comprehensive than in previous agreements. The ITAC 8 report also approves of the expanded technological choice section in the FTA, noting that it goes beyond other agreements by limiting the conditions under which both parties can specify technology to suppliers of public telecommunication services. By contrast, the ITAC 8 report points out that many of the provisions of the FTA do not apply to nonfacilities-based providers of telecommunications services.<sup>71</sup>

Similarly, the Telecommunications Industry Association (TIA) supports the telecommunications services provisions contained in the U.S.-Korea FTA. Overall, TIA states that U.S. firms would benefit from the commitments in the FTA, including, inter alia, commitments on access to and use of public telecommunications networks, interconnection, number portability, resale of services, network unbundling, and submarine cable landing stations. TIA also notes that many of the provisions expand upon commitments contained in the WTO's Agreement on Basic Telecommunications, citing provisions on number portability and dialing parity, as well as expanded language related to the independence of the telecommunications regulator.

Similar to the ITAC 8 report, the TIA singled out the FTA's provisions related to technological neutrality, noting that the FTA's strong language goes beyond other trade agreements by limiting conditions under which parties can specify the use of certain technologies. The TIA also expressed approval for FTA commitments that eliminate the 49 percent foreign investment ceiling after 2 years, although it notes that investment ceilings would still apply to KT and SK Telecom.<sup>72</sup>

The Coalition of Services Industries (CSI) also supports the telecommunication commitments contained in the U.S.-Korea FTA, stating that such commitments would foster a more open and liberalized telecommunications market and ensure that U.S. companies have improved access to the Korean telecommunications market. In general, CSI approves of the FTA's commitments related to network access, cost-oriented interconnection, dialing parity, competitive safeguards, services resale, and technology choice. CSI also supports FTA provisions that allow U.S. companies to own 100 percent of the total voting shares in a Korean telecommunications operator within 2 years of implementation. Given CSI's past concern over the independence of Korea's telecommunications regulator,<sup>73</sup> it also approves of FTA commitments that ensure that the regulatory body is separate from, and not accountable to, any supplier of public telecommunication service.<sup>74</sup>

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<sup>70</sup> Cross-connect links are used in a submarine cable landing station to connect submarine capacity to the transmission, switching, and routing equipment of telecommunication companies located within the cable station.

<sup>71</sup> ITAC (8) for Information and Communications Technologies, Services and Electronic Commerce, *Report*, April 27, 2007, 9–10. ITAC 8 represents the interests of approximately 26 telecommunication and advanced technology firms.

<sup>72</sup> Seiffert, TIA, written submission to the USITC, June 27, 2007.

<sup>73</sup> CSI asserts that Korea's telecommunications regulator, the Korea Communications Commission (KCC), is not a fully independent regulator because the MIC retains most of the regulatory responsibilities and, as such, is largely responsible for decisions regarding market entry, pricing, and service quality. CSI also objects to the KCC's physical location with the MIC headquarters. As a result, the CSI recommends that a fully independent regulatory body should be established and vested with the power to issue impartial and binding decisions and regulations. CSI, "Written Testimony on the Free Trade Agreement Between the United States and Korea for the Trade Policy Staff Committee, Office of the USTR," March 14, 2006.

<sup>74</sup> Goyer, testimony before the USITC, June 20, 2007.

# Professional Services<sup>75</sup>

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## *Assessment*

The professional services provisions of the FTA would likely contribute to increased market access and national treatment for U.S. professional services practitioners engaged in cross-border trade, especially in such services historically reserved for Korean-licensed practitioners and firms. Moreover, certain professional services are likely to benefit from the FTA's establishment of a process that promotes the creation of mutual recognition agreements<sup>76</sup> in professions such as engineering and law. Additionally, as noted earlier, the FTA's negative list approach extends trade disciplines to certain professional services, such as legal services (box 4.5), for which Korea made no commitments or only limited commitments under GATS.<sup>77</sup> Nevertheless, the FTA is likely to have a small effect on bilateral services trade in the near term because Korea's professional services market would be opened only gradually and for a limited range of services. In addition, certain U.S. professional services firms providing engineering services and major worldwide networks of accounting firms already participate in the Korean market through means such as contractual associations with licensed Korean firms.<sup>78</sup> Bilateral trade in professional services<sup>79</sup> is relatively small, with U.S. exports to Korea measuring \$930 million and U.S. imports from Korea measuring \$120 million in 2005.<sup>80</sup>

## *Summary of Provisions*

Provisions of the FTA related to cross-border trade in professional services are not included in a separate chapter, but instead Annex 12-A to chapter 12 covers measures related to licensing and certification of the other party's professional services suppliers. The annex would commit each party, upon request, to provide information including the appropriate regulatory or other bodies to consult on standards and criteria<sup>81</sup> for licensing and certification of professional services suppliers. Upon agreement, each party must encourage relevant bodies to develop mutually acceptable standards and criteria for licensing and certification of professional services suppliers, to make recommendations on mutual recognition, and to develop procedures for the temporary licensing of the other party's professional service suppliers, in particular those supplying engineering, architectural, and veterinary services.

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<sup>75</sup> Chapter 12 of the FTA defines professional services as services, the supply of which requires specialized postsecondary education, or equivalent training or experience or examination, and for which parties grant or restrict the right to practice, but not to include services supplied by tradespersons or vessel and aircraft crew members.

<sup>76</sup> An agreement whereby each party recognizes the education or experience obtained, requirements met, or licenses or certifications granted in the territory of the other party.

<sup>77</sup> WTO, "General Agreement on Trade in Services, Republic of Korea, Schedule of Specific Commitments," April 15, 1994.

<sup>78</sup> Professional services firms' Internet sites, such as Bechtel Corporation, "About Bechtel"; Samil PricewaterhouseCoopers, *Annual Report 2005*; and Samjong KPMG, "What's New at KPMG."

<sup>79</sup> Trade data include business, professional, and technical services, and thus report trade on a wider range of services than solely professional services.

<sup>80</sup> USDOC, BEA, *Survey of Current Business*, October 2006, 65–6.

<sup>81</sup> Such standards and criteria may address education, examinations, experience, conduct and ethics, professional development and recertification, scope of practice, local knowledge, and consumer protection.

**Box 4.5 U.S. legal services trade with Korea and the climate for opening the Korean market for legal services**

In 2005, U.S. cross-border exports of legal services to unaffiliated consumers in Korea amounted to \$102 million, while U.S. imports of such services from unaffiliated suppliers in Korea totaled \$21 million. Korea accounted for 2 percent of the total value of both U.S. exports and imports of legal services in 2005.

The European Union Chamber of Commerce in Korea stated that Korea is the last economy in northeast Asia (including North Korea) and one of the last in the world to partially open its legal services market to foreign participation. About 8,000 Korea-licensed lawyers serve the market, or one lawyer for every 6,100 people, compared to one lawyer per 268 people in the United States. Korean law offices are generally smaller than those in the United States. The largest Korean law firm, Kim & Chang, employs 300 lawyers, tax lawyers, accountants, and patent and trademark attorneys. The firm states that many of its attorneys practiced previously with major law firms abroad and graduated from foreign universities. Only a few Korean law firms reportedly have experience serving multinational clients, resulting in a shortage of legal expertise relative to demand for the execution of large and complex financial and corporate transactions. The shortage of legal expertise often compels multinational clients to absorb the additional costs of engaging both Korean and non-Korean law firms in connection with such transactions. Such inefficiency and cost duplication likely place Korea at a comparative disadvantage relative to other Asian economies in meeting Korea's policy goal of attracting significantly higher FDI.

About 400 foreign lawyers are employed in Korea as consultants by Korean law firms, supplementing Korean-licensed practitioners. Foreign lawyers, however, rarely pass the difficult Korean bar examination required of anyone seeking to practice law in Korea. Likewise, few U.S. law firms have long-term experience serving clients in Korea because Korean law prohibits non-Korean law firms from establishing an office in Korea or entering into partnerships with or hiring Korean-licensed lawyers. Accordingly, a small number of U.S. and other non-Korean law firms serve Korean clients from offices in Japan, Hong Kong, China, or elsewhere, which reportedly inflates U.S. and other non-Korean law firms' costs substantially. To minimize such cost effects and serve clients faster, U.S. law firms such as Paul, Hastings, Janofsky & Walker LLP, DLA Piper, and Akin Gump Strauss Hauer & Feld LLP reportedly plan to open foreign legal consultant (FLC) offices rapidly upon the FTA's entry into force. Certain other U.S. law firms with Korean clients, such as Orrick, Herrington & Sutcliffe LLP, reportedly are likely to defer a decision on opening an FLC office in Korea because Korea is only gradually opening its legal services market, and more substantial trade opportunities for U.S. lawyers and law firms exist elsewhere in Asia, especially in China.

*Sources:* Elinson, "Trade Pact News Spurs U.S. Law Firms' Interest in South Korea," April 6, 2007; European Union Chamber of Commerce in Korea. "Legal Services Committee, Overview," 2006; European Union Chamber of Commerce in Korea. "Legal Services Committee, Press Conferences 2006," 2006; Hogarth, "Expansion-Minded Law Firms Look to Korea," March 17, 2006; Kim and Chang (law firm), "Firm Profile," 2007; Petterson, "Seoul Poised to Admit Foreign Law Offices," November 8, 2006; USDOC, BEA, "U.S. International Services: Cross-Border Trade in 2005 and Sales Through Affiliates in 2004"; and Yoo, "Korea, U.S. Grapple with Sensitive FTA Issues," July 12, 2006.

To facilitate these activities, the annex would commit the parties to establish a Professional Services Working Group,<sup>82</sup> comprising representatives of both parties, which is to meet by mutual consent within 1 year of the FTA's entry into force. The Working Group would consider issues pertaining to professional services generally as well as individual professional services. The scope of work would include developing procedures to encourage mutual recognition arrangements and model procedures for licensing and certification, addressing regional-level government measures inconsistent with market access and national treatment, and discussing other mutual interests affecting the supply of professional services.

The Working Group must consider bilateral, plurilateral, and multilateral agreements related to professional services. Within 2 years after the FTA's entry into force, the Working Group must report on progress, including any recommendations on promoting mutual recognition

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<sup>82</sup> USTR, "Final Text of the U.S.-Australia Free Trade Agreement," 2007. The U.S.-Australia Free Trade Agreement provided for a similar working group on professional services.

of standards and criteria and on temporary licensing, as well as a preview of its future work program. The parties must review such recommendations within a reasonable time frame to determine consistency with the FTA. Upon a favorable review, each party commits to work with and encourage its respective bodies to implement the recommendations within a mutually agreed time. The annex would further require parties to review implementation of the provisions of the annex at least once every 3 years.

The FTA includes Korean NCMs that apply to cross-border trade in professional services supplied by foreign lawyers, accountants, architects and engineers, and by others in numerous occupations identified by Korea as professional services. The most prevalent NCMs would require licensing and registration by Korean authorities and reserve the establishment of and investment in prescribed professional services entities solely to Korean-licensed professionals. For example, only a registered Korean-licensed lawyer may supply legal services and establish and/or invest in any of four categories of legal entities.<sup>83</sup>

Three categories of accounting and auditing entities in Korea, each able to be established only by a Korean certified public accountant (CPA), are the sole authorized suppliers of accounting and auditing services in Korea.<sup>84</sup> Suppliers of labor-affairs consulting services or customs-clearing services in Korea must be licensed in Korea and establish an office there. Another Korean NCM would require local presence in order to supply architectural, engineering, integrated engineering, urban planning, and landscape architectural services in Korea, except for a foreign architect in a joint contract with a Korean-licensed architect.<sup>85</sup>

Korea's NCMs would also preserve the right to adopt or maintain restrictions on foreign legal consultants (FLCs), CPAs, and certified tax accountants to a greater extent than in other free trade or trade preference agreements negotiated by the United States. Under the exception for FLCs, Korea can place any requirements on foreign-country-licensed lawyers or foreign law firms supplying any type of legal service in Korea, entering into any relationship with Korean law firms, or entering such relationships or hiring Korean-licensed lawyers, other legal practitioners, CPAs, certified tax accountants, and customs brokers. Korea would commit to a three-phase removal of certain restrictions on the activities of FLCs in Korea. Upon the FTA's entry into force, Korea would allow a U.S. law firm to establish an FLC office in Korea and allow U.S.-licensed lawyers to supply legal advisory services on home-country law and international law as FLCs in Korea. Within 2 more years, Korea would allow FLC offices to conclude a cooperative agreement with a Korean law firm, to include profit sharing, in cases with mixed Korean and non-Korean legal affairs. Within 5 years of the FTA's entry into force, Korea would allow the creation of joint ventures between U.S. and Korean law firms, which may include employing Korean-licensed lawyers as partners or associates, although Korea would preserve the right to impose restrictions on voting shares or equity interests.

Similarly, Korea reserves the right to restrict the hiring of Korean-registered CPAs by foreign CPAs or non-Korean-registered accounting corporations, or the supply of auditing services in Korea by foreign CPAs. By or before the FTA's entry into force, Korea would allow U.S.-registered CPAs or accounting corporations constituted under U.S. law to

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<sup>83</sup> Moreover, certified judicial scriveners and notaries public must establish in the jurisdiction of the court or public prosecutor's office, respectively, in which they practice.

<sup>84</sup> Only Korean-authorized CPAs working in one of two categories of establishment may provide auditing services on public companies in Korea. Similar requirements exist for certified tax accountants in Korea.

<sup>85</sup> Local presence requirements also apply to the supply of safety and health management or diagnostic services, or related consulting services, to industrial workplaces.



establish offices in Korea to provide accounting consultancy services on U.S. or international accounting laws and standards. U.S. CPAs could also work in Korean accounting corporations. U.S. CPAs would be allowed to invest in a Korean accounting corporation within 5 years of the FTA's entry into force, although a single U.S. CPA will be limited to less than 10 percent of voting shares or equity interests and Korean-registered CPAs would hold at least 51 percent. Korea included similar exceptions for restrictions and gradual, limited opportunities for participation with respect to foreign certified tax accountants.

### ***Views of Interested Parties***

The ITAC on Services and Finance Industries (ITAC 10) report stated that as the FTA opens the Korean legal services market to the United States for the first time, the FTA should afford a substantial opportunity to U.S. law firms.<sup>86</sup> The ITAC 10 report also stated that opportunities may include mutual recognition in legal services under provisions of the annex on professional services. Nevertheless, the ITAC 10 report also asserted that the effect of the three substantial new commitments by Korea (summarized previously) to open its legal services market is uncertain, due to a lack of clarity as to the types of requirements or limitations Korea retains the right to impose.<sup>87</sup>

On the coverage of architectural and engineering services in the FTA, the ITAC 10 report stated that general provisions on the development of professional standards and criteria and temporary licensing and review provide for equity and reciprocity. Moreover, it noted with approval the absence of restrictions or exceptions relating to national treatment, MFN treatment, and market access; the absence of a local presence requirement on these particular services; and fair and transparent domestic regulation.<sup>88</sup> The ITAC 10 report stated that it accepted Korea's current NCM on the practice of architecture and engineering because the sole criterion for the restriction is reciprocity. The ITAC 10 report noted support for tasking the Working Group on Professional Services with developing procedures on temporary licensing and according priority to developing such procedures for temporary licensing of engineers and architects at the group's initial meeting. The ITAC 10 report also expressed support for the early conclusion of an agreement on temporary licensing of engineers.

The Small and Minority Business (ITAC 11) report stated that while the FTA broadly enhances opportunities for cross-border trade and investment, it did not necessarily improve prospects for trade in legal, accounting and auditing, and tax accounting services.<sup>89</sup> The ITAC 11 report further stated that Korea's current prohibition on investment in Korean law and accounting firms by non-Korean-licensed lawyers and accountants, respectively, is discriminatory and restrictive, and that Korea's potential restriction on foreign-country-licensed lawyers also discriminates against U.S. small, medium, and minority law firms by restricting their ability to supply services in Korea.

The Advisory Committee for Trade Policy Negotiations (ACTPN) cited legal and accounting services among the important services sectors to be liberalized under the FTA.<sup>90</sup> A representative of the Coalition of Service Industries stated that the U.S.-Korea FTA provides

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<sup>86</sup> ITAC (10) on Services and Finance Industries, *Advisory Committee Report*, April 25, 2007.

<sup>87</sup> *Ibid.*

<sup>88</sup> *Ibid.*

<sup>89</sup> ITAC (11) on Small and Minority Business, *Advisory Committee Report*, April 26, 2007, 5–6.

<sup>90</sup> ACTPN, *Report*, April 26, 2007, 4.

opportunities for U.S. lawyers and law firms to supply legal services in Korea and partner with Korean law firms.<sup>91</sup> He asserted that reservations in an annex to the agreement temper opportunities with regard to opening Korea's legal services market, yet not severely enough to cause the U.S. legal services industry to withhold its support for the agreement. Korea's ambassador to the United States cited legal services among the service industries for which market access opportunities would expand further under the U.S.-Korea FTA.<sup>92</sup>

## Audiovisual Services<sup>93</sup>

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### *Assessment*

The U.S.-Korea FTA would likely provide U.S. audiovisual service firms increased levels of market access and national treatment by minimizing or freezing most local content quotas and substantially liberalizing foreign ownership restrictions in the Korean broadcasting and film industries. The effect of FTA provisions on U.S. cross-border exports, however, is likely to be modest in the short term, owing to Korea's relatively mature and domestically oriented audiovisual services market (box 4.6).<sup>94</sup> Similarly, the FTA would likely have minimal impact on U.S. cross-border imports of audiovisual services from Korea, largely due to the predominance of domestic television programs and films in the United States.<sup>95</sup> In 2005, U.S. cross-border imports of film and television tape rentals from Korea reached \$4 million, while U.S. cross-border exports to Korea amounted to \$65 million.

Improvement in U.S. firms' access to the Korean audiovisual services market under the FTA is significant. The Korean government has committed to lock in most local content requirements in television programs and films at the least restrictive level under current law, including a motion picture screen quota that would not exceed 73 days (down from 146 days).<sup>96</sup> In addition, the FTA's provisions may encourage further investment in Korea's broadcasting and cable sectors, as Korea has made commitments to phase in up to 100 percent foreign ownership of Korean channel operators and to permit U.S. investment in Korea's rapidly growing digital media services market (which includes Internet-protocol television [IPTV]).<sup>97</sup> Moreover, the FTA strengthens intellectual property rights protections relating to audiovisual services by including side letters that dedicate additional resources to fight online piracy.<sup>98</sup>

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<sup>91</sup> Goyer, testimony before the USITC, June 20, 2007, 79, 93.

<sup>92</sup> Ambassador Lee, testimony before the USITC, June 20, 2007, 13.

<sup>93</sup> Audiovisual services refers to terrestrial, cable, and satellite television program broadcasting and motion picture production and distribution.

<sup>94</sup> Generally, most broadcasting and film quotas are filled to the maximum allowed level in Korea. Animation programming, however, is below its full capacity because of the dominance of Korean animation. U.S. industry representative, e-mail messages and telephone interview with Commission staff, June 19, 2007.

<sup>95</sup> USDOC, BEA, *Survey of Current Business*, October 2006, 69. The U.S. audiovisual services market is already largely open to foreign firms, except with regard to radio and transmission services, where a single company is prohibited from owning a combination of newspapers, radio, and television broadcast stations in a single local market. WTO, "General Agreement on Trade in Services, United States of America, Schedule of Specific Commitments," April 15, 1994.

<sup>96</sup> This screen quota reduction was made prior to the commencement of FTA negotiations. Korea requires that Korean motion pictures must be projected for at least 73 days per year at each Korean screen. USTR, "Final - United States - Korea FTA Texts," 2007.

<sup>97</sup> Mergent, "The Asia-Pacific Media Sectors," March 2007, 24-5.

<sup>98</sup> USTR, "Final - United States - Korea FTA Texts," 2007.

**Box 4.6** Competitive conditions in the Korean audiovisual services market

*Broadcasting and Cable*

The Korean television broadcasting and cable market is one of the largest and most technologically advanced<sup>1</sup> in the Asia-Pacific region. As of early 2006, there were 46 terrestrial television stations, 59 cable operators, and 190 relay cable operators in the country. The top three public broadcasters—Korea Broadcasting System (KBS), Educational Broadcasting System (EBS), and Munhwa Broadcasting Corporation (MBC)—all maintain national coverage. Of the three, KBS maintains the largest market share and produces the most original content. KBS' programs are also available in the United States, China, France, Japan, the Philippines, Mongolia, and Vietnam.<sup>2</sup>

Cable, pay TV, and digital satellite operators are also well established in the Korean market. Cable operators, Taekwang, C&M, CJ, and HCN, garnered the largest market shares in Korea, with Taekwang accounting for almost 3 million subscribers or 21 percent of the national cable television market in 2006. Since 2004, the largest cable operators in Korea have been positioning themselves to consolidate the overcrowded market through partnerships with various foreign investors.<sup>3</sup> Most recently, in 2006, Korean cable operator HCN, Korea's fourth-largest cable company, sold a 33.5 percent stake of its shares to the U.S. private equity firm, The Carlyle Group, for \$171 million, making Carlyle the second largest shareholder in the company.

*Motion Pictures*

Overall, the Korean film industry is dominated by domestic, and, to a lesser extent, U.S. motion pictures, with the two combining to account for almost 95 percent of the market share in 2006.<sup>4</sup> The top three Korean motion picture companies—CJ Entertainment, Showbox, and Cinema Service—were responsible for producing and/or distributing almost 82 percent of the films seen in Korea in 2006.<sup>5</sup> Moreover, seven of the top ten films at the Korean box office in 2006 were domestically produced; the other three were U.S. produced.

Internationally, 208 Korean films were exported to 53 countries in 2006. Japan, the United States, and France were the top three export destinations for Korean films with receipts totaling \$10.4 million (42 percent), \$2.0 million (8 percent), and \$1.3 million (5 percent), respectively.

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<sup>1</sup> Globally, the Korean broadcasting and cable market is recognized as a leader in the development and commercialization of new media technologies such as IPTV and mobile television. As of 2006, there were more than one million free-to-air mobile television subscribers in Korea.

<sup>2</sup> Internationally, Korean drama series and variety shows tend to be most well-received.

<sup>3</sup> Foreign investors are currently permitted to hold stakes of up to 49 percent in Korean cable companies and 33 percent in satellite broadcasters. Through the FTA, these quotas would eventually be lifted and 100 percent foreign ownership would be allowed in these sectors.

<sup>4</sup> U.S. films accounted for about 35 percent of the films shown in Korea.

<sup>5</sup> CJ Entertainment is also a majority shareholder in Cinema Service.

*Sources:* Korean Film Council, "Review of the Korean Film Industry in 2006"; Mergent, *The Asia-Pacific Media Sectors*, March 2007; and Screen Digest, *Global Cinema Exhibition Trends*, October 2006.

## ***Summary of Provisions***

The provisions that directly address audiovisual services are found in the NCMs for services and investment in Annexes I and II and also in two side letters under chapter 18 (intellectual property rights) of the FTA. Under Annex I, Korea has included two current NCMs relating to broadcasting services and motion picture services. Under the detailed broadcasting services reservation, foreign or Korean nationals may not serve as a principal senior officer for both a foreign enterprise and a terrestrial, satellite, or cable broadcasting operator or a similar type of program provider in Korea. All members of the boards of directors of public broadcasters Korea Broadcasting System and Educational Broadcasting System must be Korean nationals, and licenses to operate terrestrial, cable, or satellite broadcasts may only be granted to or held by the Government of Korea or local Korean governments or persons. Additionally, Korea stipulates various foreign equity limits for broadcasting and cable operators and sets varying local content quotas for their programming. Examples of such requirements include the following: no foreign government or person may hold an equity interest in a terrestrial broadcaster, cable operator, or program provider that is engaged in multigenre programming<sup>99</sup> or news reporting; 80 percent of quarterly programming hours for terrestrial broadcasters or program providers must be Korean content; 45 percent of a terrestrial broadcaster's annual animation programming hours must be Korean content; and 20 percent of a cable system or satellite operator's annual movie programming must be Korean content. Under the motion picture services reservation, Korea would require that Korean motion pictures must be projected for at least 73 days per year at each Korean screen.

Under Annex II, Korea has included broad NCMs for potential future measures relating to audiovisual services. For example, Korea has reserved the right to adopt or maintain any measure that accords differential treatment to persons of other countries involving the sharing of direct-to-home and direct broadcasting satellite television services.<sup>100</sup> Korea has likewise reserved the right to limit cross-ownership across media sectors and to adopt or maintain any measure with respect to a supplier of subscription-based video services. Korea has also listed potential reservations with regard to coproduction arrangements for film or television productions, criteria to determine whether audiovisual programs are "Korean," measures dealing with digital audio or video services, and measures with respect to motion picture promotion, advertising, or postproduction. Lastly, the U.S. and Korean governments would also agree to two relevant side letters under chapter 18 (intellectual property rights) of the FTA that impose unilateral obligations on the Korean government to prevent online piracy, whether by amending its law or dedicating additional resources.

## ***Views of Interested Parties***

U.S. industry representatives are generally satisfied with the FTA provisions on audiovisual services. The ITAC on Services and Finance Industries (ITAC 10) report said that the FTA will provide a more favorable environment for cross-border trade and investment in Korean audiovisual services by minimizing or freezing most quotas pertaining to local content

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<sup>99</sup> Multigenre programming refers to a program provider that offers a combination of news, entertainment, drama, movies, music programming, etc. USTR, "Final - United States - Korea FTA Texts," 2007.

<sup>100</sup> The United States also made this reservation under Annex II. In addition, under Annex I, the United States made a single reservation, which restricts investment in U.S. radiocommunications firms by foreign governments. These were the only two NCMs the United States specified with regard to audiovisual services in the FTA.

requirements and foreign ownership restrictions. The ITAC 10 report, however, stated that it is not entirely satisfied with the FTA's NCMs, because multiple restrictions continue to remain in virtually all levels of the industry.<sup>101</sup> Nonetheless, the ITAC 10 report states that it is encouraged by the progress made in several key areas, including in the area of protection of intellectual property rights, requiring that Korea adopt an anticamcording law that makes camcording, or the illicit recording of movies at movie theaters, a criminal offense.

The Intellectual Property Rights (ITAC 15) report said that it is encouraged by the provision that requires Korea, within 2 years of the FTA entering into force, to extend the term of its copyright laws from 50 years to 70 years (the report notes that protected works that come into the public domain during this transition period will not be recaptured).<sup>102</sup> In a written submission to the Commission, Time Warner Inc., said that the FTA would implement "gold standard" intellectual property rights provisions, Time Warner noted that the FTA includes language committing Korea to World Intellectual Property Organization (WIPO) digital treaty implementation, the establishment of ex officio authority for customs officials to seize pirated goods, and the guarding of technological protection measures.<sup>103</sup>

With regard to local content requirements, the ITAC 10 report indicates that the FTA will provide a modest relaxation in quotas for two key genres—the broadcast of animation, where the local content quota declines from 35 percent to 30 percent, and the broadcast of films, where the quota declines from 25 percent to 20 percent. According to an industry representative, within these two genre quotas, Korea also restricts the amount of programming from any single country. Through the FTA, however, this single-country quota increases from 60 percent to 80 percent. For example, pre-FTA conditions for animation programs dictate that within a 24-hour programming schedule, a minimum of 8 hours must be dedicated to Korean content with U.S. content limited to a maximum of 9 hours. Post-FTA, a minimum of 8 hours of programming must remain Korean, while the U.S. content limits are raised to 13 hours.<sup>104</sup>

The Entertainment Industry Coalition, in a written submission to the Commission, said that it is encouraged by Korea's commitments with regard to foreign ownership in the broadcasting sector.<sup>105</sup> Based on the FTA text, over a 3-year period, the Korean government will permit U.S. firms that establish Korean subsidiaries to have 100-percent ownership of program providers. The FTA would commit the Korean government to permit U.S.-controlled companies to invest up to 100 percent of the equity in Korean broadcast program providers after 2 years.<sup>106</sup> According to Time Warner, this provision will permit U.S. investment in IPTV, which will be increasingly important as the delivery of interactive television programming through broadband grows and provides new distribution

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<sup>101</sup> ITAC (10) on Services and Finance Industries, *Advisory Committee Report*, April 25, 2007.

<sup>102</sup> ITAC (15) on Intellectual Property Rights, *Advisory Committee Report*, April 27, 2007.

<sup>103</sup> Time Warner, "Comments of Time Warner, Inc., United State-Korea Free Trade Agreement Investigation TA-2104-24," written submission to the USITC, June 21, 2007, 2.

<sup>104</sup> These quotas are applied on a quarterly basis, with no specific time-of-day broadcast requirements. U.S. industry representative, e-mail messages and telephone interview with Commission staff, June 1–5, 2007.

<sup>105</sup> Frazier, "Korea-U.S. Free Trade Agreement: Benefits to America's Entertainment Industries," written submission to the USITC, June 6, 2007, 8.

<sup>106</sup> These program providers or channel operators must not be engaged in multigenre programming. USTR, "Final - United States - Korea FTA Texts," 2007.

opportunities for U.S. content providers in Korea.<sup>107</sup> Moreover, according to an industry representative, Korea has agreed to provide duty-free treatment of digital audiovisual products, whether imported in physical form or over the Internet.<sup>108</sup>

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<sup>107</sup> Time Warner, “Comments of Time Warner, Inc., United State-Korea Free Trade Agreement Investigation TA-2104-24,” written submission to the USITC, June 21, 2007, 2.

<sup>108</sup> U.S. industry representative, e-mail messages and telephone interview with Commission staff, June 1–5, 2007.

# CHAPTER 5

## Impact of Trade Facilitation Provisions

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This chapter assesses the potential impact of provisions in the U.S.-Korea FTA related to trade facilitation. These provisions are covered in FTA chapters addressing customs administration and trade facilitation, sanitary and phytosanitary (SPS) measures, technical barriers to trade (TBT), and electronic commerce.<sup>1</sup>

### FTA Chapter 7—Customs Administration and Trade Facilitation

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#### *Assessment*

U.S. industries that export to and invest in Korea would likely benefit from the customs administration and trade facilitation provisions of the U.S.-Korea FTA. In contrast with previous FTAs, these benefits would likely be realized more quickly because of the immediate implementation of all commitments by both parties, reflecting the greater capacity of the Korean Customs Service to implement its FTA obligations in the area of customs administration and trade facilitation.<sup>2</sup>

U.S. industry would likely gain from reduced transaction costs<sup>3</sup> with the implementation of the customs administration and trade facilitation provisions of the FTA.<sup>4</sup> The chapter's provisions would also likely contribute to an enhanced investment climate in Korea,<sup>5</sup> which could result in additional positive outcomes for U.S. industry. The commitments to transparent and efficient procedures, greater accountability and predictability, improved customs efficiency, reciprocity and fairness, and expedited goods clearance would likely reduce paperwork and speed goods delivery.<sup>6</sup> Commitments for processing express

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<sup>1</sup> These provisions cover FTA chapters 7–9 and 15.

<sup>2</sup> For example, the Korean Customs Service (KCS) employs the UNI-PASS system, which is a one-stop electronic customs clearance service. *Korea IT Times*, “KCS, Global Leader in Customs Administration,” November 1, 2006. In July 2003, the KCS announced a 3-year reform project to improve cargo management and the duty payment system, to restructure the organization, and to create a business-friendly atmosphere. APEC, Subcommittee on Customs Procedures, “Recent Reforms in Korea Customs Service.” KCS has also implemented several measures to reduce goods clearance times, which is a key goal of the organization. *Korea IT Times*, “KCS to Speed Up Customs Clearance Processes,” July 2004. Additionally, the KCS employs the Electronic Data Interchange (EDI) system for paperless import clearance, which allows importers to submit electronically an import declaration without visiting the customs house. USFCS, “Korea Trade Regulations and Standards.”

<sup>3</sup> For an in-depth discussion of the effect of trade facilitation on transaction costs, see OECD, “The Economic Impact of Trade Facilitation,” October 12, 2005, 26.

<sup>4</sup> According to the U.S.-Korea Business Council, Korea’s complicated and time-consuming Customs procedures impose costs on U.S. exporters and service providers. Reis, testimony before the USITC, June 20, 2007, 25.

<sup>5</sup> OECD, “The Economic Impact of Trade Facilitation,” October 12, 2005, 26.

<sup>6</sup> The agreement provides for advanced electronic submission of paperwork, requires timely goods clearance, and increases transparency. Reis, testimony before the USITC, June 20, 2007, 29.

shipments,<sup>7</sup> for example, meet or exceed the standards negotiated in other recent agreements, such as the proposed U.S.-Peru and U.S.-Colombia Trade Promotion Agreements. FTA chapter 7 would further build on commitments to streamline goods processing and documentation and would significantly improve on the time frame to provide binding advance rulings (e.g., on tariff classification).

Commitments in these areas address, in part, U.S. and European government and industry allegations of inefficient, arbitrary, and/or nontransparent customs regulations, delays in customs clearance,<sup>8</sup> and arbitrary and discriminatory tariff classifications<sup>9</sup> of imported goods by the KCS. Industries that have expressed concerns regarding customs administration procedures include the food processing and branded food, beverage,<sup>10</sup> and consumer products;<sup>11</sup> consumer electronics;<sup>12</sup> and information technology sectors.<sup>13</sup> Broad-based groups have also noted their interest in gaining commitments that would expedite Korea's clearance process, improve the transparency of its customs valuation process, and improve its compliance with international harmonized tariff classifications.<sup>14</sup>

### ***Summary of Provisions***

The Chapter 7 commitments of the U.S.-Korea FTA are largely the same as those negotiated in recent agreements that the United States has concluded with Peru, Colombia, and the Dominican Republic and CAFTA countries.<sup>15</sup> The chapter supports many of the General Agreement on Tariffs and Trade (GATT) goals in the areas of fees and formalities<sup>16</sup> and

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<sup>7</sup> USTR, "Final - United States - Korea FTA Texts," 2007, Article 7.7.

<sup>8</sup> USTR, *2002 National Trade Estimate Report on Foreign Trade Barriers*, March 2002, 262; and USTR, *2004 National Trade Estimate Report on Foreign Trade Barriers*, March 2004, 294.

<sup>9</sup> The U.S. Government has indicated that the Korean Customs Service has been inconsistent in classifying "blended products," such as potato flakes, soybean flakes, and flavored popcorn, and that such changes in classification ". . . are often based on arbitrary standards and are at odds with practices followed by OECD members." USTR, *2006 National Trade Estimate Report on Foreign Trade Barriers*, March 2006, 396. European manufacturers reported a similar problem with the reclassification of certain impregnated papers as plastics products, noting that this type of change "constitutes a breach of Korea's obligation to the WTO." European Commission, Market Access Database.

<sup>10</sup> For additional information relating to Customs Administration and agricultural products, see app. K of this report.

<sup>11</sup> The Grocery Manufacturers Association (GMA) and Food Products Association (FPA) identified concerns with customs clearance delays and nontransparent customs valuation procedures. Grocery Manufacturers Assoc., "Request for Public Comments," March 17, 2006; Food Products Assoc., "Request for Comments Concerning Proposed Free Trade Agreement with Republic of Korea," March 23, 2006.

<sup>12</sup> The Consumer Electronics Association (CEA) has previously cited its support for "a transparent, efficient and non-discriminatory customs administration regime," with particular interests in tariff classification, EDI systems, and customs information dissemination. Consumer Electronics Assoc., "CEA Comments on a U.S.-Korea FTA," April 6, 2006.

<sup>13</sup> The Information Technology Industry Council (ITI) supported an agreement that provides "a predictable and standardized Customs environment," including Internet publication of laws and regulations, coordination among Customs agencies, and specific arrangements for express shipments. ITI, "ITI Submission on the United States—Korea Free Trade Agreement," written submission to the Trade Policy Staff Committee, Office of the USTR, March 24, 2006.

<sup>14</sup> Business Roundtable, "Real Liberalization in the U.S.-Korea FTA," June 2006, and USKBC and the AMCHAM in Korea, U.S.-Korea Free Trade Agreement Position Paper, 2006.

<sup>15</sup> The implementation language in the U.S.-Korea FTA is stronger than that for recent agreements, in recognition of the greater capabilities of the Korean Customs Service.

<sup>16</sup> See Article VIII of the GATT.



publication and administration of trade regulations<sup>17</sup> (table 5.1). The provisions of the FTA are intended to facilitate the goods clearance process<sup>18</sup> through greater use of information technology, to establish procedures for resolving disputes, and to improve risk management and cooperation among parties. The parties would commit to immediate cooperation in the areas of information exchange, technical advice and assistance for trade facilitation, and enforcement of customs rules and regulations. Additionally, chapter 7 calls for the immediate implementation of articles that provide for simplified release procedures,<sup>19</sup> advance publication of customs regulations,<sup>20</sup> confidential information guidelines,<sup>21</sup> review and appeal of customs matters,<sup>22</sup> and penalties for customs violations.<sup>23</sup> The agreement also includes a provision for cooperation in the implementation and operation of the Customs Valuation Agreement.<sup>24</sup> Moreover, with respect to advance rulings, the parties would commit to a 90-day period for the issue of advance rulings following request,<sup>25</sup> compared to the standard 150-day period found in previous agreements.

In the case of express shipments, such shipments would not be limited by a maximum weight or customs value, and express shipments valued at \$200 or less would not be assessed duties or taxes or be required to have any formal entry documents, except when expressly identified by each party's laws and regulations. Moreover, the period for release of express shipments would be lowered to within 4 hours of the submission of the necessary documents, compared to 6 hours in recent agreements.<sup>26</sup> Like the U.S.-Peru and CAFTA-DR agreements, the U.S.-Korea FTA would require each party to adopt separate customs administration measures for express shipments. To facilitate express shipment processing, these measures would allow (1) electronic submission of documents; (2) prearrival processing of information; and (3) submission of a single manifest covering all goods in an express shipment, as well as minimized release documentation, where possible.

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<sup>17</sup> See Article X of the GATT.

<sup>18</sup> Parties are committed to release goods from port within 48 hours, to the extent possible.

<sup>19</sup> USTR, "Final - United States - Korea FTA Texts," 2007, Article 7.2.

<sup>20</sup> *Ibid.*, Article 7.1.3.

<sup>21</sup> *Ibid.*, Article 7.6.

<sup>22</sup> *Ibid.*, Article 7.8.

<sup>23</sup> *Ibid.*, Article 7.9.

<sup>24</sup> "The Customs Valuation Agreement of the World Trade Organization sets out a fair, uniform and neutral system for determining the value of imported goods on which customs officials levy duties. This system bars the use of arbitrary or fictitious customs values." USDOC, Trade Compliance Center, "WTO Agreement on Customs Valuation."

<sup>25</sup> USTR, "Final - United States - Korea FTA Texts," 2007, Article 7.10.

<sup>26</sup> UPS endorses the agreement, citing its "vital provisions for the express delivery industry, including enhanced market access and improved customs clearance times." United Parcel Service, "UPS Applauds New Trade Deal with South Korea (April 5, 2007)."

**Table 5.1** Selected GATT articles and U.S.-Korea FTA commitments related to customs administration

GATT	U.S.-Korea FTA
<p><b>Article VIII—Fees and Formalities</b></p> <p>1.(c) <i>Minimize</i> the incidence and <i>complexity</i> of import/export formalities.</p>	<p><b>Article 7.2—Release of Goods</b></p> <p>1. Shall adopt or maintain <i>simplified customs procedures</i> for the efficient release of goods (immediate).</p>
<p><b>Article X—Publication and Administration of Trade Regulations</b></p> <p>1. (in part) <i>Laws, regulations, etc. shall be published promptly</i> and in such a manner as to enable government and traders to become acquainted with them; trade policy agreements in force shall be published.</p> <p>2. <i>No measures</i> may be enforced to change import duties or charges or other customs administrative practices <i>before official publication</i>.</p>	<p><b>Article 7.1—Publication</b></p> <p>1. <i>Internet publication of laws, regulations, and administrative procedures</i> (immediate).</p> <p>2. Designate or maintain customs inquiry points and provide procedural information for inquiries via Internet (immediate).</p> <p>3. <i>Advance publication of regulations</i> governing proposed customs matters and comment period (immediate).</p>
<p><b>Article X—Publication and Administration of Trade Regulations</b></p> <p>2. <i>No measures</i> may be enforced to change import duties or charges or other customs administrative practices <i>before official publication</i>.</p>	<p><b>Article 7.5—Cooperation</b></p> <p>1. <i>Advance notice</i> of significant modifications of administrative policy likely to substantially effect Agreement's operation (immediate).</p>
<p><b>Article X—Publication and Administration of Trade Regulations</b></p> <p>1. (in part) <i>Prevents disclosure of confidential information</i>.</p>	<p><b>Article 7.6—Confidentiality</b></p> <p>1. Designated <i>confidential information</i> shall be maintained as such and <i>will not be disclosed without prior permission</i> (immediate).</p> <p>2. Parties may decline to provide such information if confidentiality has not been maintained (immediate).</p> <p>3. Adopt or maintain procedures to protect unauthorized disclosure (immediate).</p>
<p><b>Article X—Publication and Administration of Trade Regulations</b></p> <p>3. (b) Maintain and establish <i>independent tribunals to review</i> and correct customs administrative actions.</p>	<p><b>Article 7.8—Review and Appeal</b></p> <p>Importers will have access to <i>independent administrative review</i> and judicial review of determinations (immediate).</p>

Sources: USTR, "Final - United States - Korea FTA Texts," 2007; and WTO, Trade Facilitation Documents.

## *Views of Interested Parties*

In its report on the agreement, ITAC 14 (Customs Matters and Trade Facilitation) stated that it supports the FTA. The report cited the agreement's "fair and reciprocal" customs provisions, market access opportunities for U.S. industry, and economic benefits to Korean business. The report said that the FTA substantially meets the Committee's objectives, in particular its goals of consistency with customs chapters in other agreements,<sup>27</sup> and equity and reciprocity in the area of customs administration.<sup>28</sup> The report notes that the agreement adopts many of the current best practices in international customs administration, such as 48-hour release of goods, advanced publication of rules and regulations, confidentiality protection, and the use of risk assessment principles. In addition, the report says that the formation of a committee to administer the parties' obligations raises the group's confidence that its objectives would be attained. The report characterizes as "ground-breaking" the provisions that allow customs-related records to be maintained in any format, including electronic. The report also says that while the Committee is pleased with the 4-hour release period for express shipments, its goal is to reduce the time frame to one hour.

Other ITACs have also expressed their support for the customs administration provisions. In its report, ITAC 11 (Small and Minority Business) said that it believes that "the chapter on Customs Procedures will enhance these opportunities while affording protections to small, medium, and minority businesses in the United States and Korea."<sup>29</sup> The ITAC 10 (Services and Finance Industries) report includes supportive comments from the U.S. express delivery industry, namely that "the Agreement contains important provisions to facilitate customs clearance, which is critical to the efficient operation of express carriers, including a targeted window of no more than four hours for clearance of most express shipments and provisions allowing for electronic record retention."<sup>30</sup> In its report, ITAC 4 (Consumer Goods) said that the Agreement would "deliver important benefits to consumer goods firms in terms of market access, regulatory transparency, and customs procedures."<sup>31</sup> In its report, ITAC 3 (Chemicals, Pharmaceuticals, Health Science Products & Services) cited the strong customs administration provisions as "important to ensure that trade is not encumbered by onerous and nontransparent customs procedures."<sup>32</sup>

The Advisory Committee for Trade Policy Negotiations (ACTPN) also expressed support for the electronic and other modern provisions included in the agreement, which it said could result in goods being cleared through customs before they arrive at the port or airport. Furthermore, ACTPN said that it supports the provisions allowing advance comment on changes in customs rules, and binding advance rulings on tariff classification, preferential tariff treatment, and country of origin marking.<sup>33</sup>

The Information Technology Industry Council (ITI) said that it believes that the customs administration and trade facilitation commitments meet the needs of its members,

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<sup>27</sup> Committee objectives included transparency of rules and regulations and inclusion of a mechanism to maintain "best practices" for the import and export process. ITAC (14) on Customs Matters and Trade Facilitation, *Advisory Committee Report*, April 18, 2007.

<sup>28</sup> ITAC (14) on Customs Matters and Trade Facilitation, *Advisory Committee Report*, April 18, 2007.

<sup>29</sup> ITAC (11) on Small and Minority Business, *Advisory Committee Report*, April 26, 2007.

<sup>30</sup> ITAC (10) on Services and Finance Industries, *Advisory Committee Report*, April 25, 2007.

<sup>31</sup> ITAC (4) on Consumer Goods, *Report*, April 26, 2007.

<sup>32</sup> ITAC (3) on Chemicals, Pharmaceuticals, Health/Science Products and Services, *Advisory Committee Report*, April 24, 2007.

<sup>33</sup> ACTPN, *Report*, April 26, 2007.

particularly in the areas of risk assessment, customs determination review, and document retention. With respect to risk assessment, the Council said that the chapter commitments balance thorough analysis of high-risk transactions with reduced scrutiny for low-risk traders. The Council said that the agreement also establishes a review and appeals process to discuss customs determinations as well as a committee to monitor implementation of the parties' obligations.<sup>34</sup>

The Express Delivery & Logistics Association said that the agreement builds on achievements in earlier FTAs by including provisions to facilitate customs clearance for express carriers that would permit fast, reliable service to their customers.<sup>35</sup> The U.S.-Korea FTA Business Coalition said that the agreement includes "important new commitments on customs administration" and "streamlined customs procedures" that would facilitate trade by implementing measures to speed goods clearance and promote Customs efficiencies.<sup>36</sup>

## **FTA Chapter 8—Sanitary and Phytosanitary Measures**

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### ***Assessment***

The U.S.-Korea FTA does not contain any commodity-specific sanitary and phytosanitary (SPS)<sup>37</sup> provisions, but does provide for the establishment of a bilateral Standing Committee<sup>38</sup> to address SPS issues. This SPS provision would likely have some small positive effect on U.S. agricultural producers and exporters over the life of the Agreement, given that a number of the Agricultural Technical Advisory Committees (ATACs) expressed concerns about Korea's implementation of certain SPS measures in the past to restrict fruit and vegetable trade. In particular, in their views on the FTA, some agricultural groups expressed concerns about Korea's food additive measures and its use of SPS measures in fruit and vegetable trade. Additionally, beef producers expressed their disappointment that the FTA does not require Korea to recognize the equivalence of the food safety inspection system for beef, and to reinstate commercially viable trade in beef and beef products in recognition of the measures the United States has implemented in regard to bovine spongiform encephalopathy (BSE) that are consistent with international standards.<sup>39</sup> As noted in chapter 3, U.S. exports of beef and beef products to Korea have been strictly limited since 2003 due to Korea's SPS restrictions related to BSE. U.S. agricultural producers are concerned that use of SPS measures that are not based on sound science in bilateral trade with Korea could reduce the likely benefits to their industries from the U.S.-Korea FTA. Two agricultural industries, the poultry and pork industries, indicated that Korea's willingness to accept poultry and pork from USDA-approved facilities would enhance the trade benefits negotiated for these industries under the FTA.

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<sup>34</sup> ITI, "U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects," testimony before the USITC, June 20, 2006.

<sup>35</sup> Express Delivery & Logistics Assoc., "Testimony on the U.S.-Korea Free Trade Agreement."

<sup>36</sup> USKFTABC, "Views on the Economic Impact of a United States-Korea Free Trade Agreement," written submission to the USITC, June 27, 2007.

<sup>37</sup> USTR, communication with Commission staff, Washington, DC, June 8, 2007.

<sup>38</sup> USTR, "Final - United States - Korea FTA Texts," 2007, chap. 8.

<sup>39</sup> For additional information on the meat sector, see chap. 3 of this report.

## ***Summary of Provisions***

This chapter covers the protection of human, animal, or plant life or health in the parties' territories, insofar as they directly or indirectly affect trade between them, and the enhancement of the World Trade Organization (WTO) Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement). The FTA mandates no changes to either parties SPS rules. The United States and Korea would agree to establish a Committee on Sanitary and Phytosanitary Matters to coordinate administration of the chapter (Article 6.3). The Committee would provide a forum to help each party implement the SPS Agreement, enhance mutual understanding of each government's SPS measures, resolve future bilateral SPS matters, coordinate technical assistance programs, and consult on issues and positions in the WTO, various codex committees, and in other fora. The chapter specifies that no party has recourse to dispute settlement under the FTA for any matter arising under the chapter. Any SPS issue that may require formal dispute resolution would be resolved through the formal process established under the WTO SPS Agreement.

## ***Views of Interested Parties***

In its report on the agreement, the Agricultural Policy Advisory Committee (APAC) expressed the view that the U.S.-Korea FTA will benefit U.S. farmers and ranchers by increasing export opportunities through the elimination of tariff and nontariff barriers. The report said, however, that the benefits will occur for the beef industry only if meaningful science-based trade is fully restored prior to the approval of the FTA. The report identified three key issues that must be addressed for beef: beef plant inspection equivalency, Korean import certification language, and Korea's recognition of USDA Process Verified Programs (PVPs) as approved by the Agricultural Marketing Service.<sup>40</sup>

The National Cattlemen's Beef Association (NCBA), in a written submission to the Commission, said that all of Korea's bans on U.S. beef products must be lifted by the time the agreement is sent to Congress or it will not support the FTA. The NCBA said that SPS and plant equivalency precedents established in recently negotiated FTAs are the only way to assure real access to the South Korean market.<sup>41</sup>

In its report on the FTA, the Animals and Animal Products Agricultural Trade Advisory Committee (ATAC) indicated that the beef industry will withhold support for the U.S.-Korea FTA until commercially viable beef trade occurs based on international recognized guidelines established by the World Organization for Animal Health (OIE).<sup>42</sup> The report said, however, that the U.S. poultry industry supports the FTA. The report noted a separate bilateral agreement under which Korea agreed to recognize the equivalency of the U.S. food safety inspection system for poultry and to take measures to minimize poultry trade disruptions with respect to avian influenza.<sup>43</sup> According to the report, the poultry industry is of the view that these measures, combined with the tariff provisions of the U.S.-Korea FTA, will result in enhanced U.S.-Korea poultry trade.

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<sup>40</sup> APAC for Trade, *Agricultural Policy Advisory Committee for Trade Report*, April 27, 2007, 2–3.

<sup>41</sup> NCBA, "Comments on the United States-South Korea Free Trade Agreement," written submission to USITC, April 27, 2006, 3.

<sup>42</sup> ATAC for Animal and Animal Products, *Advisory Committee Report*, April 26, 2007, 1.

<sup>43</sup> *Ibid.*, 4.

The National Pork Producers Council (NPPC), in a written submission to the Commission, expressed support for the FTA. The submission cited Korea's agreement to accept all pork and pork products from USDA-approved facilities as an important factor, and said that this would allow the industry to take advantage of the eventual elimination of tariffs on fresh, chilled, and frozen pork, and on processed pork products, negotiated under the FTA.<sup>44</sup>

In its report, the ATAC for Trade in Processed Foods said that it was taking no position on the agreement. The Committee expressed concern that the benefits of the FTA from the tariff side could be nullified by continued TBTs in the form of SPS measures that are not addressed in the FTA, specifically, food additives banned by Korea but approved by the U.S. Food and Drug Administration and commonly used in U.S. manufactured processed food products that effectively preclude the export to Korea of U.S. products containing such additives. The Committee said that, for certain major U.S. food processors, addressing these technical barriers could provide benefits greater than removing tariffs.<sup>45</sup>

In its report, the ATAC on Trade in Fruits and Vegetables said that it commends the commitment of both the United States and Korea in the FTA to base their SPS measures on sound science, as required in the WTO.<sup>46</sup> The Committee said, however, that it is concerned about how Korea has applied its SPS measures in the past, and urged both the USDA and USTR to use every means to address SPS issues in bilateral trade as soon as they are identified.

## **FTA Chapter 9—Technical Barriers to Trade**

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### ***Assessment***

The technical barriers to trade (TBT) provisions of the U.S.-Korea FTA would likely benefit U.S. firms investing in and exporting to Korea. Because Korea reportedly continues to maintain non-transparent and often discriminatory standardization, certification, and testing procedures that serve as impediments to trade, there would likely be a positive effect on U.S. industries and the U.S. economy based on implementation of the FTA. Among other things, TBT provisions would likely benefit U.S. companies by (1) reinforcing transparency obligations in rule making, (2) increasing opportunities for direct participation on a nondiscriminatory basis in Korea's standards development activities, (3) establishing informal mechanisms for rapid resolution of disputes, and (4) reinforcing WTO TBT obligations. The chapter would largely affirm and improve on the implementation of the WTO TBT agreement rather than substantively expanding on it.<sup>47</sup>

The TBT chapter also contains standards and regulatory provisions specifically pertaining to the automotive industry,<sup>48</sup> including a dispute settlement mechanism to deter continued

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<sup>44</sup> NPPC, "Public Comments Concerning the U.S.-Republic of Korea Free Trade Agreement," written submission to the USITC, June 14, 2007, 3.

<sup>45</sup> ATAC for Trade in Processed Foods, *Advisory Committee Report*, April 27, 2007, 5.

<sup>46</sup> ATAC on Trade in Fruits and Vegetables, *Advisory Committee Report*, April 2007, 3.

<sup>47</sup> U.S. government official, interview by Commission staff, March 13, 2007; and U.S. industry representatives, telephone interviews by Commission staff, April 10–12, 2007.

<sup>48</sup> USTR, "Final - United States - Korea FTA Texts," 2007, Article 9.7.

use of TBTs to protect Korea's auto market from imports.<sup>49</sup> As such, this would be the first time a TBT chapter of an FTA negotiated by the United States would contain provisions that address TBTs with respect to a specific industry.<sup>50</sup> Other U.S. product sectors that would potentially benefit from the provisions include pharmaceuticals, medical devices, biotechnology, cosmetics, transportation equipment, telecommunications and other IT equipment, electrical equipment and household appliances, construction materials and equipment, food and beverage products, and energy services and equipment.<sup>51</sup>

U.S. industry and government officials indicate that in their view Korea's application of its certification, testing, regulatory, labeling, and other standards-related practices often do not conform with WTO guidelines and, thus, serve as TBTs.<sup>52</sup> The United States and other Korean trading partners contend that "lack of transparency and insufficient coordination [have] generated a rather complex standardization and certification system," with Korean regulatory agencies' rules too often overlapping one another.<sup>53</sup> The Korean government reportedly sometimes issues new regulations without adequate public consultation and comment opportunities.<sup>54</sup> The FTA addresses these issues by increasing both transparency and opportunities for U.S. industry participation in the Korean standards process.<sup>55</sup> This should reduce the likelihood of duplicative or discriminatory technical regulations being developed in Korea that could serve as technical barriers to U.S. exports.

U.S. industry officials contend that Korea's technical regulations and conformity assessment procedures currently apply differently to imports than to domestic products.<sup>56</sup> They state that Korean regulatory authorities often require that imported products such as medical devices, pharmaceuticals, chemicals (and chemical products), and electronics, and information technology equipment have prior regulatory approval in their home countries before they may be submitted for approval consideration in Korea.<sup>57</sup> Further, Korea reportedly sometimes requires use of "standards unique to Korea even when international standards

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<sup>49</sup> Stangarone, "Anatomy of a Deal: The U.S.-Korean FTA," April 2007, 1.

<sup>50</sup> Although not as extensive as the automotive provisions, the proposed FTA also includes a provision requiring each party to take steps to implement Phase II of the APEC Mutual Recognition Arrangement for Conformity Assessment of Telecommunications Equipment with respect to the other party as soon as possible for the purpose of reducing technical and regulatory barriers to trade in this sector. USTR, "Final - United States - Korea FTA Texts," 2007, Article 9.5.5.

<sup>51</sup> USCIA, "Korea, South," June 19, 2007, 1; EIU, "Country Commerce: South Korea," July 2006, 106; USTR, "Korea," *2006 National Trade Estimate Report on Foreign Trade Barriers*, March 31, 2006, 358-361; and U.S. industry officials, telephone interviews by Commission staff, May 7-9, 2007. For additional information on tariff and nontariff measures in Korea potentially affecting the U.S. automotive industry, see the sector-specific analysis on motor vehicles in chap. 3.

<sup>52</sup> Kiyota and Stern, "Economic Effects of a Korea-U.S. Free Trade Agreement," 2007, 8; USFCS, "Korea Trade Regulations and Standards," 2005, 76-81; and U.S. industry officials, telephone interviews by Commission staff, May 7-9, 2007.

<sup>53</sup> WTO, Trade Policy Review Body (TPRB), "TPR, Republic of Korea, Report by the Secretariat," September 17, 2004, 58.

<sup>54</sup> USFCS, "Korea Trade Regulations and Standards," 2005, 76-81.

<sup>55</sup> Dawson, testimony before the USITC, June 20, 2007, 71.

<sup>56</sup> Primosch, testimony before the Trade Policy Staff Committee, Office of the USTR, March 14, 2006, 5; Dawson, testimony before the USITC, June 20, 2007, 127; and U.S. industry officials, telephone interviews by Commission staff, May 7-9, 2007.

<sup>57</sup> EIU, "Country Commerce: South Korea," July 2006, 106; USTR, "Korea," *2007 National Trade Estimate Report on Foreign Trade Barriers*, April 2, 2007, 358-361; Gross and Minot, "Medical Device Registration in Korea: An Overview," January 2007, 1-4; and U.S. industry officials, telephone interviews by Commission staff, May 7-9, 2007.

exist.”<sup>58</sup> For example, the Korean government reportedly has mandated the licensing and use of unique standards<sup>59</sup> and technologies developed by Korean research institutes and trade associations that discriminate against U.S. suppliers of telecommunications products.<sup>60</sup> Also, U.S. automotive industry officials assert that Korea imposes unique and overly stringent emissions standards,<sup>61</sup> certification, and other regulatory requirements that are “out of sync with international standards”<sup>62</sup> and that the Korea regulatory system lacks transparency.<sup>63</sup> U.S. industry officials assert that NTMs have made it difficult for U.S. and other foreign automakers to achieve significant market share in Korea.<sup>64</sup>

Other industries identified as adversely affected by Korean certification, testing, and other standards-related practices include the cosmetics, nutrition products, electrical and gas appliances, and manufacturing equipment industries.<sup>65</sup> Products particularly affected by allegedly discriminatory labeling issues include pharmaceuticals, cosmetics, consumer goods, alcoholic beverages, biotechnology, and agricultural and food products.<sup>66</sup>

### ***Summary of Provisions***

Chapter 9 of the U.S.-Korea FTA would require both parties to intensify efforts to improve transparency, enhance bilateral cooperation on standards-related issues, increase mutual acceptance of one another’s regulations and procedures, and reduce or eliminate unnecessary technical trade barriers.<sup>67</sup> The chapter would establish a Committee on Technical Barriers to Trade, comprising representatives of each party, to monitor the implementation and administration of the chapter and to address any issues arising from the other’s standards, technical regulations, or conformity-assessment procedures.<sup>68</sup>

To improve transparency,<sup>69</sup> the chapter would require each party to allow persons from the other party to participate in the development of its standards, technical regulations, and conformity assessment procedures; to transmit proposals for new technical regulations and

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<sup>58</sup> Dawson, testimony before the USITC, June 20, 2007, 109; and USKBC and the AMCHAM in Korea, “U.S.-Korea Free Trade Agreement Position Paper,” 2006, 28–29.

<sup>59</sup> Dawson, testimony before the USITC, June 20, 2007, 109.

<sup>60</sup> Reis, testimony before the USITC, June 20, 2007, 27; and “Korea,” *2007 National Trade Estimate Report on Foreign Trade Barriers*, April 2, 2007, 358–361.

<sup>61</sup> A 2003 amendment to automobile emissions requirements under the Air Quality Preservation Act imposes highest emissions standards in the world on motor vehicles manufactured or imported into Korea after January 2006. EIU, “Country Commerce: South Korea,” July 2006, 25.

<sup>62</sup> Biegun, testimony before the USITC, June 20, 2007, 205 and 240.

<sup>63</sup> Meyer, testimony before the USITC, June 20, 2007; Schott, Bradford, and Moll, “Negotiating the Korea-United States Free Trade Agreement,” June 2006, 2; Cooper and Manyin, “The Proposed South Korea-U.S. Free Trade Agreement,” May 24, 2007, 27; and USTR, “Trade Facts: Fact Sheet on Auto-Related Provisions in the U.S.-Korea Free Trade Agreement,” April 3, 2007, 1.

<sup>64</sup> Biegun, testimony before the House Committee on Ways and Means, March 20, 2007, 1–5; Collins, testimony before the House Committee on Ways and Means, March 20, 2007, 1–6; Ford Motor Co., “Statement: Ford Comments on the US & Korean Free Trade Agreement Negotiations (April 2, 2007),” 1; and DaimlerChrysler, “Chrysler Group Statement Regarding U.S.-Korea Free Trade Agreement (April 2, 2005),” 1.

<sup>65</sup> USFCS, “Korea Trade Regulations and Standards,” 2005, 76–81.

<sup>66</sup> Dawson, testimony before the USITC, June 20, 2007, 70.

<sup>67</sup> USTR, “Final - United States - Korea FTA Texts,” 2007, Articles 9.4–9.6.

<sup>68</sup> *Ibid.*, Article 9.8.

<sup>69</sup> The transparency provisions of the U.S.-Korea FTA TBT chapter are consistent with overall U.S. trade negotiating objectives of increased transparency, public access, and timely publication.



conformity assessment procedures electronically to the other party at the same time they are transmitted to the WTO pursuant to the TBT agreement; to allow the other party at least 60 days to review and comment on such proposals; and to publish or otherwise make available to the public its responses to significant comments no later than the date it publishes the final technical regulation or conformity assessment procedure.<sup>70</sup> The FTA provisions would encourage each party to consider a broad range of alternatives for accepting the results of the other's conformity-assessment procedures and technical regulations, and, when this is not possible, to explain why.<sup>71</sup>

The TBT chapter would also include unique provisions to address standards- and regulatory-related issues specifically affecting the automotive industry, such as automotive emissions standards, safety standards, and onboard diagnostics requirements.<sup>72</sup> Further, the chapter would establish an Automotive Working Group<sup>73</sup> to, among other things, resolve issues that either party raises with respect to developing and enforcing standards, technical regulations, and conformity-assessment procedures for the automotive sector.<sup>74</sup>

### *Views of Interested Parties*

U.S. industry officials said that the TBT chapter of the FTA is particularly important, given the role of nontariff barriers in Korea's economy.<sup>75</sup> In general, they state that the TBT provisions of the FTA, if appropriately implemented, could be conducive to increasing trade and investment with Korea through increased transparency and bilateral coordination.<sup>76</sup> According to testimony on behalf of the U.S.-Korea Business Council, the agreement "provides for new levels of transparency and fairness in the establishment and administration of standards."<sup>77</sup>

While U.S. industry and government officials support an FTA provision that would provide for national treatment to U.S. testing and certification bodies, they nevertheless expressed concern that it could be limited in its effects since Korean government, or government-controlled, testing bodies may not be covered by the provision.<sup>78</sup> Further, a major U.S. automobile producer testified at the Commission's hearing that the U.S.-Korea FTA will not

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<sup>70</sup> USTR, "Final - United States - Korea FTA Texts," 2007, Article 9.6.

<sup>71</sup> *Ibid.*, Article 9.5.

<sup>72</sup> Lee, testimony before the USITC, June 20, 2007, 15.

<sup>73</sup> The Automotive Working Group is to provide an "early warning system" to address standards, certification, and other regulatory issues that could develop in the future. When Korea develops new regulatory requirements, it is obligated to provide such information to the working group as soon as the information becomes available. The working group is to analyze potential new regulations and provide its views to the Korean government for purposes of promoting good regulatory practices. USTR, "Final - United States - Korea FTA Texts," 2007, Annex 9-B; USTR, "Trade Facts: Fact Sheet on Auto-Related Provisions in the U.S.-Korea Free Trade Agreement," April 3, 2007, 1-2; and USTR, "Fact Sheet: Free Trade with Korea, Brief Summary of the Agreement," April 2007, 1.

<sup>74</sup> For additional information on the specific automotive standards issues to be addressed, see the sector-specific assessment for this industry in chapter 3 of this report.

<sup>75</sup> NAM, "NAM Commends U.S. Negotiators for Concluding Korea FTA (April 2, 2007)," 1; and U.S. industry officials, telephone interviews by Commission staff, April 10-12, 2007.

<sup>76</sup> Dawson, testimony before the USITC, June 20, 2007, 29; and U.S. industry officials, telephone interviews by Commission staff, April 10-12, 2007.

<sup>77</sup> Reis, testimony before the USITC, June 20, 2007, 29.

<sup>78</sup> U.S. industry officials, telephone interviews by Commission staff, April 10-12, 2007; and U.S. government officials, interview by Commission staff, February 13, 2007.

effectively address “Korea’s efforts to use automotive safety, emissions, and other technical standards as a tool to discriminate against imported auto products.”<sup>79</sup>

The Industry Trade Advisory Committee on Standards and Technical Barriers to Trade (ITAC 16), which represents a wide range of U.S. industries, stated in its report that the TBT chapter of the FTA contains several important improvements over previously negotiated FTAs with regard to transparency in the development of standards, technical regulations, national treatment, and conformity assessment procedures.<sup>80</sup> The ITAC 16 report stated, however, that it continues to have serious concerns regarding Korea’s effective implementation of the chapter provisions. To address such concerns, the Committee said it would like to see the text of the TBT chapter changed, or the Korean government offer a side letter or operational guidelines, to ensure implementation of the chapter as intended.<sup>81</sup> In its report, the Advisory Committee for Trade Policy and Negotiations recommended that a special U.S. government and private sector group be set up to monitor closely the operation of the TBT chapter.<sup>82</sup> Finally, the Industry Trade Advisory Committee on Consumer Goods (ITAC 4) said that the TBT provisions should help U.S. exporters better compete in Korea.<sup>83</sup>

U.S. automakers remain concerned that Korean commitments with regard to NTMs in the FTA may be broken as they assert has happened under past agreements.<sup>84</sup> In views attached to the ITAC 2 (Automotive Equipment and Capital Goods) report, Ford Motor Company said that while some progress was achieved with respect to existing nontariff barriers, it is disappointed that the burden of proving the existence of TBTs and to demonstrate injury before an appropriate remedy is applied continues to be borne by U.S. exporters.<sup>85</sup> Ford also said that it was disappointed that Korea “continues to complicate the auto certification process by mixing U.S. and European safety and emissions requirements.”<sup>86</sup> On the other hand, in its views attached to the ITAC 2 report, General Motors reported that because the negotiated Korean emissions standards are sufficiently harmonized with California standards, U.S. automobile manufacturers should be able to export vehicles to Korea without further modification.<sup>87</sup> General Motors also said that a duty “snapback” provision that would allow the U.S. MFN passenger car tariff to be reimposed on Korea if the dispute settlement panel determines there has been nullification and impairment of expected benefits of the FTA should discourage the creation of new technical barriers or reinstatement of old ones.<sup>88</sup>

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<sup>79</sup> Biegun, testimony before the USITC, June 20, 2007, 219.

<sup>80</sup> ITAC (16) on Standards and Technical Trade Barriers, *Advisory Committee Report*, April 25, 2007, 1–5.

<sup>81</sup> *Ibid.*

<sup>82</sup> ACTPN, *Report*, April 26, 2007, 7.

<sup>83</sup> ITAC (4) on Consumer Goods, *Report*, April 26, 2007, 4.

<sup>84</sup> Klingner and Kim, “The U.S.-South Korea FTA,” April 2, 2007, 1–2.

<sup>85</sup> ITAC (2) on Automotive Equipment and Capital Goods, *Advisory Committee Report*, April 27, 2007, 7–9.

<sup>86</sup> *Ibid.*, 10.

<sup>87</sup> *Ibid.*

<sup>88</sup> *Ibid.*, 13.

## FTA Chapter 15–Electronic Commerce

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### *Assessment*

The U.S.-Korea FTA is likely to facilitate electronic commerce (e-commerce) activity between the two countries, as well as trade in the goods and services that enable e-commerce. U.S. suppliers of information and communication technology (ICT) products, which have a competitive advantage in the Korean marketplace in terms of technology and price, are the most likely to benefit from the FTA.<sup>89</sup> Despite the steady progress of e-commerce in Korea, however, current laws and regulations continue to limit the growth of e-commerce.<sup>90</sup>

E-commerce is well established in Korea, and the country has the prerequisites in place to continue to foster a thriving e-commerce market. In particular, Korea has a relatively advanced IT infrastructure and one of the most comprehensive policy frameworks for e-commerce in Asia. The Korean framework includes provisions to support e-commerce projects at small and medium-sized companies (SMEs), which have not embraced e-commerce to the degree that larger firms have.<sup>91</sup> In addition, PC usage and Internet access rates in Korea are high, with Korea leading the Asia Pacific region in terms of broadband usage.<sup>92</sup> Broadband has proliferated in Korea due, in part, to competition within the local-call telecommunications market, the large number of Korean Internet cafes, and the country's high-density demographics.

In 2003, the e-commerce market in Korea totaled \$205.0 billion, with business-to-business (B2B) transactions accounting for 88 percent of the market's total, business-to-consumer (B2C) accounting for 2.6 percent, and business-to-government accounting for 9.2 percent.<sup>93</sup> While B2B has emerged as the predominant type of e-commerce activity in Korea, the growth of B2C has been the strongest in recent years.<sup>94</sup> For example, in 2005, approximately 3,440 B2C cyber shopping malls were operational in Korea, with estimated sales of \$7.8 billion.<sup>95</sup> Acknowledging the strength of B2C commerce in the Korean market, the U.S.-Korea FTA contains specific provisions designed to facilitate consumer access to the Internet for commercial transactions, as well as to protect consumers against fraudulent commercial practices.

Growth within the B2C sector of the Korean e-commerce market is expected to continue, as traditional businesses and "dotcom" operations combine to form strategic alliances. At present, however, e-commerce implementation by the business sector as a new engine for

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<sup>89</sup> Market entry and growth strategies commonly employed by foreign suppliers of ICT products and services in Korea include joint ventures and licensing arrangements. USDOC, ITA, Office of Technology and Electronic Commerce, "Korea Internet E-Commerce Toolbox FAQ."

<sup>90</sup> MOCIE, Republic of Korea, "E-Business in Korea," October 14, 2004.

<sup>91</sup> MOCIE, Republic of Korea, "E-commerce in Korea," September 6, 2002.

<sup>92</sup> Currently, Internet access in Korea is provided solely through broadband services. Tan, "South Korea Holds Broadband Lessons"; and Information Technology Assoc. of America, "E-Data Telecommunications: New eMarketer Report Projects 90 Million Broadband Households Worldwide by 2004," May 2001.

<sup>93</sup> MOCIE, Republic of Korea, "E-Business in Korea," October 14, 2004. By contrast, in the United States, B2B transactions comprise 93 percent of the country's total e-commerce transactions. UNCTAD, "Chapter 1: Recent Internet trends: Access, Usage and Business Applications," 2003.

<sup>94</sup> KIEC, Republic of Korea, "Korea e-Commerce: Infrastructure."

<sup>95</sup> USDOC, ITA, Office of Technology and Electronic Commerce, "Korea Internet E-Commerce Toolbox FAQ."

growth lags the implementation rate in other industrialized countries, such as Japan and the United States. In 2002, expenditures in B2B e-commerce transactions in Korea reached approximately \$130 billion. In Japan and the United States, such expenditures equaled \$516 billion and \$995 billion (2001 estimate), respectively. Explanations offered by the Korean government include a lack of collaboration among businesses, insufficient investment resources among SMEs, and the absence of a standardized payment system.<sup>96</sup> Creating an environment more favorable to B2B e-commerce will likely require, among other things, offering attractive tax reductions to firms investing in information technology research and development.<sup>97</sup>

### ***Summary of Provisions***

The provisions relating to electronic commerce within the U.S.-Korea FTA are similar to those of previous FTAs. In general, the U.S.-Korea FTA (1) would provide for nondiscriminatory and duty-free treatment of all digital products, whether delivered electronically or in physical form; (2) contains commitments by both parties to facilitate the use of electronic authentication in their respective markets; and (3) includes principles that ensure consumers' reasonable access to the Internet to conduct electronic commerce.

First, under the U.S.-Korea FTA, the parties would commit to nondiscriminatory treatment of digital products and agree not to impose customs duties, fees, or other charges on such products, whether traded in physical form or electronically over the Internet. In addition, the parties would agree not to accord less favorable treatment to some digital products than are accorded to other like products because they were created, stored, transmitted, published, or first made commercially available outside its territory, or because of the nationality of the author, performer, producer, developer, or distributor of such digital products.

Second, the U.S.-Korea FTA is aimed at ensuring that the parties accept the validity of electronic authentication and electronic signatures. Neither party, for example, may deny the legality of a signature solely because it is in electronic form.

Finally, the U.S.-Korea FTA includes provisions that are intended to promote and maintain online consumer protection, including those that foster cooperation in enforcing laws against fraudulent and deceptive e-commerce practices. The FTA introduces principles not included in previous FTAs that would promote consumer access to the Internet to conduct electronic commerce, and that would emphasize the importance of maintaining unrestricted cross-border information flows. Such principles likely reflect the rapid growth of both business-to-business and business-to-consumer electronic commerce in Korea in recent years.<sup>98</sup>

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<sup>96</sup> MOCIE, Republic of Korea, "E-Business Initiative in Korea," 2001.

<sup>97</sup> KIEC, Republic of Korea, "Korea e-Commerce: Overview"; and American Univ., "Management of Global Information Technology, Information Technology Landscape in Korea."

<sup>98</sup> KIEC, Republic of Korea, "Korea e-Commerce: Infrastructure."

## *Views of Interested Parties*

The U.S. information technology industry supports provisions in the FTA that call for the establishment of guarantees of nondiscrimination, a binding prohibition on customs duties on products delivered electronically, and the creation of a favorable environment for the development of global e-commerce.

Several of the ITAC reports addressed provisions in the agreement relating to e-commerce. For example, in its report on the FTA, the Industry Trade Advisory Committee for Information and Communications Technologies, Services and Electronic Commerce (ITAC 8) expressed support for measures that promote the most liberal treatment of e-commerce as is possible and a moratorium on taxes, duties, and other fees pertaining to e-commerce, the Internet, or electronic transmissions of software or other digital products.<sup>99</sup> The Industry Advisory Committee on Intellectual Property Rights (ITAC 15) said that it also supports the measures Korea has proposed or initiated that are likely to simplify and encourage the use of e-commerce, such as higher levels of protection regarding intellectual property rights, which lead to a stronger legal infrastructure for e-commerce, as well as improved market conditions for the distribution and transmission of materials over the Internet.<sup>100</sup> The ITAC 15 report also said that other practices particularly useful to the domestic Korean e-commerce market include fostering consumer confidence in e-commerce and providing greater data privacy protection.

Several industry groups also expressed views. For instance, the Information Technology Industry Council, in testimony at the Commission's hearing, said that it believes that the FTA's expansion of the number of IT products and services available for duty-free export to Korea, beyond what is required under the WTO Information Technology Agreement, will enable U.S. IT firms to compete more effectively in the Korean market.<sup>101</sup> In addition, the Software and Information Industry Association said that the apparent expansion in market access for services and e-commerce will provide a framework with which businesses can deliver digital products and services around the world.<sup>102</sup> Finally, the Coalition of Services Industries, in testimony before the House Committee on Ways and Means, said that it expects the FTA will have a positive effect on U.S. service providers by guaranteeing that Korea will not undertake any new restrictions that may hamper the growth of e-commerce in the Korean market.<sup>103</sup>

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<sup>99</sup> ITAC (8) for Information and Communications Technologies, Services and Electronic Commerce, *Report*, April 27, 2007.

<sup>100</sup> ITAC (15) on Intellectual Property Rights, *Advisory Committee Report*, April 27, 2007.

<sup>101</sup> Dawson, testimony before the USITC, June 20, 2007, 68.

<sup>102</sup> USTR, "Strong Support for the U.S.-Korea (KORUS) Free Trade Agreement," May 22, 2007.

<sup>103</sup> Vastine, testimony before the House Committee on Ways and Means, March 20, 2007.



# CHAPTER 6

## Impact of Regulatory Provisions

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This chapter assesses the likely impact of provisions in the U.S.-Korea FTA related to the regulatory environment. These provisions cover nine FTA chapters (10, 11, 16–22) and include the following topics: trade remedies, investment, competition policy, government procurement, intellectual property rights, labor, environment, transparency, and dispute settlement.

### FTA Chapter 10–Trade Remedies

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#### *Assessment*

Under the provisions of the trade remedies chapter, each party would retain all rights and obligations of Article XIX of GATT 1994, the WTO Agreement on Safeguards and Countervailing Measures, and the WTO Agreement on Implementation of Article VI of the GATT 1994 (the Anti-dumping Agreement). The trade remedies chapter of the U.S.-Korea FTA, like earlier FTAs that the United States has entered into, would authorize a party to apply a safeguard measure against the goods of the other party during the transition period of the agreement if, as a result of the reduction or elimination of a duty under the agreement, an article is being imported from the other party in such increased quantities as to be a substantial cause of serious injury or threat thereof to a domestic industry producing a like or directly competitive good.

The agreement does not mandate any changes to U.S. antidumping and countervailing duty (AD-CVD) law or change domestic processes for making such changes. The chapter would provide, in a departure from past FTAs, for certain consultations in the course of AD-CVD investigations, exchanges of information concerning AD-CVD practices, and the possibility of accepting undertakings on price or quantity instead of imposing AD and CVD duties. In another departure from other FTAs, the chapter would also provide for the establishment of a Committee on Trade Remedies that would oversee implementation of this chapter and facilitate exchange and cooperation among the parties related to trade remedy issues.

The U.S. industry sectors most likely to be affected by this chapter, positively or negatively, are those that would seek relief, particularly under the bilateral safeguard provision, and those whose exports to Korea would be the subject of any measures applied by Korea under the agreement. The specific industry sectors affected would depend on the products that are the subject of any such measures.

#### *Summary of Provisions*

Section A of Chapter 10 contains a bilateral safeguard provision similar to bilateral safeguard provisions in other free trade agreements that the United States has entered into in recent years. It would allow a party to increase a rate of duty or suspend further reductions in the rate of duty if its designated competent authority finds, as a result of the reduction or elimination of a duty under the agreement, that imports of a good are in such increased

quantities as to be a substantial cause of serious injury, or a threat of serious injury, to a domestic industry producing a like or directly competitive good. No duty could be increased to an amount that exceeds the lesser of the current MFN rate of duty or the rate in effect immediately preceding the date of entry into force of the agreement. The duration of any measure could not exceed 2 years, except that the period could be extended by up to 1 year if certain conditions are found to be present. A measure that exceeds 1 year must be progressively liberalized at regular intervals. A party could not apply a bilateral safeguard measure more than once against the same good, and a measure could not be applied beyond the transition period except with the consent of the other party.

A party applying a measure must provide compensation to the other party in an amount mutually agreed upon; if the parties are unable to agree on compensation, the other party could suspend concessions with respect to originating goods of the party applying the safeguard measure that have trade effects substantially equivalent to the safeguard measure. The FTA allows a party to apply a measure on a provisional basis (for up to 200 days) when critical circumstances are found to exist. The agreement defines terms and sets out certain procedural requirements, including notification consultation requirements. Each party would retain its rights and obligations under Article XIX of the GATT 1994 and the WTO Safeguards Agreement. The chapter, however, would provide that a party applying a (global) safeguard measure under the WTO Safeguards Agreement could exclude imports of a good from the other party if such imports from the other party are not a substantial cause of serious injury or threat thereof.

Section B states that each party would retain its rights and obligations under the WTO agreement with regard to the application of antidumping and countervailing duties. It states that, with the exception of paragraphs 3 and 4 of Article 10.7 (which relate to notification and consultations and certain “undertakings”), no provision of the agreement should be construed as imposing any rights or obligations on a party with respect to antidumping or countervailing duty measures. In a departure from previous FTAs, paragraph 3 would require that a party, upon receipt of an application and before initiating an investigation, provide notice to the other party and opportunity for a meeting.<sup>1</sup> Also new in this FTA, paragraph 4 of Article 10.7 would require the parties, after making a preliminary affirmative determination of dumping or subsidization and injury caused by such dumping or subsidization, to consider “undertakings” with respect to price and, in countervailing duty investigations, quantity, which may result in suspension of the investigation without the imposition of antidumping or countervailing duties.<sup>2</sup>

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<sup>1</sup> More specifically, paragraph 3 of Article 10.7 requires that a party, upon receipt of a properly documented antidumping or countervailing duty application with respect to imports from the other party, and before initiating an investigation, provide written notification to the other party of its receipt of the application and afford the other party a meeting or similar opportunity regarding the application, consistent with the party’s law.

<sup>2</sup> Paragraph 4 lists three “undertakings.” First, after initiation of an antidumping or countervailing duty investigation, a party agrees to transmit to the other party’s embassy or competent authorities written information regarding their procedures for requesting consideration of an undertaking on price or, as appropriate, quantity, including the time frames for offering and concluding any such undertaking. Second, in an antidumping investigation in which a party’s authorities have made a preliminary affirmative determination of dumping and injury, the party must afford “due consideration, and adequate opportunity for consultations” to exporters of the other party regarding proposed price undertakings, which, if accepted, may result in suspension of the investigation without imposition of antidumping duties, through the means provided for in the party’s laws and procedures. Third, in a countervailing duty investigation in which party authorities have made a preliminary affirmative determination of subsidization and injury, the party must

(continued...)



In another departure from previous FTAs, section C would provide for the establishment of a Committee on Trade Remedies, comprising representatives from each party who have responsibility for trade remedies matters, including antidumping, subsidies and countervailing measures, and safeguard issues. The functions of the Committee would include enhancing knowledge of each other's trade remedy laws, policies, and practices; overseeing implementation of the chapter, including compliance with paragraphs 3 and 4 of Article 10.7; improving cooperation between the parties' agencies having responsibilities for trade remedies matters; providing a forum for the parties to exchange information on issues relating to antidumping, subsidies and countervailing measures, and safeguards; establishing and overseeing development of educational programs related to the administration of trade remedy laws for officials of both parties; and providing a forum for the parties to discuss other relevant topics of mutual interest. These relevant topics would include international issues related to trade remedies (e.g., issues relating to the WTO Doha Round rules negotiations), practices by the parties' competent authorities in antidumping and countervailing duty investigations (such as application of "facts available" and verification procedures), and practices of a party that may constitute industrial subsidies. Section C would require that the Committee meet at least once per year.

### ***Views of Interested Parties***

The Industry Trade Advisory Committee on Steel (ITAC 12), whose members include U.S. producers of steel products, stated in its report on the agreement that it strongly objects to the new AD-CVD provisions, and asserts that they could weaken U.S. trade law, threaten to politicize the AD-CVD process, and set a dangerous precedent for future FTAs.<sup>3</sup> In particular, ITAC 12 stated that the current trade remedy process in the United States is already transparent and that the preinitiation notification and consultation requirement would merely serve to delay and politicize the process, particularly in antidumping investigations.<sup>4</sup> The report objected to the provisions in paragraph 4 of Article 10.7 regarding undertakings. It asserted that such "undertakings" will encourage the use of suspensions and the introduction of foreign governments into domestic trade law procedures. The report also objected to the establishment of a Committee on Trade Remedies, stating that such a forum will give Korea the opportunity to try to further weaken U.S. trade remedy law.<sup>5</sup>

In separate statements, the Weldbend Corporation, a U.S. producer of carbon steel butt-weld pipe fittings and flanges, the American Dehydrated Onion and Garlic Association, and the Labor Advisory Committee (LAC) expressed concern that the agreement's rules of origin may encourage producers in China and possibly other Asian countries to circumvent U.S.-imposed antidumping orders by transshipping products (including steel products such as pipe fittings and flanges and dehydrated garlic) to the United States through Korea.<sup>6</sup> LAC asserted

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<sup>2</sup> (...continued)

afford "due consideration and adequate opportunity for consultations" to the other party, and exporters of the other party regarding proposed undertakings on price, or, as appropriate, on quantity, which, if accepted, may result in suspension of the investigation without imposition of countervailing duties, through the means provided for in the party's laws and procedures.

<sup>3</sup> ITAC (12) on Steel, *Advisory Committee Report*, April 27, 2007, 7.

<sup>4</sup> *Ibid.*, 3.

<sup>5</sup> *Ibid.*, 4.

<sup>6</sup> Weldbend Corp., testimony before the USITC, April 27, 2006, 12–13; American Dehydrated Onion and Garlic Assoc., testimony before the USITC, 6; and LAC for Trade Negotiations and Trade Policy, *Report*, April 27, 2007, 22 and 28.

that such transshipment could impede efforts of the U.S. steel industry to invoke trade remedy cases against imports from China in the future.<sup>7</sup> LAC also objected to the chapter's emphasis on trade negotiation rather than trade enforcement. In particular, LAC stated that it opposes the provision allowing parties to negotiate price or quantity undertakings in lieu of paying duties resulting from affirmative determinations in AD-CVD cases. LAC added that it objected to the limited period for imposition of safeguards totaling 3 years, which is 1 year less than the period outlined in most other recent FTAs.<sup>8</sup> LAC also noted that it objected to the provision that safeguards cannot be invoked following the 10-year transition period without consent of the other party. While LAC did not endorse the discretionary exemption of Korea from future U.S. global safeguard measures in the agreement, it expressed a preference for the discretionary exemption over a mandatory exemption.<sup>9</sup> LAC also stated that the mandate of a proposed Committee on Trade Remedies should be more clearly defined and limited in scope. In particular, LAC noted that it objected to the possibility that Korea could influence trade remedy enforcement through such a committee.<sup>10</sup>

In its report, The Industry Trade Advisory Committee for Information and Communications Technologies, Services and Electronic Commerce (ITAC 8) stated that the U.S. Commerce Department should not change its practices regarding initiation or suspension of an AD-CVD investigation as a result of the provisions in this chapter. Moreover, the report noted that U.S. firms should not face a greater burden in seeking trade remedies and that suspension of AD-CVD investigations should not be accepted without support of the U.S. firms involved.<sup>11</sup>

Various other groups provided more limited comments regarding the trade remedies chapter. In particular, the Industry Trade Advisory Committee for Chemicals, Pharmaceuticals, Health/Science Products and Services (ITAC 3) stated that it supports retention of U.S. trade remedy laws and procedures as presented in this chapter, and the Industry Trade Advisory Committee on Forest Products (ITAC 7) remarked that it hopes that the U.S. government will address the issue of Korean industrial subsidy practices in the proposed Committee on Trade Remedies.<sup>12</sup> In its report, the Industry Trade Advisory Committee on Small and Minority Businesses (ITAC 11) commented that it generally supports the provisions in this chapter, with two exceptions. First, ITAC 11 said that the safeguard provisions should allow safeguard measures to be extended beyond the transition period even without the consent of the other party. Second, it added that parties should be permitted to apply safeguards on the same good more than once if the party in question has not yet taken corrective measures.<sup>13</sup>

In its report, the Industry Trade Advisory Committee on Distribution Services for Trade Policy Matters (ITAC 5) stated that bilateral trade agreement partners should be exempted from antidumping laws, which, it asserts, would assist U.S. retailers in exporting goods to Korea that may currently be subject to nontariff barriers or antidumping and safeguard measures.<sup>14</sup>

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<sup>7</sup> LAC for Trade Negotiations and Trade Policy, *Report*, April 27, 2007, 28.

<sup>8</sup> *Ibid.*, 18.

<sup>9</sup> *Ibid.*, 18.

<sup>10</sup> *Ibid.*, 28.

<sup>11</sup> ITAC (8) for Information and Communications Technologies, Services and Electronic Commerce, *Report*, April 27, 2007, 13.

<sup>12</sup> ITAC (7) on Forest Products, *Advisory Committee Report*, April 26, 2007, 6.

<sup>13</sup> ITAC (11) on Small and Minority Business, *Advisory Committee Report*, April 26, 2007, 5.

<sup>14</sup> ITAC (5) on Distribution Services for Trade Policy Matters, *Advisory Committee Report*, April 25, 2007, 5.

# FTA Chapter 11—Investment

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## *Assessment*

The investment provisions of the U.S.-Korea FTA would likely contribute to a more secure and stable investment environment for U.S. investors in Korea, and lead to increased bilateral investment flows, both into Korea and into the United States. The FTA would incorporate important protections for U.S. investors, particularly the investor-state dispute settlement mechanism, and rules on expropriation, performance requirements, transparency, and non-discriminatory national treatment standards. These changes would improve the investment environment by making it easier for U.S. investors to compete with domestic firms in Korea, and by safeguarding their investment revenues against potential political disruptions. The list of nonconforming measures (NCMs) taken by Korea would be significantly longer than for previous U.S. bilateral FTA partners. Industry representatives, however, generally believe that the FTA would provide significant gains for U.S. investors.

U.S. investors in recent years have expressed concern about the investment environment in Korea, particularly about regulatory transparency and national treatment of U.S. investors. However, there have been some improvements in recent years. For example, according to U.S. government sources, the Korea government has tried to inculcate a more positive attitude toward foreign investment, including through capital market reforms that have reduced restrictions on foreign equity ownership, and through the opening of several Free Economic Zones.<sup>15</sup> Box 6.1 provides additional information related to Korea's investment environment and bilateral investment flows. Remaining issues for U.S. investors include foreign equity limits in state-owned firms and most types of media companies.<sup>16</sup> The FTA would likely lead to additional investment in these areas, as some of the Korean equity restrictions on telecommunications and broadcasting services are phased out in the several years following entry into force of the FTA.<sup>17</sup> A number of restrictions will remain, however, limiting overall access by U.S. investors to the Korean economy in these key service areas.<sup>18</sup>

Financial services firms in general, and the insurance industry in particular, would likely be strong beneficiaries of the proposed new investment rules.<sup>19</sup> Financial services companies have faced restrictions in Korea on their ability to invest their operating funds and to offer new products and services, and foreign firms have been treated differently from Korean-based firms, with local companies permitted to provide certain services that foreign-owned companies could not provide.<sup>20</sup> Most of these restrictions on U.S. firms would be eliminated under the FTA. The removal of these restrictions will make it easier for U.S. firms to compete in the Korean market, leading to greater financial services investment in Korea.<sup>21</sup> U.S. financial service firms have a strong advantage in new, sophisticated financial products, so gaining the ability to provide their services on a national treatment basis would make

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<sup>15</sup> USTR, "Korea," *2007 National Trade Estimate Report on Foreign Trade Barriers*, April 2, 2007, 367–8.

<sup>16</sup> *Ibid.*

<sup>17</sup> For additional information on the services industry, see chap. 4 of this report.

<sup>18</sup> USTR, "Final - United States - Korea FTA Texts," 2007, Annex I, Schedule of Korea, and Annex II, Schedule of Korea.

<sup>19</sup> Industry representative, telephone interview by Commission staff, May 31, 2007; ITAC (10) on Services and Finance Industries, *Advisory Committee Report*, April 25, 2007; and Lane, testimony before the USITC, June 20, 2007, 73–74.

<sup>20</sup> Lane, testimony before the USITC, June 20, 2007, 73–74.

<sup>21</sup> *Ibid.*, 73–78.

### Box 6.1 Foreign investment in Korea

The United States is the world's largest destination for FDI, with 2005 inbound direct investment stock of \$1.6 trillion, representing 16 percent of total worldwide inbound investment stock. Inbound FDI accounts for 13.0 percent of the U.S. GDP. Korea, with a smaller economy, registered \$63.2 billion in inbound direct investment stock in 2005, equal to 8.0 percent of Korea's GDP.<sup>1</sup>

#### United States and Korea: Investment data, 2005

	<u>Korea</u>	<u>United States</u>
Inbound global investment stock (million dollars)	63,199	1,625,749
Inbound stock as percentage of GDP (percent)	8.0	13.0
Outbound global investment stock (million dollars)	36,478	2,051,284
Outbound stock as percentage of GDP (percent)	4.6	16.4
Investment inflows (million dollars)	7,198	99,443
Bilateral outbound investment stock (million dollars)	6,203	18,759

Sources: Data on total investment stock and investment inflows: UNCTAD, *World Investment Report 2006*. Data on U.S.-Korean bilateral investment: USDOC, BEA, *Survey of Current Business*, September 2006.

Note: Bilateral outbound investment stock reflects U.S. government statistics for U.S. outbound direct investment position in Korea on a historical-cost basis, and U.S. inbound direct investment position from Korea on a historical-cost basis. Korean data for Korea's outbound investment position in the United States are not available.

Korea has become more welcoming to foreign investors since reforms were instituted following the 1997–98 Asian financial crisis. As of 2005, however, foreign investors still note problems related to public and media objections to foreign investment, transparency regarding the interpretation of relevant regulations and corporate governance, intellectual property protection, and labor-management relations.<sup>2</sup> Restrictions on foreign investment in cable television and satellite broadcasters are particularly troublesome for U.S. investors.<sup>3</sup> The United States holds the largest single-country share of FDI stock in Korea, with 30 percent, compared with 30 percent for the combined EU-25 countries and 15 percent for Japan.<sup>4</sup> By operating revenue, the largest U.S.-owned companies in Korea are Halla Climate Control, owned by Visteon, and the Korean affiliates of Citigroup, 3M, Delphi, and IBM. The largest Korean-based companies operating in the United States include Samsung Electronics, LG Corp. (a chemicals manufacturer), Hyundai, LG Electronics, and POSCO (Korea-based steel manufacturer).<sup>5</sup>

The United States is the world's largest destination for FDI, with 2005 inbound direct investment stock of \$1.6 trillion. The following are the framework legal provisions governing foreign investment in Korea:

- Foreign Investment Promotion Act, Enforcement Decree, and Enforcement Rules, most recently amended in April 2007
- Regulation on Foreign Investment or Technology Introduction (as notified by the Ministry of Industry and Energy)
- Integrated bulletins on foreign investment (as notified by the Ministry of Industry and Energy)
- Tax Abatement Regulations for Foreign Investment (as notified by the Ministry of Finance and Economy)
- Tax Abatement Restriction Act (Chapter 5: Tax Abatement for Foreign Investment), Enforcement Decree, and Enforcement Rules.<sup>6</sup>

<sup>1</sup> UNCTAD, *World Investment Report 2006*, annex tables B.2 and B.3.

<sup>2</sup> USFCS, "Doing Business in Korea: A Country Commercial Guide for U.S. Companies," 2005.

<sup>3</sup> ITI, "ITI Submission on the United States-Korea Free Trade Agreement," written submission to the Trade Policy Staff Committee, Office of the USTR, March 24, 2006.

<sup>4</sup> USFCS, "Doing Business in Korea: A Country Commercial Guide for U.S. Companies," 2005. Reflects official Korean government FDI statistics, which may not match U.S. government statistics from the Department of Commerce.

<sup>5</sup> Bureau van Dijk Electronic Publishing, Orbis Database.

<sup>6</sup> *Invest Korea*.

them significantly more competitive.<sup>22</sup> The services section of this report (see chapter 4 of this report) provides additional discussion of the impact of the FTA on telecommunications, broadcasting, and financial services.

### *Summary of Provisions*

The two principal objectives of the FTA investment chapter are to create a welcoming environment for investors from each party by outlining the rights of investors and the rules that govern new cross-border investment, and to provide a clear outline of the investor-state dispute settlement process. Section A of the chapter outlines the rules that would govern new investments, and would set forth the types of investments to which these rules apply.<sup>23</sup> Specifically, the FTA would require each party to give national and MFN treatment to investors and covered investments of the other party. The treatment of investors under the FTA must comply with but need not go beyond customary international law. Other provisions include:

1. Expropriation could be only for a public purpose; it must be nondiscriminatory and accompanied by payment of prompt, adequate, and effective compensation in accordance with due process of law.
2. All financial transfers relating to covered investments, including, but not limited to, contributions to capital, payment of interest, and payments under contracts, could cover the full value of the investment and must be permitted freely and without delay.
3. Neither party could impose or enforce performance requirements as a condition of investment.<sup>24</sup>
4. Neither party could require that senior management or boards of directors be of any particular nationality.

The benefits of this chapter could only be denied in limited, delineated instances involving persons of a nonparty to the FTA. This section of the chapter also deals with NCMs, and special formalities and information requirements.

Section B of this chapter would provide for consultation and negotiation of disputes under the investor-state dispute settlement process, and provides detailed information and procedures for pursuing dispute settlement, including submission of claims to arbitration, selection of arbitrators, conduct of the arbitration, transparency of the arbitral proceedings, governing law, and awards of monetary damages (not including punitive damages) or restitution. Under the terms of the provisions of Section B, each party would consent to claims being submitted to arbitration under specified rules according to the process outlined

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<sup>22</sup> Ibid., 73–74.

<sup>23</sup> Investment related to financial services is covered separately in the financial services chapter (FTA chap. 13).

<sup>24</sup> Such provisions may include requirements to export a given level or percentage of goods or services, to purchase goods produced in a party's territory, or to transfer a certain technology or other proprietary information.

in the FTA. The awards made by any arbitration tribunal would have binding force only between the disputants and with regard to the particular case. Transparency would be required, along with public hearings.

Section C of the chapter contains definitions of terms and relevant conventions for use in the resolution of investment disputes. Annex 11-A defines “customary international law” for purposes of the chapter, while Annex 11-B deals with expropriation (direct and indirect) in some detail. To be considered expropriation, a party’s action or series of actions would be required to interfere “with a tangible or intangible property right or property interest in an investment.” Under a side letter to the FTA, the parties would agree that such property rights would include rights under contract and all other property rights in an investment, as defined in Article 11.28. Other annexes deal with the service of documents in such matters and the establishment of a possible future appellate body.

Annex 11-E—known as the “fork in the road provision”—would require a U.S. investor to choose to pursue an investment claim either in the Korean court system or under the FTA’s investor-state dispute settlement process. Annex 11-F deals with taxation and expropriation. Specifically, the annex lists factors to be considered in determining whether a taxation measure can be considered an expropriation, clarifying that most tax measures are not instances of expropriation. Annex 11-G lays out the conditions under which Korea could restrict capital transfers through its Foreign Exchange Transactions Act, so that those restrictions will not be subject to dispute settlement through arbitration.

### **Nonconforming Measures Related to Investment**

Provisions for the treatment of existing or future measures that are inconsistent with the agreement’s investment disciplines are included in each party’s Annexes I, II, and III of the FTA. Annex I lists exemptions for existing laws or regulations, maintained at the central or regional government level, that might violate the provisions of the agreement. NCMs at the local government level would be exempted without requiring any notation in an annex.<sup>25</sup> Annex II lists reservations to ensure that a party maintains flexibility to adopt or maintain measures that would be inconsistent with FTA disciplines. The actual content of the reservations in Annexes I and II varies widely. Some reservations are horizontal in nature, meaning that they address general policy provisions that affect all investment, whereas others only apply to investment in specific industries. Annex III lists NCMs specific to financial services relating to both existing and potential laws and regulations.<sup>26</sup>

Korea has not included any investment-related horizontal reservations under Annex I. Five horizontal reservations (reservations that pertain to investment in any sector) are listed by Korea under Annex II. Under the first, Korea would reserve the right to adopt any measure deemed necessary for the maintenance of public order, provided that such measures are applied in accordance with Korean law, and not applied in an arbitrary manner or as a disguised restriction on investment. The second reservation states that Korea would be able to impose any measure related to the transfer or disposition of equity interests or assets held by state-owned enterprises or governmental authorities. The third reservation specifies the conditions under which foreign persons would be permitted to purchase land. In particular, Korea would reserve the right to adopt any measure related to the acquisition of farmland by foreign persons. The fourth reservation would accord differential treatment to countries

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<sup>25</sup> USTR, “Final - United States - Korea FTA Texts,” 2007, Article 11.12(1)(a)(iii).

<sup>26</sup> Annex III is discussed in app. I, in the discussion of financial services.

that have signed any other bilateral or multilateral international agreements with Korea, prior to the entry into force of the U.S.-Korea FTA, and specifically those agreements involving aviation, fisheries, or maritime matters. Under the fifth reservation, Korea would maintain the right to impose restrictions on investment in services supplied by the government, such as law enforcement and correctional services. This measure would not apply to investors that supply such services through agreements with the Korean government, or to financial services. Other reservations are limited to specific industries or sectors.

Horizontal reservations taken by the United States under Annex I would address the programs of the Overseas Private Investment Corporation and the registration of public offerings of securities, as well as existing NCMs at the regional (state) level. Appendix I-A of Annex I for the United States provides an illustrative list of NCMs maintained at the regional (state) level.<sup>27</sup> Under Annex II, the only horizontal reservation listed by the United States that applies to investment mirrors the reservation taken by Korea, which would accord differential treatment to countries under international agreements that have been signed prior to the entry into force of the U.S.-Korea FTA.

The specific sectors for which investment-related reservations are listed in Annex I are presented in table 6.1, and potential measures listed in Annex II are presented in table 6.2.<sup>28</sup> In several cases, the reservation indicates a potential constraint on foreign investment that may not have a significant effect on investors' activities or business results. Consequently, the inclusion of a sector in an annex does not mean that the entire sector has been exempted from coverage by the investment disciplines of the FTA.

## ***Views of Interested Parties***

U.S. industry representatives state that they are generally satisfied with the investment provisions of the U.S.-Korea FTA,<sup>29</sup> and particularly cite the inclusion of the investor-state dispute settlement process, and the agreement's provisions on expropriation, transparency, performance requirements, and nondiscriminatory national treatment standards.<sup>30</sup> Various industry ITAC reports cite in particular the investor-state dispute settlement provisions and the fact that they apply to both existing and future investment agreements between a U.S. investor and the government of Korea.<sup>31</sup> The Distribution Services for Trade Policy Matters

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<sup>27</sup> This list is provided for transparency purposes only, and is not meant to be binding on the U.S. government or any state government.

<sup>28</sup> Investment-related reservations related to financial services, including insurance, are listed in Annex III, and are presented in app. I of this report.

<sup>29</sup> ITAC (11) on Small and Minority Business, *Advisory Committee Report*, April 26, 2007; industry representatives, telephone interviews by Commission staff, May 31 and June 4, 2007; USKBC, "Letter to Susan Schwab, U.S. Trade Representative (May 25, 2007)"; and ECAT, "ECAT Welcomes Announcement of Successful Conclusion of U.S.-Korea FTA Negotiations (April 2, 2007)."

<sup>30</sup> ACTPN, *Report*, April 26, 2007; ITAC (2) on Automotive Equipment and Capital Goods, *Advisory Committee Report*, April 27, 2007; ITAC (3) on Chemicals, Pharmaceuticals, Health/Science Products and Services, *Advisory Committee Report*, April 24, 2007; ITAC (8) for Information and Communications Technologies, Services and Electronic Commerce, *Report*, April 27, 2007; ITAC (10) on Services and Finance Industries, *Advisory Committee Report*, April 25, 2007; industry representative, telephone interview by Commission staff, May 31, 2007; USKFTABC, "U.S.-Korea FTA Negotiation Priorities"; and USKBC and AMCHAM in Korea, "Comments on the Proposed Free Trade Agreement Between the United States and the Republic of Korea, for the Trade Policy Staff Committee, Office of the USTR, March 24, 2006."

<sup>31</sup> ITAC (2) on Automotive Equipment and Capital Goods, *Advisory Committee Report*, April 27, 2007; ITAC (4) on Consumer Goods, *Report*, April 26, 2007; and ITAC (10) on Services and Finance Industries, *Advisory Committee Report*, April 25, 2007.

**Table 6.1** U.S.-Korea FTA: Industry sectors subject to existing nonconforming measures related to investment (Annex I)

Korea: Current Measures	United States: Current Measures
<ul style="list-style-type: none"> <li>▶ Agriculture and livestock</li> <li>▶ Distribution services for agriculture and livestock</li> <li>▶ Transportation services               <ul style="list-style-type: none"> <li>▶ Air transportation services</li> <li>▶ Specialty air services</li> </ul> </li> <li>▶ Scientific research services</li> <li>▶ Sea map-making services</li> <li>▶ Business services               <ul style="list-style-type: none"> <li>▶ Electronic billboard operator services</li> <li>▶ Outdoor advertisement services</li> <li>▶ Job placement services</li> <li>▶ Labor supply and worker dispatch services</li> <li>▶ Education services for seafarers</li> </ul> </li> <li>▶ Education services               <ul style="list-style-type: none"> <li>▶ Higher education</li> <li>▶ Adult education</li> </ul> </li> <li>▶ News agency</li> <li>▶ Manufacture of biological products</li> <li>▶ Publishing of periodicals (except newspapers)</li> <li>▶ Communications services               <ul style="list-style-type: none"> <li>▶ Broadcasting services</li> <li>▶ Telecommunications services</li> </ul> </li> <li>▶ Energy               <ul style="list-style-type: none"> <li>▶ Electric power generation other than nuclear power generation</li> <li>▶ Electric power transmission, distribution, and sales</li> <li>▶ Gas industry</li> </ul> </li> <li>▶ Recreational, cultural, and sporting services: motion picture services</li> </ul>	<ul style="list-style-type: none"> <li>▶ Communication services: Radio</li> <li>▶ Atomic energy</li> <li>▶ Mining and pipeline transportation</li> <li>▶ Transportation services               <ul style="list-style-type: none"> <li>▶ Air transportation</li> <li>▶ Specialty air services</li> </ul> </li> <li>▶ Customs brokerage</li> </ul>

Source: USTR, "Final - United States - Korea FTA Texts," 2007, Annex I.

Note: Nonconforming measures are found in Annexes I through III of the FTA. Annex I contains reservations for cross-border services and investment, excluding financial services, to preserve existing measures that are inconsistent with the disciplines concerning nondiscrimination, performance requirements, and senior personnel. For information on the nonconforming measures related to financial services, see app. I.



**Table 6.2** U.S.-Korea FTA: Industry sectors subject to potential nonconforming measures related to investment (Annex II)

Korea: Potential measures	United States: Potential measures
<ul style="list-style-type: none"> <li>▶ Firearms, swords, and explosives</li> <li>▶ State-owned national electronic/information system</li> <li>Disadvantaged groups</li> <li>▶ Social services: Human health services</li> <li>▶ Communications services               <ul style="list-style-type: none"> <li>▶ Broadcasting services</li> <li>▶ Telecommunications services</li> <li>▶ Audiovisual services</li> <li>▶ Digital audio or video services</li> </ul> </li> <li>▶ Transportation services               <ul style="list-style-type: none"> <li>▶ Railroad transportation</li> <li>▶ Passenger road transport services</li> <li>▶ Freight road transport services</li> <li>▶ Internal waterway transport services</li> <li>▶ Space transport services</li> <li>▶ Maritime passenger transportation services</li> <li>▶ Maritime cabotage services</li> </ul> </li> <li>▶ Environmental services               <ul style="list-style-type: none"> <li>▶ Water treatment and supply</li> <li>▶ Sewage</li> <li>▶ Municipal waste</li> <li>▶ Sanitation</li> <li>▶ Nature and landscape protection services (except environmental impact assessment services)</li> </ul> </li> <li>▶ Atomic energy</li> <li>▶ Energy services               <ul style="list-style-type: none"> <li>▶ Electric power generation other than nuclear power</li> <li>▶ Electric power transmission, distribution, and sales</li> <li>▶ Electricity business</li> <li>▶ Gas industry</li> </ul> </li> <li>▶ Distribution services               <ul style="list-style-type: none"> <li>▶ Commission agents</li> <li>▶ Wholesaling and retailing of agricultural raw materials and live animals</li> </ul> </li> <li>▶ Storage and warehousing</li> <li>▶ Nonmonopoly postal services</li> <li>▶ Business services               <ul style="list-style-type: none"> <li>▶ Real estate services, excluding real estate brokerage and appraisal services</li> <li>▶ Insolvency and receivership services</li> <li>▶ Examination, certification, and classification of agricultural raw materials and live animals</li> <li>▶ Cadastral surveying and map-related services</li> </ul> </li> <li>▶ Services incidental to agriculture, hunting, forestry, and fishing</li> <li>▶ Fishing</li> <li>▶ Publishing of newspapers</li> <li>▶ Education services—preprimary, primary, secondary, higher, and other education</li> <li>▶ Recreational, cultural, and sporting services               <ul style="list-style-type: none"> <li>▶ Motion picture services</li> <li>▶ Museum and other cultural services</li> <li>▶ Other recreational services</li> </ul> </li> <li>▶ Legal services—foreign legal consultants</li> <li>▶ Professional services—accountants</li> </ul>	<ul style="list-style-type: none"> <li>▶ Minority affairs</li> <li>▶ Satellite broadcasting</li> <li>▶ Social services</li> <li>▶ Transportation services: Maritime transportation</li> </ul>

Source: USTR, "Final - United States - Korea FTA Texts," 2007, Annex II.

*Note:* Nonconforming measures are found in Annexes I through III of the FTA. Annex II contains reservations for cross-border services and investment, excluding financial services, to ensure that a party maintains flexibility to impose measures in the future that may be inconsistent with the disciplines of the FTA. For information on the nonconforming measures related to financial services, see app. I.

(ITAC 5) report cited as particularly significant the transparency provisions of the FTA investment chapter, which require publication of ministerial guidance and relevant new legal opinions.<sup>32</sup>

Industry representatives stated that the FTA would serve as a positive model for other Asian countries that may be considering FTA or bilateral investment treaty (BIT) negotiations with the United States.<sup>33</sup> One industry representative noted that the United States is the only major investment partner with which Korea does not have a BIT, and said that the investment chapter of the FTA would lower the risk premium for U.S. investors in Korea, helping to level the playing field between investors from the United States and other FDI source countries.<sup>34</sup>

Several ITAC reports identified as areas of concern the annexes related to taxation measures (Annex F) and transfers of capital (Annex G), and the NCM related to the maintenance of public order.<sup>35</sup> However, these reports also expressed the view that these measures are likely to be used only in extraordinary circumstances and that, on balance, the investment provisions of the FTA provide important protections to U.S. investors, and will lead to significant new investment in Korea.<sup>36</sup>

The ITAC 10 report expressed disappointment with Korea's NCM, which provides exceptions to certain obligations for services supplied under governmental authority. The report said that the committee members would prefer that such a provision not be included in future FTAs.<sup>37</sup> The ITAC 11 report, representing small and minority businesses, added that limitations on investment in Korean law and accounting firms by professionals not licensed in Korea will restrict their opportunities to invest under the FTA. It also noted that Korea's potential restrictions on the acquisition of farmland and control over software and technology developed in Korea are seen to be significantly limiting for small and minority-owned U.S. businesses.<sup>38</sup>

The Motion Picture Industry Association cited several potentially troublesome NCMs related to streaming Internet delivery of audiovisual products and services where Korea reserved the right to impose some restrictions in the future. The Association said, however, that these

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<sup>32</sup> ITAC (5) on Distribution Services for Trade Policy Matters, *Advisory Committee Report*, April 25, 2007.

<sup>33</sup> Industry representative, telephone interview by Commission staff, June 4, 2007; USKBC, "Letter to Susan Schwab, U.S. Trade Representative (May 25, 2007)"; and see the Korea Economic Profile in app. E.

<sup>34</sup> Industry representative, telephone interview by Commission staff, June 5, 2007.

<sup>35</sup> ITAC (2) on Automotive Equipment and Capital Goods, *Advisory Committee Report*, April 27, 2007; ITAC (8) for Information and Communications Technologies, Services and Electronic Commerce, *Report*, April 27, 2007; ITAC (10) on Services and Finance Industries, *Advisory Committee Report*, April 25, 2007; AMCHAM in Korea, "AMCHAM Applauds Successful Conclusion of the U.S.-Korean FTA," 2007; and industry representatives, telephone interviews by Commission staff, May 31, 2007 and June 4, 2007.

<sup>36</sup> ITAC (2) on Automotive Equipment and Capital Goods, *Advisory Committee Report*, April 27, 2007; ITAC (8) for Information and Communications Technologies, Services and Electronic Commerce, *Report*, April 27, 2007; ITAC (10) on Services and Finance Industries, *Advisory Committee Report*, April 25, 2007; AMCHAM in Korea, "AMCHAM Applauds Successful Conclusion of the U.S.-Korean FTA," 2007; and industry representatives, telephone interviews by Commission staff, May 31, 2007 and June 4, 2007.

<sup>37</sup> ITAC (10) on Services and Finance Industries, *Advisory Committee Report*, April 25, 2007.

<sup>38</sup> ITAC (11) on Small and Minority Business, *Advisory Committee Report*, April 26, 2007.

measures were somewhat improved by related provisions requiring an open, transparent process to enact such measures.<sup>39</sup>

In a press release, AT&T stated that the FTA would open Korea's telecommunications market to U.S. investors and said that lawmakers should approve the FTA.<sup>40</sup> The U.S.-Korea Business Council remarked that the FTA will advance Korea's ability to act as a financial hub by attracting additional financial-services-related investment.<sup>41</sup> It added that it expects the FTA to lead to increased FDI from the United States to Korea.<sup>42</sup>

While industry representatives have expressed strong support for the Korea FTA's investor-state dispute settlement process, representatives of U.S. state and local governments and environmental groups are not generally supportive of the FTA investment provisions, and particularly of investor-state dispute settlement. The Intergovernmental Policy Advisory Committee (IGPAC) report, reflecting the views of state and local government representatives, asserts that legal challenges brought by foreign investors against U.S. state and local regulations have overly burdened state and local governments and caused confusion regarding the scope of states' regulatory authority. The report expresses concern that sophisticated investors will use these provisions in the United States to subvert state and local regulatory efforts, a concern shared by a minority of the Trade and Environment Policy Advisory Committee (TEPAC).<sup>43</sup>

In its report, the IGPAC sets out three additional, specific concerns with the FTA investment chapter. First, the committee sees the definition of "investment" as overly broad. In particular, it is broader than the definition included in the NAFTA agreement in that it includes licenses and permits as covered investments. Second, the committee is concerned that the language in Article 10.5 (Minimum Standard of Treatment) can be interpreted to mean that state court actions are subject to review by international investment tribunals. Third, the committee is concerned that the due process standards outlined in Article 10.5 are based not on U.S. constitutional norms of substantive due process, but on international standards that are not as clear.<sup>44</sup>

The TEPAC report states that the primary concern of representatives of the environmental community is that language regarding indirect expropriation, new to this FTA, will permit arbitrators to rule against good faith U.S. laws and regulations, and will provide foreign investors greater rights than U.S. investors have under U.S. domestic law. The report also expressed concern that the side letter to the FTA regarding property rights inappropriately defines all contract rights as property rights, thus subjecting all contract rights to arbitration under the investor-state dispute settlement process.<sup>45</sup> In comments separate from the principal TEPAC report, a minority of the group expressed a number of additional concerns related to the FTA investment chapter, including the overly broad definition of investment in

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<sup>39</sup> Frazier, testimony before the USITC, June 20, 2007, 77-78.

<sup>40</sup> AT&T, "AT&T Reaction to Free Trade Agreement with South Korea (April 2, 2007)."

<sup>41</sup> USKBC, "Letter to Susan Schwab, U.S. Trade Representative (May 25, 2007)."

<sup>42</sup> USKBC, "Overall Benefits for the U.S."

<sup>43</sup> TEPAC, *Advisory Committee Report*, April 25, 2007.

<sup>44</sup> IGPAC, *Advisory Committee Report*, April 24, 2007.

<sup>45</sup> TEPAC, *Advisory Committee Report*, April 25, 2007.

Section C of Chapter 11 and the lack of a general environmental exception to the investment chapter.<sup>46</sup>

## **FTA Chapter 16—Competition-Related Matters**

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### *Assessment*

The competition policy provisions of the U.S.-Korea FTA are likely to provide a systemic benefit for all U.S. firms seeking to invest in Korea by providing greater investor certainty through greater transparency and improved due-process procedures through which firms may address concerns. Chapter 16 appears to address an overarching business concern about the inadequate administration and enforcement of Korean competition laws, as well as the lack of transparency in decision-making during antitrust investigations. A second business concern, inconsistency in Korean competition laws and regulations, may be addressed indirectly by the FTA by giving the U.S. government an institutionalized channel for bilateral consultation and cooperation on competition-related matters.

The competition-related provisions in the agreement are more likely to affect trade and investment in the Korean economy as a whole through a more competitive business environment rather than in a sector-specific manner. Nonetheless, a number of U.S. industries in the services sector in particular may benefit from the chapter's competition-related provisions. The advertising, finance,<sup>47</sup> media,<sup>48</sup> professional,<sup>49</sup> and marketing services industries have all raised concerns about Korean nontariff barriers that cover commercial prohibitions, restrictions, overregulation, and local preference requirements.<sup>50</sup> The software technology and telecommunications industries have also voiced interest in stronger and more transparent antitrust disciplines in Korea, anticipating that the principles and provisions in chapter 16—such as national treatment, procedural rights and safeguards, transparency in regulation, and a government commitment to enforce competition law—are likely to allow U.S. companies to compete effectively in important high technology segments of the Korean market.<sup>51</sup> In the manufacturing sector, the pharmaceutical and cosmetics industries have raised concerns about nontransparent markets and discriminatory behavior;<sup>52</sup> and the

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<sup>46</sup> Center for International Environment Law, Separate Comments of TEPAC Members on the U.S.-Korea Free Trade Agreement, contained in the TEPAC report, the U.S.-Korea Free Trade Agreement. TEPAC, *Advisory Committee Report*, April 25, 2007.

<sup>47</sup> These industries include electronic commerce, banking, and insurance service industries. In testimony, one panelist noted that the national treatment provisions in the chapter appear to be prompting regulatory changes that allow new entrants to provide not only a broader range of financial services, but also more quickly than previously planned, reducing their company's time frame for the introduction of certain sophisticated forms of banking and securities services from a 5–9 year period down to a 2 year period. Lane, hearing transcript, 74.

<sup>48</sup> These industries include the broadcast television, cable television, and film industries.

<sup>49</sup> These industries include the accounting, construction, engineering, insurance, and legal services industries.

<sup>50</sup> USITC, Office of Economics, NTM Database.

<sup>51</sup> U.S. government official, interview by Commission staff, Washington, DC, June 11, 2007; and Reis, testimony before the USITC, June 20, 2007, 28.

<sup>52</sup> *Ibid.*

automobile industry has raised concerns about local preference regulations.<sup>53</sup> Many of these issues appear to be actionable in some manner under the competition policy measures adopted in the chapter that would seek to support competitive commercial behavior and would set out a framework through which to pursue remedies to anticompetitive conduct when encountered.

### *Summary of Provisions*

Chapter 16 of the FTA would address competition policy, designated monopolies, and state enterprises, with the objective of proscribing anticompetitive business conduct in order to promote economic efficiency and consumer welfare.<sup>54</sup> The chapter would obligate the United States and Korea to maintain competition laws that protect and promote competitive business conditions by proscribing anticompetitive business conduct that might hinder bilateral trade and investment, to maintain authorities responsible for enforcement of these laws on terms of national treatment and MFN treatment, and to provide transparent and nondiscriminatory due-process means to remedy disputes under the FTA concerning violations of these competition laws.

The chapter would permit either party to establish or maintain a designated monopoly or state enterprise, but would obligate each party to ensure that such designated enterprises operate in accordance with normal commercial practices that do not abuse their special status, which might otherwise, as a result, create obstacles to bilateral trade and investment.<sup>55</sup> Under the agreement, designated monopolies and state enterprises would be permitted to charge different prices in the marketplace where such differences are based on normal commercial considerations such as supply and demand conditions. The chapter's provisions governing designated monopolies do not apply to government procurement. Upon request, a party would need to provide public information on designated monopolies and state enterprises at any government level, or on exemptions and immunities to its competition laws, if furnished with specifics regarding particular products and markets as well as indications that an entity's business behavior or exemption from competition laws may be hindering bilateral trade or investment.<sup>56</sup>

The chapter includes provisions covering transparency, cross-border consumer protection, consultations, dispute settlement, and definitions of terms.<sup>57</sup> The chapter's cross-border consumer protection provisions would require the United States and Korea to cooperate on matters of mutual concern concerning consumer protection laws to enhance consumer welfare.<sup>58</sup>

The United States Federal Trade Commission, Korea Fair Trade Commission (KFTC), and Korea Ministry of Finance and Economy are to "endeavor to strengthen cooperation" through the exchange of information related to new and current consumer protection laws, including consultations on how to reduce and prevent fraudulent and deceptive commercial

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<sup>53</sup> Ibid.

<sup>54</sup> USTR, "Final - United States - Korea FTA Texts," 2007, Article 16.1.

<sup>55</sup> Ibid., Article 16.2, and Article 16.4.

<sup>56</sup> Ibid., Article 16.5.

<sup>57</sup> Ibid., Article 16.5, Article 16.6, Article 16.7, Article 16.8, and Article 16.9.

<sup>58</sup> Ibid., Article 16.6.

practices, and violations of consumer protection laws with significant cross-border aspects. The parties are to aim at identifying obstacles to effective cross-border cooperation in the enforcement of their own consumer protection laws, and are to consider modifying their domestic frameworks to overcome such obstacles.

Upon request, the parties would meet to consult on specific matters raised under the provisions of the chapter, when the requestor indicates how the matter affects bilateral trade or investment.<sup>59</sup> Under the agreement, neither party may challenge through dispute settlement the chapter's core goals and obligations regarding national competition laws or proscribing anticompetitive business conduct, the chapter's provisions on cross-border consumer protection, or the chapter's obligations concerning consultations.<sup>60</sup>

### ***Views of Interested Parties***

The report by the Advisory Committee for Trade Policy and Negotiations (ACTPN) said that the provisions of the competition chapter go beyond antitrust obligations negotiated in any previous U.S. FTA and will provide several major benefits for U.S. business.<sup>61</sup> The ACTPN in particular pointed to the provision that for the first time allows administrative or civil enforcement actions to be resolved by mutual agreement, rather than having to be resolved through the judicial system. Although noting that enforcement actions of a criminal nature would still need to be settled through the courts, the report said that U.S. investors are more concerned about civil cases involving unilateral firm conduct. The report suggested that the language in the agreement on mutual settlements may allow the Korean Assembly to grant this settlement authority to the KFTC, which could in turn resolve an ongoing domestic stalemate in Korea regarding this issue.

The ACTPN report characterized the FTA's due-process provisions as "state-of-the-art," under which a person or firm will be able to review all documents supporting a charge, remedy, or sanction brought against it and will be able to cross-examine witnesses. The report said that the competition provisions in the agreement will offer U.S. business and foreign investors clear rights and obligations concerning settlement authority in civil cases, due-process mechanisms, and improved transparency regarding necessary procedures, all of which are competition provisions that exceed those in any previous U.S. FTA. The report added that the strong disciplines negotiated in the agreement in favor of a more competitive process could set a substantial precedent for future FTAs with other Asian countries where antitrust law has been applied in a discriminatory manner against foreign investors.

The National Association of Manufacturers (NAM) cited both potential benefits as well as possible difficulties that may arise from the agreement's competition provisions.<sup>62</sup> NAM said that while Korea's competition policy laws are in themselves nondiscriminatory, their application is not always transparent, and in the past they have been applied in a discriminatory manner against foreign investors. NAM commented that, in the experience

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<sup>59</sup> Ibid., Article 16.7.

<sup>60</sup> Ibid., Article 16.8.

<sup>61</sup> ACTPN, *Report*, April 26, 2007.

<sup>62</sup> NAM, "National Association of Manufacturers Post-Hearing Statement," written submission to the USITC, June 27, 2007.

of its members, the Korean government historically has failed to enforce its competition laws in any substantive way against its large domestic industrial conglomerates, known as *chaebols*,<sup>63</sup> which in turn has permitted these firms to engage in anticompetitive practices that have made competition for U.S. investors very difficult or impossible. In addition, NAM noted Korean regulators have at times acted in a nontransparent manner that disadvantages foreign firms, such as investigating U.S. firms that have already been reviewed by U.S. antitrust authorities or courts, and in some instances even imposing penalties on U.S. firms that assist specific Korean competitors but disregard the competition authorities' goal of Korean consumer protection.

NAM stated that it views the antitrust chapter as providing greater transparency in the application and enforcement of competition law in Korea, in particular preventing their discriminatory application and enforcement. In addition, NAM said that the disciplines negotiated in the agreement supporting the competitive process may act as a precedent for other Asian countries where competition policy has in the past been applied in a discriminatory manner against foreign investors, or to advance industrial policy goals that differ from an open and transparent competitive process.

In a 2006 report, the U.S.-Korea Business Council and American Chamber of Commerce in Korea stated that the major competition policy issue facing U.S. businesses in Korea was that the KFTC did not actively investigate and discipline anticompetitive practices by Korean firms—including the Korean chaebol conglomerates.<sup>64</sup> They also commented that the KFTC in recent years appeared to be increasing enforcement efforts against U.S. and other foreign firms; for example, targeting U.S. company behavior aimed at creating market efficiencies. Whereas the council and the chamber stated that they recognized that the Korean government has taken steps recently to improve the KFTC's ability to enforce existing competition law, they added that their U.S. member companies continued to experience nontariff barriers in the marketplace in the form of anticompetitive behavior by Korean firms, particularly the chaebol conglomerates.

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<sup>63</sup> The term “chaebol” refers in Korea to several dozen large corporate groups, often family-controlled, that dominate the economy as business conglomerates. The largest chaebols in Korea include companies such as Samsung Group, Hyundai Motor Company, LG Group, SK Corporation, Hanjin Shipping, and Hyundai Heavy Industries. Most chaebol firms were established after the Korean war and, assisted by government financing and economic planning, played a central role in rapidly building the South Korean economy in the subsequent decades. Prompted in large part by the 1997–98 Asian financial crisis, the South Korean government instituted a number of structural economic reforms—particularly in the areas of financial markets and competition policy—moving away from the past government-directed industrial policy focused on exports toward a more market-oriented economy based on open private-sector competition in order to attract more foreign investment. As a consequence of these ongoing reforms (e.g. in such fields as merger and acquisitions policy or a program of corporate restructuring intended to make operations of Korean companies more transparent and accountable to shareholders), the chaebols are becoming less influential, more transparent, and more competitive than before, although they nonetheless continue to dominate nearly every area of economic activity in Korea. EIU, “Country Profile 2006: South Korea”; and USFCS, “Doing Business in Korea: A Country Commercial Guide for U.S. Companies,” 2005.

<sup>64</sup> USKBC and AMCHAM in Korea, “Competition Policy,” *U.S.-Korea Free Trade Agreement Position Paper*, 2006, 27.

## FTA Chapter 17—Government Procurement

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### *Assessment*

The government procurement provisions of the U.S.-Korea FTA would likely provide improved access for U.S. firms bidding on government procurement contracts. In a Korean procurement market of approximately \$100 billion,<sup>65</sup> the FTA would increase the number of Korean government agencies for which U.S. businesses can bid beyond those available through the WTO Agreement on Government Procurement (GPA), and also reduces by nearly one-half the contract thresholds available to bid on.

Chapter 17 broadly would address the procedural concerns raised by U.S. businesses about government procurement in Korea; in particular, complaints about inefficient and nontransparent procurement procedures. Provisions in the agreement would set out common standards for supplier qualification and documentation requirements for tender, as well as published and standard periods for procurement. The FTA would reinforce and clarify rights and obligations of both parties under the GPA, thereby providing a dispute settlement process should consultations under the FTA's Working Group on Government Procurement not resolve an issue.

From the more specific perspective of individual industries, benefits from the FTA provisions on government procurement would vary by industry. For example, the pharmaceutical and medical equipment industries have raised concerns about inefficient and nontransparent procurement procedures, as well as arbitrary regulations, although such procurement may fall under private rather than public sector (i.e., government) procurement. The chapter's exclusions of financial payments and other noncontractual procurement, however, may limit the potential impact on finance-related industries.

The U.S. IGPAC mentioned in its report that the FTA makes no specific reference to U.S. states and their possible obligations under this agreement, as well as to the fact that the annex to the agreement does not extend to procurement contracts by subcentral government entities.<sup>66</sup> Access to government procurement contracts by Korean subcentral and other entities, however, is provided to U.S. firms under the GPA, which is incorporated into the FTA.<sup>67</sup>

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<sup>65</sup> The government procurement market in Korea is estimated at approximately 12 percent of Korea's gross domestic product (GDP) in a report by the U.S.-Korea Business Council and American Chamber of Commerce in Korea. Korean GDP was approximately \$888 billion in 2006, which would indicate the size of its procurement market at roughly \$100 billion. USKBC and AMCHAM in Korea, U.S.-Korea Free Trade Agreement Position Paper, 2006, 30–31. Other estimates of the Korean public procurement market place its size in 2003 at \$67 billion, of which the Korean Public Procurement Service covers around 30 percent, divided approximately into \$7 billion for supplies and services, and \$12 billion for construction. Choi, "Republic of Korea: The Potential of E-Procurement," 2005, 95.

<sup>66</sup> IGPAC, *Advisory Committee Report*, April 24, 2007.

<sup>67</sup> The Korean schedule under the GPA covers procurement contracts valued at Special Drawing Rights (SDR) 200,000 for supplies and services, and SDR 15 million for construction services, for subcentral government and other covered entities. Annex 2 lists the covered entities of Cheju-do, Chollabuk-do, Chungchongbuk-do, Chungchongnam-do, Kang-wan-do, Kyonggi-do, Kyongsangbuk-do, Kyongsangnam-do, City of Incheon, City of Kwangju, City of Pusan, City of Taegu, City of Taejeon, and the Seoul Metropolitan Government. (A -do suffix indicates the rough equivalent of an administrative province or state.) Annex 3 covers other entities that apply the provisions of the GPA, for example, a number of largely public-sector

(continued...)



Alternatively, the U.S. services sector may benefit from the Korean Private Participation in Infrastructure Act, where five firms dominate the market and foreign participation is reported as very limited.<sup>68</sup> The electronic procurement procedures set out in the chapter may help support the government's anti-corruption efforts through greater transparency and, in particular, help expand access for foreign participation under the Korean Public Procurement Service Implementation Pact.<sup>69</sup>

## *Summary of Provisions*

Chapter 17 of the FTA would address procurement of goods and services by any contractual means—purchase, lease, rental, hire, etc.—where the value of the contract reaches or exceeds the threshold level for procurement contracts issued by the government entities listed in the annex to the chapter. The procurement covered under the chapter is government procurement and may not involve commercial sale, resale, or use in commercial production. Exclusions would include (1) noncontractual agreements or assistance in the form of grants, loans, fiscal incentives and guarantees, equity infusions, and the like; (2) procurement by a fiscal or similar agency, services related to regulated financial institutions, and matters related to public debt, government bonds, notes, and other securities; and (3) procurement specifically for the provision of international assistance, including development aid. Procurement under the chapter would cover digital/information technology products, although the FTA chapter on electronic commerce imposes no further obligation regarding procurement of digital products.

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<sup>67</sup> (...continued)

banks and corporations. The U.S. schedule under the GPA covers procurement contracts valued at SDR 355,000 for supplies and services, and SDR 15 million for construction services (the latter applicable to Korea only) for subcentral government and other covered entities. Annex 2 lists various entities of the 37 U.S. state governments, which agreed to be bound by the trade agreement containing the GPA that the U.S. federal government signed into law (the 1995 Uruguay Round Agreements). Annex 2 lists the covered entities in Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Hawaii, Idaho, Illinois, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, New Hampshire, New York, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Dakota, Tennessee, Texas, Utah, Vermont, Washington, Wisconsin, and Wyoming. Annex 3 covers other entities at various contract value thresholds, for example, regional power and port authorities.

<sup>68</sup> Prompted by the 1997–98 Asian financial crisis, the Korean government began to institute a number of structural economic reforms to make its economy more attractive to foreign investment by moving toward a more market-oriented economy based on open private-sector competition. The government enacted the Private Participation in Infrastructure Act to remove impediments to private investment in infrastructure works such as transport, water, electricity, and telecommunications projects. This market has hitherto been dominated by five main Korean construction and engineering firms: Samsung, Daewoo, Posco, Hyundai, and Kumbo construction. Numba and Dinghem, “Private Participation in Infrastructure Projects in the Republic of Korea,” September 2005, 2 and 25.

<sup>69</sup> Korea became a member of the OECD in December 1996 and a signatory of the WTO Agreement on Government Procurement in 1997, and joined the OECD Convention on Combatting Bribery of Foreign Public Officials in International Business Transactions in 1999. As a consequence, the government enacted in 2001 the Corrupt and Illegal Practices Prevention Act and in 2002 launched the Korea Independent Commission Against Corruption. Since 2001 the Korean Public Procurement Service has operated an Integrity Pact that requires contract officials and private businesses to certify in a written pledge that they have conducted business in an open and fair manner that does not hamper competition. Choi, “Republic of Korea: The Potential of E-Procurement,” 93–96, 289–291. Korea launched the Government e-Procurement Systems (GePS), a national electronic procurement system, on September 30, 2002 as part of a national information technology project to institute electronic government (“e-government”) services started in 1978. Seong, and Lee, “Developing E-Procurement Systems,” 138 and 150.

Both the United States and Korea are signatories to the WTO Agreement on Government Procurement (GPA), and the FTA chapter on government procurement reaffirms both parties' rights and obligations under the GPA.<sup>70</sup> The chapter would also affirm both parties' determination to apply the Asia-Pacific Economic Cooperation (APEC) Non-Binding Principles on Government Procurement for government procurement that falls outside the scope of the GPA and FTA chapter 17.<sup>71</sup> As a consequence, the FTA would follow the GPA provisions concerning most government procurement matters, including national treatment and market access for goods, cross-border trade in services, and financial services and investment.<sup>72</sup> For all government procurement covered in the FTA, chapter 17 would apply the GPA provisions concerning unlisted entities, contract valuation, national treatment and nondiscrimination, rules of origin, technical specifications, and many tendering procedures such as supplier qualification, participation, documentation, awards, limited tendering, offsets, and challenge procedures.<sup>73</sup> The FTA would incorporate the GPA articles covering such subjects, as well as the GPA notes and appendices, including GPA rules governing technical specifications to promote the conservation of natural resources or to protect the environment.<sup>74</sup>

Chapter 17 would further address the use of electronic means for conducting government procurement covered under the FTA, and clarify the GPA provisions on contract valuation to include the estimated maximum total value of the procurement over its entire duration, including all forms of fees, commissions, premiums, or other revenue streams that the procurement may generate.<sup>75</sup> The chapter provisions also aim to ensure that suppliers may qualify and participate in a procurement tender less on narrowly drawn criteria—such as previously awarded procurement contracts or previous work undertaken in Korea—and more on principles aimed at allowing broader participation.<sup>76</sup>

The chapter provisions would require notice of intended procurement in the appropriate electronic medium, and would require that sufficient, common periods be provided, taking into account issues such as the complexity of the procurement, the likely extent of subcontracting required, and time to transmit tenders from foreign locations when electronic means are not used.<sup>77</sup> A number of minimum tender periods are set out in the chapter that depend on various factors such as procurement in urgent situations or selective procurement, but in no case can the period for tendering be less than 10 days from published notice of an intended procurement to final date for tender submission, with periods usually ranging from 35 to 40 days.<sup>78</sup>

The agreement would provide for consultations and possible compensatory adjustments if modifications are made to the coverage under the chapter's annex.<sup>79</sup> The chapter also

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<sup>70</sup> USTR, "Final - United States - Korea FTA Texts," 2007, Article 17.1.

<sup>71</sup> *Ibid.*, Article 17.1.

<sup>72</sup> *Ibid.*, Article 17.2.

<sup>73</sup> *Ibid.*, Article 17.3.

<sup>74</sup> *Ibid.*, Article 17.3 and Article 17.7.

<sup>75</sup> *Ibid.*, Article 17.4.

<sup>76</sup> *Ibid.*, Article 17.5.

<sup>77</sup> *Ibid.*, Article 17.6.

<sup>78</sup> *Ibid.*, Article 17.8.

<sup>79</sup> *Ibid.*, Article 17.9.

establishes a Working Group on Government Procurement that would meet to consider issues regarding government procurement and to exchange information.<sup>80</sup>

The government procurement annex contains each party's schedule listing the entities at the central level of government to which the estimated threshold of the procurement value applies.<sup>81</sup> A \$100,000 or 100 million Korean won threshold is set out in the annex for the procurement of goods and services, and a Special Drawing Rights of 5 million (stated in the text as \$7,407,000, or 7.4 billion Korean won) threshold is set out for procurement of construction services.<sup>82</sup> Adjustments concerning the former threshold that may arise in the future would be worked out through consultations between the parties as necessary, and for the latter threshold through conversion to national currencies as provided for in the WTO GPA.<sup>83</sup> For Korea, only certain categories of goods involving the Ministry of National Defense would be open to foreign procurement tendering, as listed in the annex.<sup>84</sup>

### *Views of Interested Parties*

In its report on the FTA, the Advisory Committee for Trade Policy and Negotiations (ACTPN) said that the agreement would likely increase opportunities for U.S. companies to bid on government procurement contracts in Korea.<sup>85</sup> The report stated that the FTA will likely give U.S. companies privileged access to Korean procurement contracts through its provisions that offer to U.S. firms alone both increased contract coverage as well as lower contract threshold values, both of which are superior to the terms currently available to signatories to the GPA. The report also noted that the establishment of a working group on government procurement would provide a good channel to help U.S. business—particularly small and medium-sized firms—benefit from the agreement's procurement provisions, particularly considering past instances where government procurement matters in Korea have proved contentious.

The Industry Trade Advisory Committee on Services and Finance Industries (ITAC 10) expressed views in its report similar to those in the ACTPN report regarding the agreement's procurement provisions.<sup>86</sup> In its report, the Industry Trade Advisory Committee for Information and Communications Technologies, Services and Electronic Commerce (ITAC

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<sup>80</sup> Ibid., Article 17.10.

<sup>81</sup> USTR, "Government Procurement Annex 17-A," *Draft—Free Trade Agreement Between the United States of America and the Republic of Korea*.

<sup>82</sup> USTR, "Final - United States - Korea FTA Texts," 2007.

<sup>83</sup> Ibid.

<sup>84</sup> Ibid. For the United States, certain categories of goods involving the Department of Defense are exempt from the chapter's provisions, including particular ships and ship-related equipment; certain "specialty metals" such as certain steels, titanium, or zirconium and their alloys; and a number of types of weapons and ordnance, aircraft and ships and related components, as well as other categories involving related electronic, fiber optic, and communication components. Various exemptions on the U.S. schedule also include certain items procured by the Departments of Agriculture, Commerce, Energy, Homeland Security, and Transportation, and the General Services Administration. The parties also list particular limitations on coverage, including the U.S. set-asides for small and minority-owned business. USTR, "Final - United States - Korea FTA Texts," 2007, "Notes to United States Schedule."

<sup>85</sup> ACTPN, *Report*, April 26, 2007.

<sup>86</sup> ITAC (10) on Services and Finance Industries, *Advisory Committee Report*, April 25, 2007.

8)<sup>87</sup> also expressed support for the government procurement provisions of the agreement, in particular, provisions that provide for greater certainty surrounding government procurement of digital products, to be defined and clarified in the agreement's chapter on electronic commerce. The report of the Industry Trade Advisory Committee on Small and Minority Business (ITAC 11) also expressed support for the agreement's government procurement provisions.<sup>88</sup>

In its report, the Labor Advisory Committee (LAC) for Trade Negotiations and Trade Policy stated that it found the agreement's provisions problematic because they tended to erode the ability of the U.S. federal government to maintain government procurement restrictions that underpin legitimate public policy aims for U.S. workers through measures such as domestic sourcing preferences, prevailing wage laws, previous management-labor agreements for particular projects, and responsible contractor requirements.<sup>89</sup> LAC added that many exclusions embodied in previous U.S. FTAs that tended to support U.S. workers have been removed in the U.S.-Korea FTA. LAC also questioned whether the text language in the annex is intended to bind 37 U.S. states to the procurement disciplines in the agreement covering services by incorporating parts of the GPA into the U.S.-Korea FTA annex.

Alan Reuther, Legislative Director of the United Automobile, Aerospace and Agricultural Implement Workers of America (UAW), in testimony before the House Committee on Ways and Means, said that the UAW considered the agreement's government procurement provisions to be problematic because the FTA provisions tend to restrict the ability of the U.S. government to enact laws and implement regulations that protect U.S. public-policy goals such as "living wage" standards for procurement contracts, sustainable economic development, environmental protection, or public health and safety.<sup>90</sup>

In a submission to the USTR, the Information Technology Industry Council (ITI) said that U.S. exporters of information technology (IT) products and services will likely gain substantially from the agreement.<sup>91</sup> ITI said, however, that it shared a number of the concerns outlined by the U.S.-Korea Business Council and the American Chamber of Commerce in Korea regarding unlimited liability clauses in Korean procurement contracts,<sup>92</sup> ownership of

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<sup>87</sup> ITAC (8) for Information and Communications Technologies, Services and Electronic Commerce, *Report*, April 27, 2007.

<sup>88</sup> ITAC (11) on Small and Minority Business, *Advisory Committee Report*, April 26, 2007.

<sup>89</sup> LAC for Trade Negotiations and Trade Policy, *Report*, April 27, 2007.

<sup>90</sup> Reuther, "Statement by Alan Reuther, . . . on the Subject of The United States-Korea Free Trade Negotiations Before the Subcommittee on Trade, CWM, U.S. House of Representatives," March 20, 2007, 7.

<sup>91</sup> ITI, "ITI Submission on the United States-Korea Free Trade Agreement," written submission to the Trade Policy Staff Committee, Office of the USTR, March 24, 2006, 8-9.

<sup>92</sup> According to ITI, Korean procurement clauses typically state that "the Contractor shall compensate for any damage inflicted on the object of technical service and/or a third party during the process of performing the Agreement," as well as provide that "the Contractor shall be civilly and criminally liable for any damages inflicted by the Contract," both of which the ITI finds extreme in the scope of unlimited liability.

intellectual property rights under these contracts,<sup>93</sup> confidentiality of technical knowledge and other matters,<sup>94</sup> and problems regarding IT security products.<sup>95</sup>

## **FTA Chapter 18—Intellectual Property Rights**

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### *Assessment*

Full and effective enforcement of the intellectual property rights (IPR) provisions of the U.S.-Korea FTA would likely benefit U.S. industries that rely on copyrights, patents, trademarks, and other intellectual property by reducing their losses from infringement and increasing export and foreign sales opportunities for their products. U.S. copyright industries report substantial losses in Korea as a result of hard goods and online infringement of software, music, motion pictures, and books. U.S. pharmaceutical industries report problems with the grant of marketing approvals to generic products in violation of patent and data protections (see box 6.2 for a summary of the current IPR environment in Korea). To the extent it successfully addresses these and other IPR issues, the U.S.-Korea FTA should improve the business environment in Korea for U.S. industries that rely on intellectual property protections.

The IPR chapter of the FTA would reiterate certain existing protections and establish enhanced standards of protection and enforcement. The enhanced standards are generally consistent with the negotiating objectives that Congress set for FTAs in the Trade Promotion Act of 2002. These objectives include providing strong protection for emerging technologies; ensuring that IPR provisions reflect standards similar to those found in U.S. law; and ensuring strong civil, administrative, and criminal IPR enforcement.<sup>96</sup> The IPR provisions of the U.S.-Korea FTA are more rigorous than those included in U.S. FTAs with some developing countries and would address many issues identified as problematic in the annual intellectual property reviews of Korea conducted under the Special 301 provisions of the Trade Act of 1974.<sup>97</sup>

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<sup>93</sup> The ITI cites Korean procurement contracts that clearly state that “all rights including the ownership rights for the materials submitted to the Ordering Party shall be vested to the Ordering Party.”

<sup>94</sup> The ITI stated that a standard government procurement contract has several clauses under the “Use of Technical Knowledge and Confidentiality,” one allowing the contractee to disclose essentially any information, and another prohibiting the contractor from disclosing any information or confidential matters, both clauses the ITI considers far too broad and restrictive.

<sup>95</sup> The ITI stated that since 1999, the Korean government has required vendors of certain IT security products to any government agency to submit the security device source code to Korea’s National Intelligence Service as part of the supplier certification process, whether the contract is related or not to national security end users. ITI further states that the requirement to submit security-device source code has also affected security markets outside of government, such as sales to the financial services, education, and health-care industries.

<sup>96</sup> Trade Promotion Act of 2002, 19 U.S.C. Sec. 3802(b)(4)(A).

<sup>97</sup> U.S. Government official, telephone interview by Commission staff, June 11, 2007.

## **Box 6.2** Recent conditions of IPR protection in Korea

Korea has been on the USTR's Special 301 Watch List or Priority Watch List for countries with particular IPR concerns since 1992. In 2005, the USTR lowered Korea from the Priority Watch List to the Watch List based on a finding of meaningful improvements to the IPR regime. Korea remained on the Watch List in 2006 and 2007. In 2007, the USTR announced its intent to work closely with Korea to implement the far-reaching IPR commitments it made in the FTA. The current environment for IPR protection in Korea is described below.

### *Copyrights*

Korea ratified the World Intellectual Property Organization (WIPO) Copyright Treaty in 2004, and committed to accede to the WIPO Performances and Phonograms Treaty (collectively, the WIPO Internet Treaties) by the date the FTA enters into force. The WIPO Internet Treaties address the application of IPR in the digital environment. To update its legal framework, Korea passed a new copyright law in 2006 with implementing decrees to take effect in June 2007. Further revisions are anticipated to comply with the requirements of the FTA.

The International Intellectual Property Alliance (IIPA) estimates trade losses and levels of copyright infringement in Korea across five industries: business software, records and music, motion pictures, entertainment software, and books. These losses are for hard goods only and do not take into account online copyright infringement. IIPA estimates total trade losses in Korea of \$619 million in 2006 down from \$660 million in 2005. IIPA reports that the copyright industries face extraordinary enforcement challenges because of the prevalence of broadband access to the Internet in Korea. The music and motion picture industries are particularly impacted by unauthorized streaming and downloading, peer-to-peer (P2P) and "Web-hard" services, closed-file sharing systems in which unauthorized copies are stored online and access is obtained through passwords and online payments. The unauthorized photocopying and printing of textbooks, particularly around university campuses, substantially impacts book publishers.

### *Trademarks*

Trademark protection in Korea lasts for 10 years and is renewable every 10 years. Korea has acceded to Trademark Protocols administered by WIPO, which simplify procedures for registering and maintaining trademarks among member states. Korea's Trademark Act has been amended to allow trademark examiners to reject the mark of a foreign trademark holder that is registered in bad faith. The USTR reports, however, that U.S. companies are discouraged from pursuing the cancellation of such marks because of complex and lengthy legal procedures. The EU Chamber of Commerce in Korea reports that nondeterrent monetary penalties and minimal criminal sentences undermine effective enforcement against counterfeiters.

### *Patents and Regulated Products*

Patents are protected for 20 years from the application filing date. Patent filings by foreign applicants have steadily increased in Korea over the last 5 years, from 28 percent of all filings in 2002 to 33 percent in 2006. Japan and the United States were the largest sources of foreign applications in 2006. With respect to pharmaceuticals, U.S. producers report problems with the unauthorized use of test data submitted in support of marketing approval and with the grant of marketing approvals to generic producers while patents on original products are still pending.

*Sources:* USTR, "Final - United States - Korea FTA Texts," 2007; USTR, "Korea," *2007 National Trade Estimate Report on Foreign Trade Barriers*, April 2, 2007; IIPA, "South Korea, 2007 Special 301 Report," 2007; IIPA, "U.S. Trade Representative 'Special 301' Decisions," 2007; EIU, "Country Commerce: South Korea," July 2006; Primosch, testimony before the Trade Policy Staff Committee, Office of the USTR, March 14, 2006; European Union Chamber of Commerce in Korea, "Trade Issues and Recommendations 2007," 2007; Korean Intellectual Property Office, Republic of Korea, "Statistics"; and May, testimony before the USITC, June 20, 2007, 275-77.

Full implementation and enforcement of the copyright and digital technology protection and enforcement provisions in the FTA likely would benefit the U.S. motion picture, music, business and entertainment software, and book publishing industries. U.S. industries that may benefit from patent and confidential data protections include pharmaceuticals and agricultural chemicals. A broad range of U.S. industries with valuable brand names may benefit from the strengthened trademark and enforcement provisions of the FTA. Implementation by the United States of its FTA obligations will likely have little effect on the U.S. economy, because the United States already meets or exceeds the standards of IPR protection contained in the FTA.

### ***Summary of Provisions***

The IPR chapter contains detailed provisions governing the protection and enforcement of major forms of intellectual property including trademarks, copyrights, and patents. The chapter begins with general provisions that would require ratification or accession to specified international conventions, and reasonable effort to ratify or accede to others.<sup>98</sup> The general provisions also contain national treatment and transparency obligations, as well as an exception to national treatment for particular analog communications.<sup>99</sup>

### **Trademarks, Geographical Indications, and Domain Names**

The trademark section of the FTA would broaden the scope of trademarks to be protected to include marks that are not visually perceptible, certification marks, and geographical indications,<sup>100</sup> and would establish broader protections for well-known marks. It would provide for the automation of trademark services with online databases and electronic means of communication and eliminate the requirement that trademark licenses be recorded. This section also sets forth procedures for the protection of geographical indications and prohibits recognition of a geographical indication that is confusingly similar to a prior trademark or a well-known trademark.<sup>101</sup> In the area of Internet domain names, the FTA would require the establishment of Uniform Domain-Name Dispute-Resolution procedures for the settlement of disputes.<sup>102</sup>

### **Copyrights and Related Rights and Protection of Certain Satellite Signals**

The copyright and related rights sections contain detailed provisions that would require implementation of the obligations of the WIPO Internet Treaties, including the treatment of temporary copies (such as those made in a computer's random access memory) as regular copies, establishment of the copyright owner's right to control any technological manner of transmitting works, and the protection of technological protection measures that owners use to control access to their works. Korea would also agree to extend its term of copyright

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<sup>98</sup> USTR, "Final - United States - Korea FTA Texts," 2007, Article 18.1.3 and 18.1.4.

<sup>99</sup> Ibid., Article 18.16. A similar-carve out also is contained in the U.S.-Australia FTA.

<sup>100</sup> Examples of geographical indications from the United States include "Idaho" for potatoes and "Florida" for oranges.

<sup>101</sup> USTR, "Final - United States - Korea FTA Texts," 2007, Articles 18.2.6–18.2.8, 18.2.10, and 18.2.13–18.2.15.

<sup>102</sup> Ibid., Article 18.3.1.

protection to life of the author plus 70 years for most works, subject to a 2-year transition period. The section also contains a requirement that the two governments issue decrees mandating the use of noninfringing software in government agencies.<sup>103</sup>

The FTA would require Korea to bring all means of digital dissemination of sound recordings within the scope of the exclusive rights of recording producers and would obligate Korea to allow right holders to exercise economic rights in their own names.<sup>104</sup> The FTA also includes provisions similar to those in NAFTA that protect against the theft of encrypted satellite and cable signals and the manufacture of, and trafficking in, tools to steal those signals.<sup>105</sup>

### **Patents and Measures Related to Certain Regulated Products**

The patents section would provide that patents shall be available for any invention if it is new, involves an inventive step, and is capable of industrial application, including new uses of known products. Exclusions from patentability would be recognized where necessary to protect public order or morality and for diagnostic, therapeutic, and surgical procedures and inventions. The patents section identifies permissible grounds for revocation of a patent and precludes opposition proceedings that occur before the patent is granted.<sup>106</sup>

The patents section also includes limitations on how a third party may use a patented invention to generate data needed for the marketing approval of a generic pharmaceutical. It would provide for extension of the patent term beyond 20 years to compensate for “unreasonable delays,” defined as the later of 4 years from the filing of an application or 3 years after a request for examination, or delays in the marketing approval of a new pharmaceutical product. The patents section also includes procedural definitions that facilitate patent examination and establish a framework for cooperation between patent offices in the United States and Korea.<sup>107</sup>

The section on measures related to regulated products contains provisions that govern the regulatory approval and marketing of pharmaceutical or agricultural chemical products. The data exclusivity provisions would preclude reliance by another person, without consent of the submitter, on safety or efficacy information provided in support of a new pharmaceutical product, or evidence of the marketing approval of that product, for a period of at least 5 years from the date of marketing approval. The data exclusivity period for an agricultural chemical product would be at least 10 years from marketing approval. In cases where new clinical information, or evidence of marketing approval based on new information, is submitted in support of a pharmaceutical product containing a previously approved chemical entity, the data exclusivity period would be at least 3 years.<sup>108</sup> The section contains a new provision, which clarifies that a party may take measures to protect public health in accordance with the Declaration on the Trade-Related Aspects of Intellectual Property Rights (TRIPS) Agreement and Public Health (the Doha Declaration), notwithstanding these data exclusivity provisions. Later in the IPR chapter, the parties affirm their commitment to the Doha

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<sup>103</sup> Ibid., Articles 18.4.1, 18.4.7, 18.4.4, and 18.4.9.

<sup>104</sup> Ibid., Articles 18.6.3 and 18.4.6.

<sup>105</sup> Ibid., Article 18.7.

<sup>106</sup> Ibid., Articles 18.8.1, 18.8.2, and 18.8.4.

<sup>107</sup> Ibid., Articles 18.8.5, 18.8.6, and 18.8.8-18.8.11.

<sup>108</sup> Ibid., Article 18.9.1-2.



Declaration and confirm that the obligations of the IPR chapter would not prevent a party from taking measures to protect public health by promoting access to medicine for all.<sup>109</sup>

The section on measures related to regulated products also would require the implementation of measures in the marketing approval process to prevent the approval of generic drugs during the term of the patent without the patent owner's consent (a "patent linkage" provision), including a requirement that the patent owner be notified of the identity of a person seeking marketing approval during the patent term.<sup>110</sup>

## **Enforcement**

The enforcement section of the FTA contains detailed measures intended to promote full and effective IPR enforcement. It contains general obligations, civil and administrative procedure and remedies provisions, provisional measures, special requirements related to border measures, criminal procedures and remedies, and provisions on liability of Internet service providers. In particular, Korea would agree to supplement its civil remedies with a regime of statutory damages, costs, and attorney's fees and to provide criminal remedies for trafficking in counterfeit labels and the illegal recording of audiovisual works (so-called "camcording").<sup>111</sup>

## **Side Letters**

The IPR chapter includes a series of side letters addressing Internet service provider obligations, copyright infringement on university campuses, enforcement against online piracy, and patent linkage. More specifically, the first side letter contains detailed provisions for an effective "notice and takedown" process for Internet service providers when online materials are claimed to be infringing and when it is asserted that online materials should not have been removed from the Internet. The second side letter would require the Korean government to take appropriate measures—such as the training of personnel, public education campaigns, and increased enforcement—to control infringement of books on or near school campuses. The third letter would confirm the commitment of the parties to shut down Internet sites that permit the unauthorized downloading and distribution of copyrighted works. Korea would further agree, within 6 months of entry in force of the Agreement, to issue a policy directive establishing clear jurisdiction for effective enforcement against online piracy. In the fourth side letter the parties would agree not to invoke the dispute-settlement provisions of the FTA during the first 18 months after the FTA enters into force if a problem arises in the implementation of the patent linkage provision.

Although the first side letter is similar to side letters contained in other FTAs, the other side letters are unique to the U.S.-Korea FTA. The side letter on copyright infringement near school campuses and the letter on online infringement would address particular IPR protection and enforcement challenges noted in the USTR's Special 301 review of Korea. The fourth side letter was added to the FTA as a result of the Bipartisan Trade Deal.

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<sup>109</sup> Ibid., Articles 18.9.3 and 18.11. These new provisions are the result of a "Bipartisan Trade Deal" between the Office of the U.S. Trade Representative and certain Members of Congress. USTR, "Bipartisan Trade Deal," May 2007, 3.

<sup>110</sup> Ibid., Article 18.9.5.

<sup>111</sup> Ibid., Articles 18.10.6, 18.10.28, and 18.10.29.

## *Views of Interested Parties*

A number of interested parties provided testimony and written submissions to the Commission on the IPR chapter of the U.S.-Korea FTA. With regard to the copyright provisions, the Entertainment Industry Coalition for Free Trade (EIC), a group of entertainment companies and trade associations, and the Motion Picture Association of America (MPAA) testified at the Commission's hearing that the infringement of copyrights on their materials represents the single largest trade barrier that the entertainment industries face and that enforcement is particularly difficult given the prevalence of broadband access in Korea. They said that the U.S.-Korea FTA would help to address these problems by providing high standards of copyright protection and by requiring the parties to ensure strong enforcement.<sup>112</sup> The EIC and MPAA particularly cited as a "tremendous move forward" the side letter in which Korea undertakes to issue a policy directive establishing clear jurisdiction for effective enforcement against online piracy and to prosecute persons who profit from developing services to induce infringement.<sup>113</sup>

In a written submission to the Commission, the IIPA, also representing industries that depend on copyright protection, stated that if the provisions of the FTA are fully implemented, increased U.S.-Korea trade in copyright materials with accompanying positive effects on U.S. employment is likely to be achieved. IIPA added that the copyright-dependent industries consider the U.S.-Korea FTA to be one of the strongest and most progressive ever negotiated and expect its value to be substantial given Korea's large and dynamic economy.<sup>114</sup>

Similarly, Time Warner reported in a written submission to the Commission that access to the significant media market in Korea has been held back by widespread piracy. Time Warner stated that implementation of the IPR provisions, and the market access commitments, is likely to bring significant benefits to U.S. and Korean companies. Time Warner particularly cited as the important the copyright term extensions, which it said would support a continuing return on investment on older content that still has market value.<sup>115</sup>

With regard to the patent provisions of the IPR chapter, the testimony of the Pharmaceutical Research and Manufacturers of America (PhRMA) cited three provisions as particularly important: the provision establishing a patent linkage system to prevent patent-infringing products from gaining market access, the data exclusivity provision, and the provision allowing for extension of the patent term to compensate for unreasonable delays in the patent or marketing application process.<sup>116</sup>

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<sup>112</sup> Frazier, "Korea-U.S. Free Trade Agreement: Benefits to America's Entertainment Industries," written submission to the USITC, June 6, 2007, 5; and Frazier, testimony before the USITC, June 20, 2007, 56-58.

<sup>113</sup> Frazier, "Korea-U.S. Free Trade Agreement: Benefits to America's Entertainment Industries," written submission to the USITC, June 6, 2007, 7.

<sup>114</sup> IIPA, "Comments submitted to the U.S. International Trade Commission in inv. TA-2104-24," written submission to the USITC, June 25, 2007, 2-3; See also USKFTABC, "Views on the Economic Impact of a United States-Korea Free Trade Agreement," written submission to the USITC, June 27, 2007, 7.

<sup>115</sup> Time Warner, "Comments of Time Warner, Inc., United State-Korea Free Trade Agreement Investigation TA-2104-24," written submission to the USITC, June 21, 2007, 2. The Information Technology Industry Council (ITI) also notes that the IPR chapter is one of the strongest to be achieved and supports its provisions. Dawson, testimony before the USITC, June 20, 2007, 69.

<sup>116</sup> PhRMA, "PhRMA Statement on the U.S.-Korea Free Trade Agreement (April 3, 2007)," 3; May, testimony before the USITC, June 20, 2007, 275-77.

In another submission to the Commission regarding the patent provisions, the Semiconductor Industry Association (SIA) urged further definition of the “inequitable conduct” basis for patent revocation included in the IPR chapter. SIA seeks an exchange of notes between the two governments to clarify what it believes would otherwise be a vague term that could erode protection for semiconductor patents.<sup>117</sup>

Several of the Trade Advisory Committee Reports commented on the IPR chapter. The Industry Trade Advisory Committee on Intellectual Property Rights (ITAC 15) stated that it “strongly supports” the IPR chapter, stating that it “restores key provisions that had not been included in recent Trade Promotion Agreements (TPAs) or FTAs.”<sup>118</sup> The report added that ITAC 15 particularly supports the copyright text of the agreement, which it believes “materially advances the U.S. national interest.”<sup>119</sup> The report cited some “limitations” of the FTA, including the exception to the national treatment obligation for particular analog communications; a 2-year transition period for copyright term extension; and the lack of provisions on compulsory licensing, patent disclosure, and parallel importation. The report, however, noted that the FTA, taken as a whole, is “very strong” and ITAC 15 strongly supports its approval by Congress.<sup>120</sup>

In its report, the Advisory Committee for Trade Policy and Negotiations (ACTPN) stated that it strongly endorses the IPR chapter. The ACTPN report said that the FTA contains “the strongest ever bilateral protections for intellectual property,” and cited particularly the enforcement provisions and state-of-the-art protections for trademarks, patents, Internet domain names, and copyrighted works.<sup>121</sup> The Industry Trade Advisory Committee for Information and Communications Technologies, Services, and Electronic Commerce (ITAC 8) and the Industry Trade Advisory Committee on Consumer Goods (ITAC 4) also expressed support for the IPR chapter in their respective reports.<sup>122</sup>

The Industry Trade Advisory Committee for Chemicals, Pharmaceutical, Health/Science Products and Services (ITAC 3) said that most of its members support the IPR provisions of the FTA and particularly the provisions relating to patent linkage, data exclusivity, and patent-term extension, which they consider necessary to promote pharmaceutical innovation.<sup>123</sup> The report noted, however, that one of ITAC 3’s members, the Generic Pharmaceutical Association (GPHA), believes that while the standard of IPR protection in the United States carefully balances the goals of fostering pharmaceutical innovation with ensuring access to medicine, the FTA imposes barriers to the generics industry that do not exist in U.S. law.<sup>124</sup>

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<sup>117</sup> SIA, “Comments Re: No. TA-2104-24, U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects,” written submission to the USITC, June 25, 2007, 4.

<sup>118</sup> ITAC (15) on Intellectual Property Rights, *Advisory Committee Report*, April 27, 2007, 2–3.

<sup>119</sup> *Ibid.*, 13.

<sup>120</sup> *Ibid.*, 6.

<sup>121</sup> ACTPN, *Report*, April 26, 2007, 5.

<sup>122</sup> ITAC (8) for Information and Communications Technologies, Services and Electronic Commerce, *Report*, April 27, 2007, 13; and ITAC (4) on Consumer Goods, *Report*, April 26, 2007, 5.

<sup>123</sup> ITAC (3) on Chemicals, Pharmaceuticals, Health/Science Products and Services, *Advisory Committee Report*, April 24, 2007, 15.

<sup>124</sup> ITAC (3) on Chemicals, Pharmaceuticals, Health/Science Products and Services, *Advisory Committee Report*, April 24, 2007, 16.

GPHA stated in testimony before the USTR that the patent-term extension, data exclusivity, and linkage provisions can operate to delay the entry of generic products on the market in Korea substantially beyond the time when the same products are available in the United States. GPHA also asserted that while U.S. law requires that generic companies be permitted to conduct research on a product during its patent life without infringing the patent, the FTA contains no such requirement.<sup>125</sup>

In testimony before the House Committee on Ways and Means, the Program on Information Justice and Intellectual Property at American University's Washington College of Law also said that the patent-term extension, data exclusivity, and linkage provisions of the FTA would inhibit the introduction of generics and access to medicine in Korea.<sup>126</sup>

## **FTA Chapter 19—Labor<sup>127</sup>**

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### *Assessment*

The labor provisions contained in the proposed U.S.-Korea FTA text would likely have little impact on the U.S. or Korean labor markets or on U.S.-Korea trade because they do little to change existing labor regulations in the two countries and focus primarily on enforcement. The principal labor provisions of the agreement require the parties to effectively enforce their own existing labor laws (box 6.3) and would enable parties to challenge the failure to enforce such laws under certain circumstances through consultations or the dispute-settlement procedures established in chapter 22 of the FTA. Industry and labor groups have differing views regarding the adequacy and potential value of the proposed FTA labor provisions (see Views of Interested Parties section below).

### *Summary of Provisions*

As with the labor chapters of several previous FTAs, chapter 19 of the U.S.-Korea FTA would commit each party to effectively enforce its respective labor laws while providing for the reasonable exercise of discretion regarding such enforcement. In addition, the parties would reaffirm their obligations as members of the International Labour Organization (ILO). Much like the labor chapter of the U.S.-Panama TPA, however, chapter 19 of the U.S.-Korea FTA would also commit the parties to maintain the rights specified in the ILO Declaration of Fundamental Principles and Rights at Work and Its Follow-up and ILO Convention No. 182 Concerning the Prohibition and Immediate Action for the Elimination of the Worst Forms of Child Labour (ILO Declaration) in their regulations and statutes. Further, whereas

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<sup>125</sup> Brown, "Proposed Free Trade Agreement with Republic of Korea," testimony before the Trade Policy Staff Committee, Office of the USTR, March 14, 2006.

<sup>126</sup> Flynn, "Access to Medicines Issues in the US-Korea Free Trade Negotiations," testimony before the House Committee on Ways and Means, March 20, 2007, 5–7.

<sup>127</sup> Under the Trade Act of 2002, the U.S. Department of Labor is responsible for the preparation of three reports that address the labor issues associated with each new FTA: (1) Laws Governing Exploitive Child Labor Report, (2) Labor Rights Report, and (3) United States Employment Impact Review. As of October 2006, the Department of Labor had not published those reports related to the U.S.-Korea FTA. USDOL, ILAB, "Labor-Related Reports for U.S. Free Trade Agreements."

### **Box 6.3** Labor market conditions in Korea

Korea maintains and enforces legislation that protects workers' rights and has become a contributor to International Labour Organization (ILO)-sponsored projects in other countries. Several groups indicate, however, that problems persist in Korea's workers' rights regime, most notably with regard to temporary employment, migrant labor, the right to organize and bargain collectively, and working conditions in the Kaesong Industrial Complex.

As compared with the United States, Korea has a smaller labor market, a lower unemployment rate, and lower labor costs. Specifically, the Korean labor market comprised 23.7 million workers, posted an unemployment rate of 3.7 percent, and registered an average labor cost of \$13.56 per hour for manufacturing-sector production workers<sup>1</sup> in 2005.<sup>2</sup> In that same year, the U.S. labor market comprised 149.3 million workers, registered an unemployment rate of 5.1 percent, and posted an average hourly labor cost for manufacturing-sector production workers of \$23.65.<sup>3</sup> The service sector is the principal employer in both countries, accounting for 65 percent and 78 percent of total employment in Korea and the United States, respectively, in 2005.<sup>4</sup>

Korea has undertaken international obligations on labor standards, having ratified four of the eight fundamental ILO conventions on workers' rights, two of which pertain to the ban on child labor, and two of which address discrimination in employment.<sup>5</sup> The U.S. State Department reported that Korean law provides a number of workers' rights protections, including measures protecting the right to associate, organize, and bargain collectively; standards regarding minimum employment age; and prohibitions on forced, compulsory, and child labor.<sup>6</sup> The OECD noted that Korea has taken steps to improve its labor legislation in recent years.<sup>7</sup> Although arrests of union officials typically exceed 200 per year, a representative of the Korea Labor & Society Institute (KLSI) indicated that law enforcement generally limits such arrests to organizers of nonpeaceful demonstrations.<sup>8</sup> The U.S. Embassy in Seoul reported that Korea has improved the enforcement of certain regulations, meets minimum standards on this issue,<sup>9</sup> and has demonstrated a commitment to employee welfare in the region by contributing \$500,000 to ILO-sponsored projects that will address various labor issues in six Asian countries.<sup>10</sup>

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<sup>1</sup> Data reflecting overall average labor costs in Korea are unavailable.

<sup>2</sup> EIU, "Country Commerce: South Korea," July 2006, 93; and USDOL, BLS, "Hourly Compensation Costs for Production Workers in Manufacturing," April 30, 2007.

<sup>3</sup> EIU, "Country Commerce: United States of America," May 2006, 68; and USDOL, BLS, "Hourly Compensation Costs for Production Workers in Manufacturing," April 30, 2007.

<sup>4</sup> World Bank, "WDI and GDF Online."

<sup>5</sup> Korea's ratification of these four core conventions took place relatively recently, with the earliest ratification having occurred on December 8, 1997 and the most recent ratification having occurred on March 29, 2001. ILO, "Ratifications of the Fundamental Human Rights Conventions by Country," June 20, 2007.

<sup>6</sup> USDOS, "Korea, Republic of," Country Reports of Human Rights Practices, March 6, 2007.

<sup>7</sup> OECD, "Report by the Chair of the Employment, Labour and Social Affairs Committee," 2.

<sup>8</sup> USDOS, U.S. Embassy, Seoul, "The Past and Future of Labor Struggles in Korea," June 2007.

<sup>9</sup> USDOS, U.S. Embassy, Seoul, "Republic of Korea (Tier 1)," Trafficking in Persons Report, June 12, 2007.

<sup>10</sup> ILO, "A New Era for South Korea," March 2004.

**Box 6.3** Labor market conditions in Korea—*Continued*

At the same time, several sources reported a number of remaining problems with the observance of labor standards in Korea. Korea reportedly has placed limitations on workers' ability to organize. For example, the implementation of legislation that would permit the establishment of more than one union at a single establishment has been delayed until 2009, and employees in a broadly defined group of essential sectors are not permitted to strike.<sup>11</sup> Further, a representative of a U.S. workers' union testified that efforts by Korean auto workers' to form unions and bargain collectively have faced significant obstacles and that more than 100 individuals are currently serving prison sentences in Korea due to their participation in labor union activities.<sup>12</sup> The large and growing share of temporary employees in the Korean workforce is problematic, as such employees generally receive lower wages than regular workers and are ineligible for unemployment and health insurance.<sup>13</sup> Despite the recent introduction of the Employment Permit System for Migrant Workers (EPS), it has been reported that migrant workers continue to experience discrimination and the unfavorable effects of legislation that binds them to a certain employer.<sup>14</sup> Further, certain sources contend that the workers' rights protections accorded to North Korean employees in the Kaesong Industrial Complex—while superior to the measures applied elsewhere in North Korea—remain inadequate, and that such employees' salaries are often paid to the government of North Korea.<sup>15</sup> Although goods produced by South Korean firms in the Kaesong Industrial Complex would not benefit from the current provisions of the U.S.-Korea FTA, there are concerns that these provisions may change following further consultations between the United States and Korea.<sup>16</sup>

<sup>11</sup> USDOS, "Korea, Republic of," Country Reports of Human Rights Practices, March 6, 2007; and Kim, "The 'Second Opening' of Korea: The U.S.-South Korea FTA," Spring 2007.

<sup>12</sup> Meyer, testimony before the USITC, June 20, 2007, 221–222, 305.

<sup>13</sup> USDOS, "Korea, Republic of," Country Reports of Human Rights Practices, March 6, 2007; and LAC for Trade Negotiations and Trade Policy, *Report*, April 27, 2007, 11-12.

<sup>14</sup> Agence France-Presse, "Amnesty urges South Korea to improve foreign workers' rights," April 30, 2007; and Read, "The Harsh Reality of Migrant Labor in South Korea," May 19, 2007.

<sup>15</sup> CRS, "The Proposed South Korea-U.S. Free Trade Agreement (KORUS FTA)," April 23, 2007, 24; and Richardson, "Not a Sweatshop, but No Workers' Heaven," October 8, 2006.

<sup>16</sup> CRS, "The Proposed South Korea-U.S. Free Trade Agreement (KORUS FTA)," April 23, 2007, 7; and Brevetti, "Rep. Levin Expresses Concern with U.S.-Korea FTA's Kaesong Provisions," June 12, 2007.

the labor provisions in many previous FTAs were subject to a separate dispute settlement mechanism, the provisions in chapter 19 of the FTA would be subject to the same dispute settlement procedures as the agreement's other obligations.

Each party would agree to provide access to domestic tribunal proceedings, allowing persons with a recognized interest under its law in a particular matter to seek enforcement of its labor laws. Such proceedings must be fair, equitable, and transparent; adhere to due process of the law; and provide an opportunity for persons involved in such proceedings to support or defend their positions. Each party also would agree to ensure independent review of tribunal actions, provide legal remedies to ensure enforcement, and promote public awareness of its labor laws. The FTA defines labor laws as statutes or regulations at the central level of government that directly relate to internationally recognized labor rights, including the right of association, the right to organize and bargain collectively, a ban on forced or compulsory labor, the protection of children and other young laborers, and standards on conditions of work, including minimum wages, hours of work, and occupational health and safety.

As with previous U.S. FTAs, the U.S.-Korea FTA would establish a Labor Affairs Council that would oversee the implementation of chapter 19 provisions. Each party would be required to designate an office within its labor ministry to serve as a contact with the other

party and the public and to be responsible for, inter alia, the review of communications from persons of a party. A side letter clarifies that the parties would not be required to establish discrete procedures for the review of such communications if there are existing procedures for other communications relating to chapter 19, and that parties could consider whether a particular communication has merit, substantively resembles another communication, or is being addressed in another domestic or international forum. The FTA would allow each party to call together a national labor advisory committee, which may include representatives of business and labor, members of the public, and others. Annex 19-A would also create a Labor Cooperation Mechanism to further advance common commitments on labor matters, including the ILO Declaration, and to enhance opportunities to improve labor standards.

Under Article 19.7, a party could request consultations with the other party on matters under this chapter with a view toward finding a mutually acceptable resolution. Failing to find a mutually acceptable resolution, a party could call upon the Labor Affairs Council to consider the matter. If a matter is not resolved within 60 days of a request for labor consultations, the complaining party could ask for consultations or refer the issue to the Joint Committee under the provisions established in Articles 22.7 and 2.8 of the FTA, following which, the party could seek to settle the dispute under the other provisions included in chapter 22 of the agreement.

### ***Views of Interested Parties***

U.S. advisory groups differ in their views on the potential effect of the proposed FTA labor provisions and on whether the FTA meets the statutory negotiating objectives. The report of the Advisory Committee for Trade Policy and Negotiations (ACTPN) provides a positive view of these provisions, stating that the FTA fulfills U.S. negotiating objectives on labor issues and enhances guarantees regarding due process and transparency. The report stated that ACTPN supports the agreement's cooperative approach to labor issues.<sup>128</sup>

By contrast, the report of the Labor Advisory Committee for Trade Negotiations and Trade Policy (LAC) report states that the agreement does not fulfill U.S. negotiating objectives, advance U.S. economic interests, or protect the rights of U.S. or Korean workers. The report states that weaknesses exist in Korea's workers' rights regime (see box 6.3), and that the agreement does not obligate parties to adhere to international workers' rights standards, does not preclude the weakening or elimination of labor regulations, and does not protect workers from the possible trade effects of provisions regarding safeguards and rules of origin.<sup>129</sup> At the Commission's hearing, prior to the finalized labor provisions, a representative of the International Union, United Automobile, Aerospace and Agricultural Implement Workers of America also expressed dissatisfaction with the agreement's labor provisions, and indicated that these provisions should be accorded status equal to that of other FTA provisions.<sup>130</sup>

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<sup>128</sup> ACTPN, *Report*, April 26, 2007, 9.

<sup>129</sup> LAC for Trade Negotiations and Trade Policy, *Report*, April 27, 2007, 3 and 9.

<sup>130</sup> Meyer, testimony before the USITC, June 20, 2007, 221.

## FTA Chapter 20—Environment<sup>131</sup>

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### *Assessment*

The environment provisions of the U.S.-Korea FTA would likely have little effect on the U.S. economy or on U.S.-Korea trade because the chapter does not significantly change existing regulations, but focuses primarily on enforcement. Like the U.S.-Panama TPA, the environmental provisions now in the FTA reflect the recent agreement between the administration and the U.S. Congress to incorporate several environmental changes in the FTAs (see Summary of Provisions section below).

### *Summary of Provisions*

Chapter 20 of the FTA would commit each party to strive to ensure that its environmental protection laws provide for high levels of protection and to strive to improve those laws, to provide appropriate and effective remedies and sanctions for violations of environmental protection laws, to not fail to effectively enforce its laws, to provide opportunities for public participation, and to promote public awareness of its environmental laws. The parties would agree that trade or investment will not be encouraged by weakening or reducing domestic environmental laws, although there is a provision for a waiver or a derogation that is not inconsistent with a party's obligations under a covered agreement (see below). The two parties would also agree to ensure that domestic judicial, quasi-judicial, or administrative proceedings will be available to sanction or remedy violations of environmental laws. Such proceedings would be required to be fair, open, and equitable; to comply with due process of law; and to provide access to persons with recognizable legal interests. An Environmental Affairs Council would be established that would meet to consider the implementation of the provisions contained in chapter 20 as well as the separate Environmental Cooperation Agreement (ECA), and to strive to resolve any controversies that may arise regarding these environmental provisions. They would also agree to pursue cooperative environmental activities and provide for environmental consultations. The parties will also commit to work in multilateral fora to enhance the mutual supportiveness of multilateral environmental and trade agreements.

The FTA would incorporate a specific list of multilateral environmental agreements (MEAs), collectively referred to as “covered agreements,” under which the United States and Korea have assumed obligations, including the Convention on International Trade in Endangered Species (CITES), the Montreal Protocol on Ozone Depleting Substances, the Convention on Marine Pollution, the Inter-American Tropical Tuna Convention (IATTC), the Ramsar

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<sup>131</sup> In a mandate separate from the Commission's mandate, the USTR is tasked with providing an environmental review of the U.S.-Korea FTA. Although the USTR has not yet released its final environmental review of the U.S.-Korea FTA, it appears unlikely that the agreement will have significant environmental effects in the United States. Pursuant to the Trade Act of 2002 and the environmental review guidelines, the USTR provided an interim report to Congress in December 2006 on the probable environmental effects on the United States of a U.S.-Korea FTA. In its report, the USTR stated that such an FTA would be unlikely to result in any significant economically driven environmental effects in the United States but that it may have positive environmental consequences for Korea. The USTR added that such an FTA would not be expected to have a negative effect on the ability of U.S. government authorities to enforce or maintain U.S. environmental laws or regulations.



Convention on Wetlands, the International Whaling Convention (IWC), and the Convention on Conservation of Antarctic Marine Living Resources (CCAMLR) (Annex 20-A). In previous FTAs, environmental dispute settlement procedures have focused on the use of fines, as opposed to trade sanctions, and were limited to the obligation to effectively enforce environmental laws.<sup>132</sup> In the U.S.-Korea FTA, all FTA environmental obligations would be enforced on the same basis as the commercial provisions of the agreements and would be subject to the same remedies, procedures, and sanctions.<sup>133</sup>

### *Views of Interested Parties*

The Advisory Committee for Trade Policy and Negotiations (ACTPN) report states that the environmental provisions of the U.S.-Korea FTA meet Congressional environmental objectives. The report adds that ACTPN endorses the environmental provisions of the FTA, noting that each party must enforce its own domestic laws in an effective manner so as to avoid having a negative effect on trade.<sup>134</sup>

The Trade and Environment Policy Advisory Committee (TEPAC) report states that a majority of the committee members believe that the U.S.-Korea FTA meets the U.S. environmental negotiating objectives.<sup>135</sup> Similarly, a majority of TEPAC members report that are also pleased to see the enhanced provisions for public participation and view such public participation as increasing the opportunities for effective enforcement of environmental laws. Moreover, the report states that the majority of TEPAC members also believe that the Environmental Cooperation Agreement (ECA) will provide a reasonable basis for fulfilling negotiating objectives regarding capacity building and sustainable development. It notes, however, that the majority believes that without a dedicated funding source, the achievement of the goals of the ECA is doubtful. On the other hand, a minority expressed the view that dedicated funding for the ECA would mean that funds for other priorities, even for similar projects associated with other FTAs, may not be available.<sup>136</sup> The TEPAC report states that most members also believe that the dispute-resolution procedures are sufficient to meet U.S. environmental negotiating objectives.<sup>137</sup> A majority were disappointed with the absence of an article on biological diversity such as those included in other FTAs.<sup>138</sup>

The ITAC 9 (Non-Ferrous Metals and Building Materials), ITAC 7 (Forest Products), and ITAC 3 (Chemicals) reports also addressed the environment provisions. The ITAC 9 report expressed support for use of side agreements, as opposed to the agreement text. It said that the side-agreement approach encourages private-sector cooperation toward furthering the advancement of environmentally sustainable economic development. It also expressed concern about the environment provisions that appear to approve use of measures to achieve environmental goals in the context of MEAs, noting that there is no assurance that these

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<sup>132</sup> USTR, "Bipartisan Trade Deal," May 2007, 2.

<sup>133</sup> For additional information on such remedies, procedures, and sanctions, see the section on Dispute Settlement in this chapter.

<sup>134</sup> ACTPN, *Report*, April 26, 2007, 9.

<sup>135</sup> TEPAC, *Advisory Committee Report*, April 25, 2007, 2.

<sup>136</sup> *Ibid.*, 16.

<sup>137</sup> *Ibid.*, 3.

<sup>138</sup> *Ibid.*, 5.

trade measures are the least disruptive necessary to meet the goals of the MEAs.<sup>139</sup> In its report, ITAC 7 said that the environment provisions and the associated ECA provide an opportunity to demonstrate the parties' commitment to improving global forestry practices and taking steps to eliminate illegal logging, associated illegal border trade, and the use of illegally obtained timber in the manufacturing of forest products. The report noted that the ECA cites joint initiatives related to these global forestry practices and to combating the illegal trade in wildlife and wildlife parts as a priority issue under the ECA.<sup>140</sup> In its report, ITAC 3 stated that it believes that approaching environmental issues through bilateral FTAs is inadvisable. The industry members of ITAC 3 also indicated that inclusion of environmental provisions in future trade agreements in such a way as to lead to trade sanctions is misguided.<sup>141</sup>

## **FTA Chapter 21–Transparency**

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### *Assessment*

Lack of transparency in Korea's regulatory system has been cited as a fundamental and longstanding impediment to the operation of a wide range of U.S. firms in the country, including those, for example, in the financial services, information technology, pharmaceutical, and telecommunications industries.<sup>142</sup> Provisions in the U.S.-Korea FTA regarding transparency would likely offer far-reaching improvements over the policies and practices that they are intended to replace, enhancing the security of business transactions and creating the potential to foster U.S.-Korea trade and investment.<sup>143</sup> For example, the FTA would likely provide the public with improved access and information in dispute-settlement cases. Such dispute-settlement mechanisms provide for public hearings, public access to documents, and the opportunity for third parties to submit views in an open forum. Additional transparency provisions apply in the areas of customs administration, pharmaceutical pricing and reimbursement, technical regulations, financial services, and telecommunications.<sup>144</sup> For instance, included in the agreement are provisions that would improve transparency in customs procedures, which have been a significant impediment to the transport of express delivery shipments, and that would require more open and public processes for customs rulings and administration. Similarly, transparency provisions on financial services would likely improve market access for foreign firms by requiring that application requirements for financial service suppliers be made publicly available, and by requiring that such suppliers have the opportunity to comment on proposed regulations.<sup>145</sup> Finally, the FTA would continue the U.S. effort to obtain bilateral commitments to transparency disciplines applicable to domestic regulation, including provisions that are intended to enhance and ensure communication and disclosure between parties.

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<sup>139</sup> ITAC (9) on Non-ferrous Metals and Building Materials, *Advisory Committee Report*, April 27, 2007, 5.

<sup>140</sup> ITAC (7) on Forest Products, *Advisory Committee Report*, April 26, 2007, 6.

<sup>141</sup> ITAC (3) on Chemicals, Pharmaceuticals, Health/Science Products and Services, *Advisory Committee Report*, April 24, 2007, 13.

<sup>142</sup> USTR, "Korea," *2007 National Trade Estimate Report on Foreign Trade Barriers*, April 2, 2007, 369; and USITC hearing transcript, June 20, 2007, 23–29, 48, 69, and 189.

<sup>143</sup> Reis, testimony before the USITC, June 20, 2007, 29.

<sup>144</sup> USTR, *Free Trade with Korea - Summary of the KORUS FTA*, April 2007.

<sup>145</sup> Vastine, testimony before the House Committee on Ways and Means, March 20, 2007.

## *Summary of Provisions*

Chapter 21 of the U.S.-Korea FTA is similar to the transparency chapters in recent FTAs. As in recent agreements, the U.S.-Korea FTA would require each party to make publicly available all laws, regulations, and procedures regarding any matter covered by the agreement. Further, under the chapter, each party must establish or maintain procedures to provide review and appeal capabilities to any entities that would be affected by actions, rulings, measures, or procedures under the FTA. The agreement would also require the adoption of transparency principles within specific industries, including financial and telecommunication services. Applicable provisions also cover protection for U.S. trademarks, procedures for government procurement contracts, and the administration and enforcement of environmental laws. The U.S.-Korea FTA contains a prior notice and comment period for all new laws and regulations. This chapter also includes anticorruption provisions relating to trade and investment that would require each party to make corruption a criminal offense and to establish penalty procedures for bribery and corruption.

## *Views of Interested Parties*

In its report on the FTA, the Industry Trade Advisory Committee on Services and Finance Industries (ITAC 10) stated that the agreement's commitments will improve the business climate in Korea, stimulate new investment, improve the operation of financial and other markets, and reduce corruption. Further, it added that the FTA will result in greater transparency in domestic regulation that would enhance the quality of the regulatory environment, thereby creating new market opportunities for U.S. services providers. The report remarked that transparency in domestic regulation is particularly important in the services area, where government regulation is prevalent and where discriminatory regulatory practices have been encountered in the past, essentially closing some services sectors to U.S. participation.<sup>146</sup>

Other ITAC reports, including those of the consumer goods and distribution service industries, reached similar conclusions, although some cautioned that additional measures are necessary to ensure the efficacy of transparency provisions under the FTA.<sup>147</sup> For example, the report of the Industry Trade Advisory Committee on Small and Minority Business (ITAC 11) stated that laws, regulations, and administrative rulings and procedures should be required to be made available to all interested parties both in print form and through publication on the Internet.<sup>148</sup> Nonetheless, before the House Committee on Ways and Means, Tami Overby, the President and CEO of the American Chamber of Commerce in Korea, said that the overall industry assessment of the transparency provisions included in the U.S.-Korea FTA remain positive, with the agreement seen as an important opportunity to advance regulatory reform in Korea.<sup>149</sup>

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<sup>146</sup> ITAC (10) on Services and Finance Industries, Advisory Committee Report, April 25, 2007.

<sup>147</sup> ITAC (4) on Consumer Goods, *Report*, April 26, 2007; and ITAC (5) on Distribution Services for Trade Policy Matters, *Advisory Committee Report*, April 25, 2007.

<sup>148</sup> ITAC (11) on Small and Minority Business, *Advisory Committee Report*, April 26, 2007.

<sup>149</sup> Overby, testimony before the House Committee on Ways and Means, March 20, 2007, 4.

## **FTA Chapter 22–Institutional Provisions and Dispute Settlement**

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### *Assessment*

The Dispute Settlement chapter outlines guidelines for producing a conducive environment for dispute settlement. The dispute-panel procedures of the U.S.-Korea FTA would require that hearings be open and public, that the public has access to the legal submissions of the parties to the panel, and that interested parties have the opportunity to submit views to the panel. The major obligations of the FTA would be subject to the dispute settlement provisions of the FTA. The dispute-settlement provisions emphasize the use of consultations and trade-enhancing remedies to promote compliance. The enforcement mechanism includes the potential use of monetary assessments, as well as trade retaliatory measures.

The dispute-settlement provisions of the U.S.-Korea FTA would provide parties a formalized way to settle disputes concerning the major obligations of the FTA. The auto industry may benefit from more expeditious dispute settlements, because of proposed alternative dispute-resolution procedures (new to this FTA) for disputes relating to automotive products as presented in Annex B of this chapter.

### *Summary of Provisions*

The first section of the chapter deals with the administration of the FTA. It would require each party to designate one or more contact points to facilitate bilateral communication on matters under the FTA. Such contact points would, on request, identify other offices or officials responsible for the pertinent matter and assist in linking an official with a question to the person who might answer it. Article 22.2 would set up the Joint Committee comprising officials of each party and cochaired by the USTR and the Minister for Trade of Korea or their designees. This committee would have a wide range of functions in supervising the implementation and operation of the agreement, and play a part in dispute resolution for covered matters. It could delegate responsibilities to ad hoc bodies, seek input from outside experts, consider possible FTA amendments, interpret FTA provisions, and handle its own procedures. It would meet at least once per year in as transparent a manner as possible, seeking views of the public and taking into account the need for protection of confidential information.

Under the provisions in this chapter, although the parties commit to consult and cooperate on FTA matters, one party could invoke dispute settlement on a subject matter not excluded by any FTA provision if it believes that the other has an FTA-inconsistent measure or has failed to carry out an FTA obligation, or that a benefit it reasonably expected has not been given. Where a dispute arises, the complaining party could choose the forum for settling the matter. If a party requests consultations and the consultation fails to resolve the matter by a prescribed deadline, either party could refer the matter to the Joint Committee, followed by a request for a dispute settlement panel, if necessary. Once a panel constituted under the chapter has supplied its final report, the report must be made public and the parties would be obliged to agree on the resolution of the dispute in question, normally in a manner which conforms with the determinations of the panel. If parties are unable to agree on a resolution,

compensation could be negotiated, payable in either party's currency. If the parties fail to agree on the terms of compensation, or the report or agreed resolution is not implemented, an actual suspension of benefits of equivalent effect could be undertaken in accord with the panel's report, or the party complained against could pay a monetary assessment in U.S. dollars for an amount equal to 50 percent of the total benefit the panel deems to have been involved. The Joint Committee could decide that an assessment should be paid into a fund established by the Joint Committee and expended for appropriate initiatives to facilitate trade between the parties.

This chapter also contains provisions directing compliance reviews and a 5-year review for disputes under the FTA. Actions relating to measures subject to exception under Article 23.1 could not be taken. The chapter contains administrative procedures for requesting a panel, selecting panelists, and issuing reports. It would prohibit any private right of action related to the consistency of a national law with the FTA. The chapter also states that parties should facilitate the use of arbitration and alternate dispute resolution to settle international commercial disputes between private parties in the free trade area.

Unlike in previous FTAs, there are provisions in Annex B to this chapter outlining alternative, expedited dispute-settlement procedures for disputes concerning motor vehicles. The proceedings are similar to those for other FTA obligations as described above, except that the Joint Committee would submit the dispute to a panel if it could not resolve it within 30 days. The panel would have 120 days in which to draft a preliminary report and to determine whether an FTA-inconsistent measure materially affected the sale, offering for sale, purchase, transportation, distribution, or use of originating goods of a party. If the panel finds that the violating party has not conformed with its obligations, or that its actions materially injured the other party, the complaining party could increase the rate of customs duty on passenger cars of heading 8703 of the Harmonized System (HS) to a level not to exceed the prevailing MFN applied rate of duty on such goods, to be rescinded upon corrective action taken by the other party. If the panel determines that there is a nonconformity but that it did not materially injure the other party, the dispute-settlement rules and outcomes otherwise provided in chapter 22 as described above would apply. Unless a panel is convened and finds an NCM under these provisions, the procedures in the annex would expire 10 years after the date of entry into force of this agreement.

Annex C to this chapter would establish a Committee on Outward Processing Zones on the Korean Peninsula, comprising members from each party, to identify areas on the Korean Peninsula that may be designated outward processing zones. In making such a determination, the committee is to consider criteria such as progress toward denuclearization of the Korean Peninsula, the effect of the outward processing zones on intra-Korean relations, and the environmental and labor standards and wage and business practices prevailing in the outward processing zone. The committee would also determine the maximum threshold for the value of the total input of the originating final good that may be added within the outward processing zone.

The provisions of Annex D to this chapter would establish a Joint Fisheries Committee. This committee is to serve as a forum to discuss issues concerning fisheries matters, including but not limited to, policies on commercial activities within the exclusive economic zones of the parties and scientific research on fisheries matters.

## *Views of Interested Parties*

The Industry Trade Advisory Committee on Automotive Equipment and Capital Goods (ITAC 2) and U.S. auto manufacturer General Motors (GM) stated that the expedited alternate dispute resolution process for automotive products has the potential to discourage the use of nontariff barriers.<sup>150</sup> Ford, the Labor Advisory Committee (LAC), the United Automobile, Aerospace, and Agricultural Implement Workers of America (UAW), and U.S. Representative Sander Levin, expressed concerns that U.S. auto firms face the burden of proving that they have suffered “injury” under the alternate dispute resolution process for automotive products before an appropriate trade remedy can be applied.<sup>151</sup> They said that the threat of applying the prevailing MFN applied rate of duty of 2.5 percent would be ineffective and objected to its application only to passenger cars and not to light pickup trucks as well.<sup>152</sup> Moreover, Ford stated that it would have preferred a process in which the MFN duty would be immediately reinstated at the beginning of the dispute with negotiations to follow.<sup>153</sup>

In its report, the LAC stated that the process should allow participation of labor unions and should require the selection of panelists with specialized experience.<sup>154</sup> LAC said that safeguards resulting from this alternate dispute-settlement procedure should be permanent,<sup>155</sup> and that the alternate dispute settlement procedure for automotive products would not benefit U.S. workers or the U.S. auto industry.<sup>156</sup> LAC also added that the provisions would not prevent Korea from waiving or weakening its existing domestic labor laws and that the provisions do not provide for adequate enforcement of the International Labor Organization’s (ILO) core labor standards, particularly employment discrimination.<sup>157</sup> LAC remarked that if goods from the Kaesong Industrial Complex (KIC), a free trade zone located in North Korea, enter the U.S. market, then failure to enforce internationally recognized labor rights in the KIC should be subject to the dispute settlement procedures in this chapter.

LAC added that its members object to three changes in the wording of this chapter from most previous FTAs: (1) the phrase “or as the parties otherwise agree” in section 22.4 of this chapter that will allow parties to alter the scope of what is subject to the dispute-settlement provisions; (2) the FTA omitted the requirement in other FTAs that parties suspending benefits as part of a dispute settlement must first attempt to apply such suspensions to the same sector as was affected by the dispute; and (3) the FTA did not contain a requirement as to the qualification criteria for panelists in section 22.9 of this chapter. Finally, LAC stated

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<sup>150</sup> ITAC (2) on Automotive Equipment and Capital Goods, *Advisory Committee Report*, April 27, 2007, 13.

<sup>151</sup> *Ibid.*, 9; LAC for Trade Negotiations and Trade Policy, *Report*, April 27, 2007, 26; Meyer, testimony before the USITC, June 20, 2007, 220; and Congressman Levin, testimony before the USITC, June 20, 2007, hearing transcript, 161–162.

<sup>152</sup> Meyer, testimony before the USITC, June 20, 2007, hearing transcript, 220–222; Congressman Levin, testimony before the USITC, June 20, 2007, hearing transcript, 161–162; ITAC (2) on Automotive Equipment and Capital Goods, *Advisory Committee Report*, April 27, 2007, 11; and LAC for Trade Negotiations and Trade Policy, *Report*, April 27, 2007, 20.

<sup>153</sup> Biegun, testimony before the USITC, June 20, 2007, hearing transcript, 235.

<sup>154</sup> LAC for Trade Negotiations and Trade Policy, *Report*, April 27, 2007, 26; and Meyer, hearing transcript, 220.

<sup>155</sup> LAC for Trade Negotiations and Trade Policy, *Report*, April 27, 2007, 25.

<sup>156</sup> *Ibid.*, 20.

<sup>157</sup> *Ibid.*, 7.

that the procedural deadlines as outlined in the chapter could lead to delays and have an injurious effect on a complaining party.<sup>158</sup>

In its report on the agreement, the Trade and Environment Policy Advisory Committee (TEPAC) stated that it approves of the transparency provisions relating to dispute-settlement proceedings as outlined in this chapter, but would prefer that the acceptance of submissions from the public in dispute-settlement proceedings be mandatory rather than permissive.<sup>159</sup> TEPAC added that its members approve of the panel selection procedures and believe the procedures would ensure that panelists dealing with environmental issues have the requisite expertise. TEPAC, however, expressed concern about the clarity and implication of the side letter to the FTA related to environmental dispute resolution that states that parties should first consider whether the party at issue maintains environmental laws “of substantial equivalent scope” as the potential dispute-settlement matter before initiating such a proceeding. TEPAC urged that this side letter be clarified before the FTA is approved.<sup>160</sup>

In its report, the Intergovernmental Policy Advisory Committee (IGPAC) recommended the creation of a federal-state international trade commission that would provide an infrastructure to facilitate cooperation and understanding of trade issues across all levels of government and to address state and local interests in such issues, including dispute-settlement proceedings.<sup>161</sup> IGPAC said that such a committee should be based on U.S. constitutional federalism, and cited the Canadian federal-provincial committee for trade consultations (C-Trade) as a potential model. IGPAC also said that the USTR and the U.S. Department of Justice should request that the federal government cover expenses that state governments incur in the course of defending state laws or regulations in the dispute-settlement process associated with this FTA.<sup>162</sup>

In its report, the Advisory Committee for Trade Policy and Negotiations (ACTPN) stated that the procedures in this chapter are fully transparent and supports the use of public hearings and acceptance of submissions of interested parties.<sup>163</sup> ACTPN added that it supports the provisions throughout the chapter to settle disputes through consultation.<sup>164</sup>

In their respective reports, the Industry Trade Advisory Committee on Customs Matters and Trade Facilitation (ITAC 14)<sup>165</sup> and the Industry Trade Advisory Committee on Small and Minority Business (ITAC 11) also expressed support for the dispute-settlement procedures as outlined in this chapter.<sup>166</sup>

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<sup>158</sup> *Ibid.*, 20–21.

<sup>159</sup> TEPAC, *Advisory Committee Report*, April 25, 2007, 10.

<sup>160</sup> *Ibid.*

<sup>161</sup> IGPAC, *Advisory Committee Report*, April 24, 2007, 12.

<sup>162</sup> *Ibid.*, 20. IGPAC notes that California, under NAFTA Chapter 11, will be the state most frequently involved in such proceedings.

<sup>163</sup> ACTPN, *Report*, April 26, 2007, 5.

<sup>164</sup> *Ibid.*, 9.

<sup>165</sup> ITAC (14) on Customs Matters and Trade Facilitation, *Advisory Committee Report*, April 18, 2007, 7.

<sup>166</sup> ITAC (11) on Small and Minority Business, *Advisory Committee Report*, April 26, 2007, 8.





# CHAPTER 7

## Literature Review and Summary of Positions of Interested Parties

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This chapter provides a review of relevant studies that have analyzed the U.S.-Korea FTA. This literature review is followed by a summary of positions of interested parties based on oral testimony or written submissions made to the USITC regarding this investigation.

### Literature Review

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#### *Overview*

A number of studies have estimated the potential impact of a possible U.S.-Korea FTA in the last decade. Wang and Cheong produced the first published computable general equilibrium analysis of the topic in 1998.<sup>1</sup> Subsequent studies have been performed by the USITC, several Korean research groups, and unaffiliated researchers. The Peterson Institute for International Economics has also published a series of estimates for a U.S.-Korea FTA. This literature review will focus on the more recent studies, because they have generally employed updated data and liberalization scenarios that more closely resemble the negotiated FTA. Only the current USITC study, however, assesses the actual negotiated FTA tariff and TRQ liberalization; all other studies assessed a hypothetical U.S.-Korea FTA.

The model that has been used most frequently to analyze the U.S.-Korea FTA is the Global Trade Analysis Project (GTAP) model. Studies that have employed the GTAP model include Choi and Schott in 2001, USITC in 2001, DeRosa and Gilbert in 2004, Lee and Lee in 2005, and Zhuang and Koo in 2006.<sup>2</sup> The current study also uses the GTAP model. A few recent studies have employed other models. In 2006, Schott, Bradford, and Moll used a model based on the Harrison, Rutherford, and Tarr model, and in 2007 Kiyota and Stern employed the Michigan model to analyze the FTA.

Regardless of model, base year, and liberalization scenario, all studies estimated that agricultural and manufacturing liberalization in an FTA would very modestly increase U.S. welfare. Studies also agreed that total U.S. exports to Korea would increase by more than total imports from Korea, in both percentage and value terms. Results for individual U.S. sectors are also generally consistent across studies. Estimated U.S. output changes are small, generally less than two percent, with the largest increases in agricultural products and the largest decreases in textile and apparel sectors. Although only two studies report bilateral trade on a sectoral basis, they both found that U.S. agriculture and food sectors would have the largest export increases, and textiles would have the largest import increases, which mirror the estimated U.S. output changes in these studies.

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<sup>1</sup> Wang and Cheong, "The Effects of a Korea-U.S. FTA," December 1998.

<sup>2</sup> The GTAP model has undergone a number of revisions since the first of these studies. A large part of these revisions has involved updating world trade, production, and protection data to successive base years. GTAP version 4 employed base-year data from 1995; version 5 used 1997 data; and version 6, the most recent, uses 2001 data.

Effects in the Commission's analysis for a fully implemented FTA are broadly consistent with, though generally lower than, effects identified in other studies employing a similar model and scenario assumptions. The main difference is that the Commission's analysis is based on the negotiated FTA rather than a proposed or hypothetical FTA, and so may incorporate smaller changes in Korean and U.S. barriers than in other studies. In addition, the Commission's analysis employs an updated baseline that reflects more recent trade data than the 2001 GTAP baseline; for example, lower U.S. imports of Korean textiles and apparel in the Commission baseline are reflected in lower estimated increases in imports of these products after liberalization, and hence lower increases in overall imports from Korea than in other studies.

All of the studies discussed in this review incorporated GTAP-based estimates of protection. This has important implications for estimates of welfare, trade, and output changes, because the GTAP database does not include nontariff barriers in most sectors.<sup>3</sup> Thus, there are large sectors of the economy, particularly services, for which GTAP has no estimates of the magnitude of trade barriers. The current study addresses this lack of services data by providing qualitative assessments of the impact of the FTA on the U.S. services sectors, as well as estimating the reduction in tariff equivalents in the banking sector that would result from the FTA.<sup>4</sup> In two studies, researchers used additional sources to estimate ad valorem equivalents of U.S. and Korean services-sector barriers. These studies estimated larger welfare gains because of larger two-way trade in service sectors, but reported that removal of these barriers would have little effect on service-sector output.

### ***Aggregate Welfare and Bilateral Trade***

There have been four GTAP-based studies of the FTA that do not examine service liberalization. All of these studies have estimated that liberalization of agricultural and manufacturing sectors would raise U.S. welfare by less than 0.3 percent (table 7.1).<sup>5</sup> The liberalization scenarios in Choi and Schott, USITC, and DeRosa and Gilbert included complete elimination of all agricultural and manufacturing tariffs.<sup>6</sup> Choi and Schott estimated that U.S. welfare would increase by 0.13 percent. The USITC did not report welfare changes, but estimated that U.S. GDP would increase by 0.23 percent. DeRosa and Gilbert estimated that U.S. welfare would rise by 0.03 percent. Zhuang and Koo analyzed a 50 percent reduction in agricultural and food barriers and a complete removal of all other tariffs and export taxes.<sup>7</sup> They also assumed that U.S. and Korean productivity in high-tech sectors would increase by 1 percent as a result of the FTA, and estimated that this combined liberalization and productivity gain would raise U.S. welfare by 0.24 percent.

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<sup>3</sup> The GTAP database also does not explicitly include data on the prevalence or costs and benefits of rules on origin. The reduction of preferential tariff rates to zero implicitly assumes that all traded goods qualify under FTA rules of origin.

<sup>4</sup> The banking-sector tariff equivalents developed by the Commission include measures affecting commercial presence, which is not captured by the GTAP model. Therefore, the banking-sector tariff equivalents have not been included in the Commission's GTAP-based estimations.

<sup>5</sup> Welfare increases are given as a percentage of GDP. Welfare gains are often reported in dollar terms as well, but comparison across studies in dollar terms is less informative because the base years of studies differ.

<sup>6</sup> Choi and Schott, "Free Trade Between Korea and the United States?" April 2001, 56; *USITC, U.S.-Korea FTA: The Economic Impact of Establishing a Free Trade Agreement (FTA) Between the United States and the Republic of Korea, 2001*, 5-14; and DeRosa and Gilbert, "Technical Appendix," 2004, 394.

<sup>7</sup> Zhuang and Koo, "Implications of the Korea-U.S. Free Trade Agreement," 23.

**Table 7.1** Model, liberalization experiment, and aggregate results: Selected economic literature on a U.S.-Korea FTA

Author, year	Model <sup>a</sup>	Database, base year	Type of liberalization experiment <sup>b</sup>	Change in welfare (percent of GDP)	Change in U.S. exports to Korea (percent)	Change in U.S. imports from Korea (percent)
USITC, 2001	GTAP	GTAP-4, 1995	All tariffs	0.23 <sup>c</sup>	54.0	21.4
Choi and Schott, 2001	GTAP	GTAP-4, 1995	All tariffs	0.13	49.4	30.3
			Only manufacturing tariffs	0.06	25.5	23.3
DeRosa and Gilbert, 2004	GTAP	GTAP-5, 1997	All tariffs	0.03	48.2	23.4
Lee and Lee, 2005	GTAP	GTAP-6, 2001	80% agricultural tariffs, 100% manufacturing tariffs, and 50% service barriers	— <sup>e</sup>	4.1 <sup>f</sup>	4.5 <sup>f</sup>
Zhuang and Koo, 2006	GTAP	GTAP-6, 2001	50% food and agriculture tariffs, 100% manufacturing tariffs, and hi-tech productivity increase	0.24	33.5	21.2
Schott, Bradford, and Moll, 2006	Harrison, Rutherford, and Tarr	GTAP-6, 2001	All tariffs	0.07	— <sup>e</sup>	— <sup>e</sup>
			All tariffs except rice	0.10	— <sup>e</sup>	— <sup>e</sup>
Kiyota and Stern, 2007	Michigan	GTAP-6, 2020	All tariffs and service barriers <sup>d</sup>	0.14	31.3	18.4
			Only agricultural tariffs and export subsidies <sup>d</sup>	-0.01	— <sup>e</sup>	— <sup>e</sup>
			Only manufacturing tariffs <sup>d</sup>	0.04	— <sup>e</sup>	— <sup>e</sup>
			Only service barriers <sup>d</sup>	0.11	— <sup>e</sup>	— <sup>e</sup>
USITC, 2007	GTAP	GTAP-6, 2008	All tariffs and TRQs in negotiated FTA	0.01–0.02	22.6–25.3	9.9–10.6

Sources: USITC, *U.S.-Korea FTA: The Economic Impact of Establishing a Free Trade Agreement (FTA) Between the United States and the Republic of Korea*, 2001; Choi and Schott, "Korea-U.S. Free Trade Revisited." In *Free Trade Agreements: U.S. Strategies and Priorities*, 2004; DeRosa and Gilbert, "Technical Appendix," 2004, 383–417; Lee and Lee, "Feasibility and Economic Effects of a Korea-U.S. FTA," December 30, 2005; Zhuang and Koo, "Implications of the Korea-U.S. Free Trade Agreement," 2006; Schott, Bradford, and Moll, "Negotiating the Korea-United States Free Trade Agreement," June 2006; and Kiyota and Stern, "Economic Effects of a Korea-U.S. Free Trade Agreement," 2007.

<sup>a</sup>The GTAP model employs Armington differentiation and assumes constant returns to scale and perfect competition in all sectors. With Armington differentiation, domestic imports compete against aggregate imports. In the Michigan model, imports from specific countries compete more directly with U.S. products. The Michigan model assumes constant returns and perfect competition in agriculture, but increasing returns and monopolistic competition in all other sectors. The Harrison, Rutherford, and Tarr model employs Armington differentiation. It is capable of employing increasing returns, but Schott, Bradford, and Moll imposed constant returns and perfect competition in all sectors.

<sup>b</sup>All simulations are static in nature. USITC is a static simulation that compares changes in two projected future periods. Choi and Schott and Schott, Bradford, and Moll report long-run static simulations, in which capital stock may change.

<sup>c</sup>USITC reported the change in GDP rather than welfare.

<sup>d</sup>Assumes Doha Round tariff reductions have been implemented prior to U.S.-Korea FTA implementation.

<sup>e</sup>Not reported.

<sup>f</sup>Trade increases based on increased manufacturing trade as a share of total trade; agriculture and services increases not reported.

The Petersen Institute for International Economics has produced a series of reports on a U.S.-Korea FTA. The first report was Choi and Schott, discussed above. Schott, Bradford, and Moll updated these results in 2006.<sup>8</sup> Schott, Bradford, and Moll incorporated GTAP version 6 data into a model originally created by Harrison, Rutherford, and Tarr.<sup>9</sup>

Relative to the GTAP model, their model produced much higher estimates of sectoral reallocation resulting from liberalization, although both models estimated similar welfare gains for the United States. U.S. welfare would increase by 0.10 percent in the long run in their liberalization scenario that excluded service sectors and rice. The inclusion of Korean rice in the liberalization scenario slightly reduced the estimated U.S. welfare gain, despite increased U.S. rice production, because of increased payments under U.S. agricultural support programs.

There are two studies that have estimated ad valorem equivalents of U.S. and Korean service barriers and included reductions in these barriers as part of the FTA analysis. Lee and Lee used GTAP to analyze an 80-percent reduction in agricultural tariffs and complete elimination of all manufacturing tariffs.<sup>10</sup> They estimated service barriers based on Uruguay Round Schedules submitted to the WTO, and assumed the FTA would reduce these barriers by 50 percent. They did not report U.S. gains, but they estimated that liberalization of all sectors would increase Korean welfare more than liberalization of only agriculture and manufacturing.

Kiyota and Stern used the Michigan model to separately analyze the economy-wide effects of four liberalization experiments: agricultural, manufacturing, services, and full liberalization.<sup>11</sup> The Michigan model, unlike the GTAP model, incorporates increasing returns to scale and monopolistic competition in all nonagricultural sectors.<sup>12</sup> The use of increasing returns did not significantly alter the results relative to the GTAP model except in the agricultural liberalization scenario, which they estimated would lead to a very small U.S. welfare decline of 0.01 percent.<sup>13</sup> Manufacturing liberalization would increase U.S. welfare by 0.04 percent, in line with other studies. Kiyota and Stern included estimated service barriers based on financial data on price-cost margins constructed by Hoekman.<sup>14</sup> Services liberalization produced an 0.11-percent welfare gain for the United States, the largest U.S. gain in their model.

In all of the models discussed in this review, U.S. trade with Korea is expected to increase, and U.S. exports consistently rise more than U.S. imports, in both value and percentage

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<sup>8</sup> Schott, Bradford, and Moll, "Negotiating the Korea-United States Free Trade Agreement," June 2006, 26–27. In this series, Choi and Schott updated the policy discussion without providing new model results in Choi and Schott, "Korea-U.S. Free Trade Revisited." In *Free Trade Agreements: U.S. Strategies and Priorities*, 2004.

<sup>9</sup> Harrison, Rutherford, and Tarr, "Quantifying the Uruguay Round," 1997, 1406–1409.

<sup>10</sup> Lee and Lee, "Feasibility and Economic Effects of a Korea-U.S. FTA," December 30, 2005, 78–104.

<sup>11</sup> Kiyota and Stern, "Economic Effects of a Korea-U.S. Free Trade Agreement," 2007, 39. Kiyota and Stern used a liberalization scenario with a time frame considerably different from the other studies. They estimated changes from a U.S.-Korea FTA relative to an extrapolation to 2020 that incorporated potential Doha tariff liberalization.

<sup>12</sup> The GTAP model assumes constant returns to scale and perfect competition, whereas the Michigan model assumes increasing returns to scale and monopolistic competition.

<sup>13</sup> They reported that this welfare decline may reflect the movement of workers and capital away from increasing-returns manufacturing sectors to constant-returns agricultural sectors. The U.S. welfare decline was not because of increased payments under U.S. agricultural programs as in Schott, Bradford, and Moll.

<sup>14</sup> Hoekman, "The Next Round of Services Negotiations: Identifying Priorities and Options," 2000, 38.

terms. Much of the increase in U.S. exports is in agricultural products, so simulations that do not include agricultural liberalization, such as the alternative scenario in Choi and Schott, have smaller estimated export changes. In addition, more recent studies have estimated smaller increases in agricultural exports than earlier studies, which has led to lower overall U.S. export increases in these studies (table 7.1). This difference can be seen by comparing sectoral exports estimated by USITC in 2001 to Zhuang and Koo in 2006, which are the only two studies to report sectoral bilateral trade (table 7.2). The estimated change in imports from Korea has been more steady across studies. Textiles and apparel are important components of these imports, and estimates of the overall increase in U.S. imports from Korea have fallen slightly, chiefly for two reasons: Korean textile and apparel output has declined, and estimated protection has declined with the phaseout of quotas under the Agreement on Textiles and Clothing. This reduction is reflected in reduced U.S. textile and apparel imports in Zhuang and Koo compared to the earlier USITC study.

**Table 7.2** Changes in bilateral trade by sector: Selected economic literature on a U.S.-Korea FTA

Sector	U.S. exports to Korea (million dollars)		U.S. imports from Korea (million dollars)	
	USITC	Zhuang and Koo	USITC	Zhuang and Koo
All agriculture and food	10,424	4,370	193	90
Paddy rice	0 <sup>a</sup>		0 <sup>a</sup>	
Fruits and vegetables	69		0 <sup>a</sup>	
Other agriculture	9,432		178	
Meat products	716		0 <sup>a</sup>	
Dairy	207		15	
All natural resources	91	540	1	110
All manufacturing	8,580	4,900	10,278	7,910
Textiles and apparel	163	240	7,008	5,240
Mineral, metal products	396		383	
Midtech manufacturing		1,760		670
High-tech manufacturing		2,900		2,000
Other manufactures	8,021		2,887	
All services	8	70	-209	-130
Total	19,175 <sup>b</sup>	9,880	10,262	7,980

Source: USITC, *U.S.-Korea FTA: The Economic Impact of Establishing a Free Trade Agreement (FTA) Between the United States and the Republic of Korea*, 2001, 5-10; and Zhuang and Koo, "Implications of the Korea-U.S. Free Trade Agreement," 2006, 25.

Note: Because of differences in aggregation, studies do not report in all sectors and subsectors.

<sup>a</sup>Less than 0.5 million.

<sup>b</sup>Total as provided in original report.

## ***Sectoral Output***

Although welfare is the most commonly reported measure in these reports, four studies also discussed sectoral output changes. The effect on U.S. output, when reported, was broadly consistent across studies, despite differences in model structures, base years, and liberalization scenarios. In general, estimated U.S. sectoral output changes are small, generally less than two percent, with the largest decreases in textile and apparel sectors and the largest increases in agricultural and natural resource products (table 7.3).

**Table 7.3** Change in output by sector: Selected economic literature on a U.S.-Korea FTA

Sector	Change in output (percent)			
	USITC	Zhuang and Koo	Kiyota and Stern	Schott, Bradford, and Moll
All agriculture, food, and beverages	0.6	0.8	0.2	1.9 <sup>b</sup>
Rice (paddy and processed)	0.0 <sup>a</sup>			-0.8
Wheat			0.2	-5.9
Other grains			1.6	
Fruits and vegetables	0.0 <sup>a</sup>		0.2	-0.9
Oilseeds			1.7	
Sugar			0.1	
Plant-based fibers			0.0 <sup>a</sup>	
Other crops			0.3	
Agriculture n.e.c.	1.0			6.9 <sup>b</sup>
Meat products	0.7		0.1	-0.6
Beef				-0.6
Other meat				-0.7
Dairy	0.5			0.0 <sup>a</sup>
Food and beverages n.e.c.			0.1	0.4
All natural resources	0.0 <sup>a</sup>	-0.3	0.0 <sup>a</sup>	
All manufacturing	-0.1	0.0 <sup>a</sup>	0.0 <sup>a</sup>	-0.6
Textiles, apparel, and leather	-1.3	-1.5	-0.4	-1.1
Textiles			-0.4	-1.3
Wearing apparel			-0.5	-0.7
Leather products and footwear			-0.1	-1.2
Wood and wood products			0.0 <sup>a</sup>	
Chemicals			0.0 <sup>a</sup>	-0.4
Minerals and metals n.e.c.	0.0 <sup>a</sup>		0.0 <sup>a</sup>	-0.9
Transportation equipment			-0.1	-0.5
Motor vehicles				-0.4
Other transport				-0.6
Machinery and equipment			0.0 <sup>a</sup>	-0.6
Electronic equipment				-0.7
Machinery and equipment n.e.c.				-0.5
Midtech manufacturing		-0.3		
High-tech manufacturing		0.6		
Manufacturing n.e.c.	0.0 <sup>a</sup>		0.0 <sup>a</sup>	-0.7
All services	0.0 <sup>a</sup>	0.6	0.0 <sup>a</sup>	0.1
Trade and transport			0.0 <sup>a</sup>	0.0 <sup>a</sup>
Business services			0.0 <sup>a</sup>	0.0 <sup>a</sup>
Other services				0.1
Construction			0.0 <sup>a</sup>	
Electricity, gas, and water			0.0 <sup>a</sup>	
Government services			0.0 <sup>a</sup>	

Sources: USITC, *U.S.-Korea FTA: The Economic Impact of Establishing a Free Trade Agreement (FTA) Between the United States and the Republic of Korea*, 2001, 5–13; Zhuang and Koo, "Implications of the Korea-U.S. Free Trade Agreement," 25; Kiyota and Stern, "Economic Effects of a Korea-U.S. Free Trade Agreement," 2007, 41; Schott, Bradford, and Moll, "Negotiating the Korea-United States Free Trade Agreement," June 2006, 27. Some values in aggregated categories are USITC calculations based on authors' reported values and output shares in GTAP v. 4 and 6 databases.

Note: Because of differences in aggregation, studies do not report in all sectors and subsectors.

<sup>a</sup>Less than a 0.05 percent positive or negative change.

<sup>b</sup>This study combined agriculture and natural resource sectors.

Liberalization generated small increases in all U.S. agricultural sectors in three of these four studies; Schott, Bradford, and Moll estimated that some agricultural sectors would contract.<sup>15</sup> Estimated changes in these sectors were less than 1 percent in the two GTAP-based studies, though the non-GTAP models had a few larger reallocations. Three studies reported changes in food, and all agreed that U.S. food production would increase, by 0.1 to 0.5 percent. Textile and apparel output was uniformly expected to shrink, by 0.4 to 1.5 percent. The estimated effect on manufacturing was mixed, with some sectors increasing and others declining, but estimated output changes did not exceed 1 percent in any manufacturing sector. Zhuang and Koo, which exogenously imposed a 1 percent productivity improvement in high-tech sectors, reported the largest U.S. manufacturing increase, of 0.6 percent, in these sectors.

Motor vehicles and transportation sectors were addressed by two studies. Schott, Bradford, and Moll estimated declines of 0.4 percent in motor vehicles and 0.6 percent in other transport; Kiyota and Stern estimated a decline of 0.1 percent in transportation overall. It is likely that this decline reflects increased U.S. imports from Korea. Although neither study reported U.S.-Korea bilateral trade values, Kiyota and Stern estimated that, in these sectors, U.S. imports from the world would increase by \$680 million, while exports would increase by only \$34 million, in 2007 dollar terms.

The estimated change in U.S. service-sector output was small, even in the studies that included service liberalization. USITC and Schott, Bradford, and Moll did not include service liberalizations, and they estimated that nonservices liberalization would have essentially no effect on service-sector output. Although Kiyota and Stern included service liberalization, they also estimated that service-sector output would not change.<sup>16</sup> Lee and Lee estimated that Korean services would increase output; although they did not provide quantitative results for the United States, they reported that U.S. service providers would increase exports to Korea in the long run.

## **Summary of Positions of Interested Parties**

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### ***Government of the Republic of Korea<sup>17</sup>***

In written and hearing testimony presented to the Commission, Lee Tae-sik, Korea's ambassador to the United States, expressed support for the U.S.-Korea FTA. Ambassador Lee stated that the U.S.-Korea FTA is a large, comprehensive, high-quality, and well-balanced FTA that manages to reflect each country's interests over all sectors. He said that agriculture was the most beneficial area of opportunity for the United States, with almost two-thirds of U.S. farm products to become free of duty immediately; the FTA would eliminate virtually all tariffs within 10 years, increasing competitiveness and efficiency; the U.S. automobile sector would gain immensely from the FTA; most textile and apparel goods would receive reciprocal duty-free access immediately; the FTA would expand market

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<sup>15</sup> Schott, Bradford, and Moll also generally had the largest estimated output changes, both positive and negative, among all studies. These larger sectoral reallocations were consistent with larger allocative efficiency gains in this model.

<sup>16</sup> Their large estimated welfare gains are not inconsistent with small output increases because they also estimated large increases in U.S. service-sector imports and exports.

<sup>17</sup> Lee Tae-sik, ambassador to the United States from the Republic of Korea, testimony before the U.S. International Trade Commission, June 20, 2007, and written submission, June 20, 2007.

access across almost all major service sectors; that legal stability would be provided for U.S. investors operating in Korea; U.S. financial institutions would be able to expand operations in Korea; the FTA would reinforce Korean government efforts in promoting IPR protection; the FTA would provide assurances for the U.S. auto industry and ensure that U.S. autos have a fair opportunity to compete in Korea, and most of the U.S. Congressional proposals for the automotive sector negotiations were met, except for the setting of numerical targets; and the creation of a medicines and medical devices working group would allow for continued dialogue between the U.S. and Korea on policy issues.

Ambassador Lee stated that the FTA is important to Korea because 70 percent of Korea's GDP is from trade. Further, he noted that the FTA would make Korea more competitive by boosting confidence in the Korean economy and stimulating foreign investment in Korea, helping sustain Korean efforts to reform and open its economy, and helping "Korea to become a hub for East Asian finance and trade, and a gateway for the U.S. and the rest of the world to the opportunities East Asia can offer." For the United States, he said that the FTA would be the most commercially significant since NAFTA, and noted that the U.S. government expects the U.S. economy to see an estimated \$17–\$40 billion dollar benefit once the FTA is in place. He believes that Korea would become more important as an export destination for many U.S. states, that many small and medium enterprises would stand to gain from new opportunities for trade, and that the FTA would become a strategic springboard for U.S. businesses into many other northeast Asian economies. Ambassador Lee reported that the big winners of the FTA would be consumers, who would benefit from greater choices and cheaper prices.

### ***Sherrod Brown, Member of the U.S. Senate from Ohio<sup>18</sup>***

In a written submission to the Commission, Sherrod Brown, U.S. Senator from Ohio, expressed concern that the proposed U.S.-Korea FTA would create "unbalanced benefits for Korean automakers at the expense of U.S. auto workers and manufacturers." Senator Brown stated that the agreement, as negotiated, would provide an incentive for auto parts manufacturers elsewhere to circumvent duties and gain duty-free access to the U.S. market because the agreement would weaken the domestic content provisions to 35 percent. He added that the FTA would provide an incentive for foreign auto companies to "locate production in Korea and use it as a platform to export autos, auto parts, and pickup trucks duty-free into the U.S." Senator Brown expressed concern regarding the Government of Korea's prediction that the agreement would "prompt a surge in U.S. imports of autos from Korea to the tune of \$1 billion." He also noted that the agreement, as negotiated, could pose a serious threat to the auto and auto parts industries. Further, he stated that an alternative way to address difficulties accessing the Korean consumer market would be through objective and verifiable benchmarks.

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<sup>18</sup> Senator Sherrod Brown, written submission, June 20, 2007.



### ***Sander Levin, Member of the U.S. House of Representatives from Michigan<sup>19</sup>***

Congressman Sander Levin, who represents Michigan's twelfth Congressional District, focused principally on the impact of the FTA on the U.S. auto industry in his written testimony to the Commission. He stated that Korea maintains an "economic iron curtain against all imported autos, using a powerful and extremely effective combination of tariffs, prohibitive and discriminatory taxes, and regulations designed specifically for the purpose of keeping imports out." He also said that "the FTA as currently negotiated will simply lock in a structure of one-way trade . . . and allow the Korean auto industry to continue an export driven strategy using the profits from their protected home market to fund R&D and broader incursions into the US and other major markets."

Congressman Levin also addressed several provisions in the FTA and their impact on the U.S. automotive industry. With respect to discriminatory taxes, he stated that the FTA merely reduced two of them and left the third intact. On existing nontariff barriers, he noted that four such barriers were identified by U.S. industry during the negotiations, and characterized the outcome as follows: "delay of one onerous discriminatory regulation, delay of another with an exemption dependent on a low volume of sales, an artificial resolution of the third and no handling of the fourth." With respect to the low-volume sales exemption, he noted that this was a self-defeating concession. With respect to the FTA's special dispute settlement provisions pertaining to autos, Congressman Levin added that "the only thing 'innovative' about it might be that the expedited structure assures failure sooner," and that it will be even more difficult for a U.S. automaker to win a case under the FTA provisions than to win a case under WTO dispute settlement rules. Congressman Levin also noted that the automotive working group created under the FTA is not mandated to meet. He estimated that tariff reductions would amount to a savings of \$217 million for Korean automakers exporting to the United States, but only \$12 million for U.S. automakers exporting to Korea.

### ***The Government of the U.S. Virgin Islands<sup>20</sup>***

John P. de Jongh, Jr., the Governor of the U.S. Virgin Islands, stated that duty-free entry of watches from Korea into the U.S. market under the FTA has the potential to cause serious harm to the watch industry in the Virgin Islands in his written submission to the Commission. He remarked that watch production is the largest light manufacturing industry in the Virgin Islands and that the watch sector is essential to the economic stability of the Virgin Islands. He noted that the FTA would permit duty-free entry from Korea for several classifications of watches for which eligibility under the Generalized System of Preferences (GSP) has been denied because of potential material injury to the watch industry in the United States and the Virgin Islands.<sup>21</sup> The governor noted the 2004 Miscellaneous Trade and Technical Corrections Act included a "hold harmless" mechanism that provides watch producers in the Virgin Islands with additional wage-based benefits under the Production Incentive Certificate (PIC) program to offset the loss in comparative advantage from duty-

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<sup>19</sup> Congressman Sander Levin, testimony before the U.S. International Trade Commission, June 20, 2007 and written submission, June 20, 2007.

<sup>20</sup> Governor John P. de Jongh, Jr., U.S. Virgin Islands, written submission, June 28, 2007.

<sup>21</sup> Korea is not eligible for GSP treatment.

free imports of competing foreign-produced watches following completion of multilateral tariff negotiations. He said that the Government of the Virgin Islands would withdraw its opposition to the FTA if the FTA either excludes watches or includes safeguards comparable to the “hold harmless” mechanism approved by Congress to protect the Virgin Islands in the event of worldwide watch tariff reductions.

### ***Aerospace Industries Association of America, Inc.***<sup>22</sup>

In a written submission to the Commission, the Aerospace Industries Association of America, Inc. (AIA) stated that it is the principal U.S. trade association representing the nation’s major aerospace and defense manufacturers. AIA’s submission supported Congressional approval of the U.S.-Korea FTA and stated that the FTA, if ratified, could make Korea the United States’ largest FTA trading partner in 15 years of such negotiations. It sees almost 95 percent of all bilateral trade becoming duty-free within 3 years of implementation, with most of the remaining items becoming duty-free within 10 years. The agreement will eliminate tariffs and trade barriers, promote economic growth, enhance intellectual property rights, and strengthen economic ties between the two nations. In addition, the FTA would also underscore U.S. commitment to U.S. East Asian allies.

### ***American Apparel & Footwear Association***<sup>23</sup>

In a written submission to the Commission, the American Apparel & Footwear Association (AAFA), a national association representing apparel and footwear companies and their suppliers, stated that it supports passage of the FTA. AAFA expressed concern, however, that the “restrictive and cumbersome” rules of origin and “less-than-ambitious” tariff phaseout schedule for textiles and apparel would provide little incentive to further develop trade with Korea in textiles and apparel. It noted that “well over one-half” of current U.S.-Korea apparel and textile trade would receive less than immediate and reciprocal duty-free treatment.

AAFA expressed concern about the FTA short-supply provision, noting that, while the FTA appears to adopt a more CAFTA-DR-friendly short-supply process, it has yet to designate any fibers, yarns, or fabrics as not commercially available in the FTA region or to include items already designated in short supply under other U.S. trade programs. The association also noted that the FTA would place quantitative limits on the volume of fabrics and apparel made of short-supply inputs that would be eligible for FTA preferences. According to AAFA, the absence of “cumulation” provisions that permit integration of inputs among U.S. FTA partners would limit opportunities to create new markets for U.S. textile and apparel exports that flow through FTA partners (such as garments made in Guatemala with U.S. fabric exported to Korea). It views the apparel and textile provisions in CAFTA-DR as a model that would have worked well in the U.S.-Korea FTA because the CAFTA-DR provisions are designed to create export opportunities for U.S. textile firms and provide the region the tools it needs to effectively compete, including cumulation, a “robust” short-supply list, a single transformation rule of origin for key goods, and immediate and reciprocal duty-free entry for all apparel and textiles.

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<sup>22</sup> Aerospace Industries Association of America, Inc., written submission, June 20, 2007.

<sup>23</sup> American Apparel & Footwear Association, written submission, June 27, 2007.

Regarding footwear and travel goods, the FTA's flexible and forward-looking provisions for these goods should provide new opportunities to increase footwear and travel goods trade between the United States and Korea. According to AAFA, the FTA rules of origin will not only help stem the decline in footwear and travel goods trade between the United States and Korea, but also provide a mechanism to rebuild this vital relationship.

### ***American Council on Education<sup>24</sup>***

In a written submission to the Commission, the American Council on Education (ACE), whose members and associates include about 1,800 accredited, degree-granting colleges and universities and higher-education-related associations, organizations, and corporations, stated that it is a coordinating body that seeks to influence public policy on higher education issues through advocacy, research, and program initiatives. ACE expressed reservations about including higher education services for coverage under chapter 12 (cross-border trade in services) in the U.S.-Korea FTA; it also noted that it had expressed similar reservations to the USTR in response to the most recent U.S. offer in the Doha Round of negotiations on services under the WTO General Agreement on Trade in Services (GATS). According to ACE, the U.S.-Korea FTA fails to adequately protect the diverse mix of public and private institutions that has made the United States a global leader in education services. ACE members are concerned that language in the U.S.-Korea FTA could subject public higher education institutions to treatment different from private institutions because public institutions may exercise delegated government authority. It would welcome further explanation from the USTR as to how the distinction between delegating to one entity the power to regulate other entities as compared to delegating to one entity the power to self-regulate would ensure equal treatment of public and private higher education institutions. Until such an explanation is provided, no further U.S. commitments should be made concerning higher education services in either the U.S.-Korea FTA or the GATS.

### ***American Council of Life Insurers<sup>25</sup>***

In written and hearing testimony, the American Council of Life Insurers (ACLI), which represents 373 life insurers in the United States, stated that it strongly endorses the U.S.-Korea Free Trade Agreement. The ACLI noted that the agreement would have certain strategic advantages for U.S. insurance firms as the Korean insurance market is the eighth-largest in the world, and the largest to be included in an FTA with the United States. The agreement would strengthen the United States' position as a global competitor in Asia, where the volume of trade agreements is growing. The financial services provisions included in the FTA set a new, higher standard for all future FTA negotiations.

ACLI also noted that the FTA would strengthen Korea's economy and capital markets, further its efforts toward reform and financial services liberalization, and ensure the adoption of international best practices. In particular, the agreement contains several provisions that will benefit U.S. insurance firms operating in the Korean market. These include regulatory transparency reforms, competitive equity with Korea Post, lifting of data-processing

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<sup>24</sup> American Council on Education, written submission, June 26, 2007.

<sup>25</sup> Brad Smith, vice president, American Council of Life Insurers, testimony before the U.S. International Trade Commission, June 20, 2007; written submission, June 20, 2007; and posthearing submission, June 27, 2007.

restrictions, establishment of an insurance working group, cross-border trade commitments for insurance and portfolio management, and implementation of the negative list approach, giving insurance providers latitude to introduce new products without being subject to an onerous approval process. ACLI noted that in the near term, cost savings to U.S. industry resulting from the FTA—particularly the data-processing provisions—will likely exceed \$50 million, and that in the long term, new market growth resulting from the agreement could exceed \$5 billion.

### ***American Dehydrated Onion and Garlic Association<sup>26</sup>***

The American Dehydrated Onion and Garlic Association (ADOGA), composed of two companies accounting for the majority of U.S. dehydrated onion and garlic production, reported in its written submission to the Commission that it does not support the U.S.-Korea FTA. ADOGA stated that Korea already has an adequate climate for raising onions and garlic, has dehydration facilities with capacity for producing dehydrated onions and garlic, and has exported such products to the United States in the past. According to ADOGA, Korea has lower costs of production for onions and garlic, and that Korean dehydration companies have invested in, and have close ties with, the Chinese dehydrated onion and garlic industry.

ADOGA noted that it is concerned about the likelihood of transshipments of dehydrated onions and garlic from China through Korea to the United States. While U.S.-Korea FTA rules of origin may seem strict enough to prevent transshipments, enforcement of the rules of origin has been lacking. ADOGA also stated that China has been shipping undervalued dehydrated garlic to the U.S. market in an effort to lower the amount of tariff due and that enforcement at the U.S. border has been lacking.

According to ADOGA, the Korean market offers little in the way of U.S. dehydrated onion and garlic export opportunity, principally because the market is already supplied by China. Also, it noted that U.S. exports to Korea may prove unsuccessful because the existing duties on Korean imports of U.S. product will be phased out over 15 years and a TRQ snapback tariff for over-quota products will be 360 percent ad valorem. By contrast, U.S. duties on imports of dehydrated onions and garlic from Korea, currently 21.3 percent and 29.8 percent, respectively, will be decreased in five equal installments, and there are no U.S. TRQs on dehydrated onions or garlic.

### ***American Insurance Association<sup>27</sup>***

The American Insurance Association (AIA) stated in a written submission to the Commission that it represents more than 400 property and casualty insurers operating in the United States, many of which are active in foreign markets. The AIA said that it fully supports the U.S.-Korea FTA and urges its approval. According to AIA, the proposed FTA presents large and commercially meaningful market openings for U.S. insurers in the Korean market, creates new options for Korean consumers of insurance products, contributes to

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<sup>26</sup> American Dehydrated Onion and Garlic Association, written submission, June 19, 2007.

<sup>27</sup> American Insurance Association, written submission, June 20, 2007.

Korea's establishment as a regional insurance center, and sets the standard for future financial-services negotiations in FTAs.

While the Korean insurance market is open in theory, U.S. insurers currently face barriers to competition. AIA noted that the following provisions, included in the FTA, would help to address such barriers: use of the negative list approach; inclusion of national treatment, MFN treatment, market access, and cross-border trade provisions; protection of new financial services offerings; absence of nationality requirements for management and directors; comprehensive regulatory transparency provisions; inclusion of new rules for self-regulatory organizations; and mechanisms for ongoing consultation and dispute settlement.

### ***American Manufacturing Trade Action Coalition***<sup>28</sup>

In a written submission to the Commission, the American Manufacturing Trade Action Coalition (AMTAC), a trade association representing a wide range of industrial sectors, including textiles, apparel, chemicals, furniture, tool and die, mold making, metal products, packaging products, lumber, and luggage, reported that, given Korea's current capabilities as a major producer and exporter of industrial goods, the FTA will be a "major blow" to the U.S. manufacturing base, especially for textiles and apparel. It is concerned that Korea has a history of using unfair trading practices and it questioned whether U.S. Customs would be able to monitor and enforce the FTA. AMTAC added that, given Korea's proximity to China, where production costs are much lower, China will have an enormous incentive to take advantage of Korea's zero-duty access to the U.S. market through illegal transshipments and false documentation. AMTAC noted that the FTA would present unique concerns beyond those associated with previous FTAs such as CAFTA-DR, where the free trade partners generally were apparel assemblers with limited textile capabilities. AMTAC stated that the FTA would grant Korea immediate duty-free access to the U.S. market for 60 percent of the textile product categories that it identifies as sensitive, including those covered by the U.S.-China Textile Bilateral Agreement, threatening both U.S. domestic sales and U.S. coproduction relationships in the NAFTA/CAFTA region. According to AMTAC, the FTA tariff phaseout schedule would likely undermine the U.S.-China Textile Bilateral and create increased potential for illegal transshipments in the region. AMTAC also commented that Korea has only limited ability to consume finished goods manufactured in the United States, and said that it expects to see a significant increase in the U.S. trade deficit and the loss of more textile and apparel jobs in the United States as a result of the FTA.

### ***American Potato Trade Alliance***<sup>29</sup>

In a written submission to the Commission, the American Potato Trade Alliance (APTA), composed of potato-grower organizations, national potato organizations, major processing companies, an academic institution, an export company, a U.S. port, and quick-service restaurants, stated that it strongly supports implementation of the recently concluded U.S.-Korea FTA. APTA added that implementation of the agreement is vital to the U.S. firms involved in exporting potato products to Korea. It reported that, despite current tariffs, Korea represents a large export market for frozen potato products, noting that U.S. exports of

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<sup>28</sup> American Manufacturing Trade Action Coalition, written submission, June 27, 2007.

<sup>29</sup> American Potato Trade Alliance, Steering Committee, written submission, June 22, 2007.

frozen french fries account for an 80-percent share of the Korean french-fry market already, and said that the immediate elimination of the 18-percent duty would allow for a significant expansion of product to that market.

According to APTA, the quota on dehydrated potatoes is small and, together with the snap-back tariff of 304 percent, impedes further shipments of these products to Korea. U.S. firms have entered this product under a different tariff classification with a lower duty in recent years, but must first blend this product with other additives for it to be reclassified, which seriously limits its end uses. APTA added that the implementation of the FTA will also allow U.S. product to maintain, and even increase, its market share in the highly competitive and price-sensitive Korean processed-potato market.

### ***Bumble Bee Foods, LLC***<sup>30</sup>

Bumble Bee Foods stated that it is the nation's largest brand of seafood, with U.S. facilities producing canned tuna, among other foods in its written submission to the Commission. It reported it operates the only remaining tuna cannery in the continental United States (in Santa Fe Springs, CA) and the only remaining tuna cannery in Puerto Rico (in Mayaguez). It stated it is one of three U.S. tuna canners (along with StarKist and Chicken of the Sea, which operate canneries in American Samoa) that together supply more than 85 percent of tuna consumption in the U.S. market, the largest tuna market in the world.

Bumble Bee Foods stated that it opposes any reductions in U.S. tariffs on tuna from Korea. It supports the current U.S. duty structure for canned tuna (consisting of an ad valorem tariff for tuna packed in oil and a tariff-rate quota for tuna packed in water). A rise in low-cost imports has led to the demise of the U.S. tuna processing industry (since 1979 at least ten canneries have closed, with a loss of 20,000 jobs). It cannot compete with foreign labor rates as low as \$1.75 per hour compared with hourly labor rates of \$11.50 and \$7.50 in California and Puerto Rico, respectively. Korea, according to Bumble Bee, has tuna canning operations and could easily divert additional shipments to the U.S. market should the proposed U.S.-Korea FTA lead to the elimination of the U.S. tariffs on canned tuna from Korea. Bumble Bee remarked that any terms regarding canned tuna in the proposed agreement should include similar rules of origin as in the Andean Trade Preference Act, where tariff preferences were given only for tuna harvested by Andean and/or U.S.-flag harvesting vessels (thereby offering increased market opportunities for the U.S. tuna fleet, now that most U.S. canneries have closed).

### ***The California Table Grape Commission***<sup>31</sup>

In a written submission to the Commission, the California Table Grape Commission stated that it was established by an act of the state's legislature in 1967 and currently represents over 500 of California's fresh-grape growers. The California Table Grape Commission said that its primary activities are focused around research, trade management, issue management, education and promotion.

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<sup>30</sup> Bumble Bee Foods, LLC, written submission, June 21, 2007.

<sup>31</sup> California Table Grape Commission, written submission, June 25, 2007.

The California Table Grape Commission supports the U.S.-Korea FTA and the respective tariff reductions for grapes. The agreement will allow California's table grapes to be more competitive in the Korean market with both domestic Korean grapes, which have a similar growing season to California grapes, and Chilean grapes, which already benefit from tariff reductions as a result of the 2004 Chile-South Korea FTA. It added that the agreement will make U.S. growers more competitive with Chinese growers, who also have a similar growing season to California, should they enter the South Korean market. It supports the agreement and sees it as crucial to the competitiveness of California grapes in Korea.

### ***Coalition of Services Industries***<sup>32</sup>

In hearing testimony, the Coalition of Services Industries (CSI), whose members include U.S. services companies and associations across a broad range of service sectors, stated that it seeks the liberalization of trade and investment in services markets worldwide in all negotiating forums. CSI said that it supports the U.S.-Korea FTA, stating that the agreement would provide substantial new trade and investment opportunities, investor protections, regulatory transparency, and other benefits to U.S. services firms. The FTA addresses current impediments to U.S. services trade with Korea and said that the potential commercial significance of the agreement to U.S. services firms is substantial given the large size of the Korean services market. Korea's services commitments under the FTA are a significant improvement over its GATS commitments or the Doha Round services offer.

CSI is particularly encouraged by the agreement's transparency provisions, which will allow services firms, which tend to be heavily regulated, to comment on proposed regulations prior to their entry into force. The agreement would enhance opportunities for U.S. services firms to participate in government procurement. CSI stated that the agreement's insurance provisions surpass the level of openness reached in previous agreements, and noted the provisions on telecommunications, which it said will allow U.S. firms to acquire or maintain full equity ownership in telecommunication firms in Korea and ensure the independence of the regulator. Finally, CSI added that the U.S.-Korea FTA has the potential to have positive strategic implications for U.S. trade policy throughout the region.

### ***Corn Refiners Association***<sup>33</sup>

The Corn Refiners Association (CRA) stated that it is a national trade association representing the corn refining (wet milling) industry in the United States in its written submission to the Commission. The CRA said that it fully supports the U.S.-Korea FTA, and said that it will provide expanded and new market access for the U.S. corn refining industry. CRA also noted that Korea committed to phase out most current applied tariffs of 8 percent on refined corn products in 5 to 7 years. CRA noted that tariffs on corn starch and modified starches, which are relatively higher (ranging from 226 to 385.7 percent), will be eliminated over a longer period (12 years for modified starch and dextrin and 15 years for corn starch).

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<sup>32</sup> John Goyer, vice president, International Trade Negotiations & Investment, Coalition of Service Industries, testimony before the U.S. International Trade Commission, June 20, 2007.

<sup>33</sup> Corn Refiners Association, written submission, June 21, 2007.

While noting that the tariff phaseouts for corn starch and modified starch last several years, the CRA is pleased that the United States was able to obtain country-specific TRQs or safeguards that will facilitate the export of U.S. corn starch, dextrin, and modified starches to Korea. Despite the relatively modest amounts of duty-free access provided in the TRQs for corn and modified starch, the CRA expects that higher-value specialty starches for the food, pharmaceutical, and paper industries will fill these TRQs. It estimates the value of this new market access at approximately \$50 million.

### ***Emergency Committee for American Trade***<sup>34</sup>

In a written submission to the Commission, the Emergency Committee for American Trade (ECAT) stated that it is an association of chief executives of leading U.S. business enterprises with global operations. ECAT said that its members represent the major agricultural, financial, high technology, manufacturing, merchandising, processing, publishing, and services sectors of the U.S. economy. ECAT noted that its member companies are “strong supporters of negotiations to eliminate tariffs, remove nontariff barriers and promote trade liberalization and investment worldwide.”

According to ECAT, the FTA includes “strong provisions on protection for U.S. investment in Korea, strong provisions promoting improved U.S. access to Korea’s market for agriculture, manufactured goods, and services through the elimination of tariff and nontariff barriers to U.S. exports and U.S. investment to Korea, strong protections of U.S. intellectual property rights, and strong provisions promoting greater transparency in the Korean market.” ECAT noted, however, that the U.S.-Korea FTA does not address all the issues sought by their association and urged that the United States continue efforts to ensure that market access barriers in Korea are addressed quickly.

ECAT said that the investment chapter in the FTA contains “strong protections to guarantee fair and equitable treatment; national treatment and most-favored nation treatment; prompt, adequate, and effective compensation for direct and indirect expropriations; the free movement of capital; and restrictions on performance requirements.” ECAT added, however, it was disappointed that the investment chapter does not extend the investor-state procedure to financial institutions for national treatment claims.

With regard to the market access provisions, the elimination of tariffs will have a positive impact on U.S. exports; that it is critical to ensure that Korea reestablishes and provides access to U.S. beef; that it supports intensive U.S. Government efforts to ensure that Korea barriers to U.S. automotive trade are eliminated quickly; and that the FTA will promote greater access for U.S. innovative pharmaceutical products in the Korean market through increasing transparency and strong intellectual property protections agreed to by Korea. With regard to textiles and apparel, the FTA provides duty-free access under a yarn-forward rule only for textiles and apparel made from U.S. or Korean yarn and fabric, and said that the provision is of limited usefulness to U.S. apparel companies because of its restrictive nature. With regard to services, certain provisions will provide substantial new economic opportunities to some of the most competitive U.S. industries. The FTA would permit greater expansion, competition, and business opportunities for all insurance providers, provide greater market access for U.S. banking and securities firms through investment and cross-

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<sup>34</sup> Emergency Committee for American Trade, written submission, June 27, 2007.



border activity, and facilitate expansion of U.S. information technology opportunities in the Korea market. Finally, the FTA includes strong intellectual property rights, a transparency chapter, and the competition policy chapters.

### ***Entertainment Industry Coalition***<sup>35</sup>

In written and hearing testimony, the Entertainment Industry Coalition (EIC) stated that it is an organization comprised of 27 organizations and their members, including six trade associations representing movies, music, video games, and theater owners, three guilds, and the largest trade union in the entertainment industry. EIC said that it broadly supports the U.S.-Korea FTA, and that the FTA provides important provisions regarding the enforcement of intellectual property rights and open-market access for entertainment goods and services.

According to EIC, piracy is the single-largest trade barrier the entertainment industry faces in markets outside of the United States. It noted that the International Intellectual Property Alliance estimated losses to U.S. copyright industries because of piracy in Korea at \$659 million in 2005. EIC added that both online piracy, such as peer-to-peer file sharing and physical piracy, such as the illicit “burning” of DVDs, continue to challenge the legitimate audiovisual marketplace in Korea.

The U.S.-Korea FTA will effectively address these piracy challenges by implementing high-standard copyright protections for digital and nondigital products. Under the FTA’s intellectual property rights provisions Korea would criminalize end-user piracy, shut down Internet sites that permit the unauthorized downloading of copyrighted works, and incorporate World Intellectual Property Organization (WIPO) Copyright Treaty and WIPO Performances and Phonograms Treaty obligations.

The agreement will improve market access for U.S. firms by minimizing or locking in most broadcasting, cable, and theatrical quotas at the least-restrictive levels allowed under current Korean law. The EIC noted that (1) the agreement decreases the domestic content quota on the broadcast of animation programs and films, and increases the quota applicable to single-country sources of foreign-content broadcast in Korea; (2) Korea has committed to phase in 100 percent foreign ownership of selected program providers; and (3) Korea will allow U.S. investment in Internet-protocol television (IPTV).

The EIC noted, however, it had some concerns with several of the reservations Korea made in the FTA with regard to new services and delivery platforms such as video-on-demand and broadcasting via the Internet. Nonetheless, the U.S.-Korea FTA is a “high-standard” agreement that should be widely supported.

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<sup>35</sup> Motion Picture Association of America (MPAA), on behalf of the Entertainment Industry Coalition (EIC), written submission, June 6, 2007; and Greg Frazier, executive vice president, Motion Picture Association of America (MPAA), testimony before the U.S. International Trade Commission, June 20, 2007.

### ***Express Delivery and Logistics Association<sup>36</sup>***

In hearing testimony, the Express Delivery and Logistics Association (XLA), whose members include large firms with global delivery networks and smaller businesses with strong regional delivery networks, said that it strongly supports the FTA. XLA noted that previous bilateral FTAs have resulted in increased shipping volumes for their members because of increases in trade, assurances of market access, and improved customs procedures.

According to XLA, the Korean Postal Law raises legal complications on paper for the operation of U.S. express delivery firms in Korea, but the industry maintains de facto market access rights. The FTA will provide legally enforceable market access and national treatment rights. Additionally, the FTA will provide a 4-hour customs-clearing target, which is superior to the 6-hour customs-clearing target included in previous FTAs.

### ***Ford Motor Company<sup>37</sup>***

In written and hearing testimony, Ford Motor Company, a U.S.-based manufacturer of automotive products, stated that it does not support the U.S.-Korea FTA. In his testimony before the Commission, Mr. Stephen Biegun of Ford noted that Ford has operated in Korea since 1995, and despite 12 years of investment and effort, Ford currently has one remaining dealership in Korea and sells just 1,700 vehicles in Korea each year. Mr. Biegun said that 96 percent of the vehicles sold in Korea are built in Korea, and said that this “would be impossible to sustain without the active intervention of the Korean government.” The 1995 and 1998 Memoranda of Understanding were intended to reduce NTBs and increase market access, but “the real effects of the agreements were minimal.” Korea safety and environmental regulations are “nontransparent and out of sync with international standards,” and said that the cost of these regulations is proportionately much higher for importers than for Korean domestic automakers because importers must amortize the cost across a much smaller amount of sales.

Mr. Biegun stated “the changes can be so costly as to destroy the business case to remain in the Korean market.” According to Mr. Biegun, the U.S. industry prenegotiation proposal to tie U.S. tariff liberalization to measurable market access in Korea as a way to “incentivize” the Korean government to dismantle its import barriers. He added that his company was disappointed that the burden of proof with respect to trade remedies will continue to lie with U.S. companies, which effectively means that they will have “to litigate our way into the Korean market.” He was disappointed that the 25 percent U.S. truck tariff was not included as part of the snapback provisions, and stated that “instead of using the leverage of U.S. tariffs to drive market access into Korea, this agreement gives away the U.S. tariff and merely established another legal obstacle course for U.S. companies seeking market access into Korea.” The agreement will merely provide temporary relief from current NTBs, and that new NTBs will arise in the future. He said that the “only option that would really make a convincing business case for a U.S.-based exporter would be to take the small-volume exceptions that were carved into each of the NTBs.”

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<sup>36</sup> James Min, chair, Trade Subcommittee, Express Delivery and Logistics Association, testimony before the U.S. International Trade Commission, June 20, 2007.

<sup>37</sup> Stephen Biegun, vice president, International Governmental Affairs, Ford Motor Company, testimony before the U.S. International Trade Commission, June 20, 2007; and posthearing submission, June 27, 2007.

At the Commission’s hearing, Mr. Biegun stated that importers tend to import higher-cost vehicles into the Korean market because they bring a higher margin that can more easily bear the expenses that come from unique Korean designs, shipping costs, tariffs, and other costs, and also because consumers of luxury vehicles are less price-sensitive. On the subject of NTBs, Mr. Biegun noted that the FTA addressed two of the current most onerous standards—OBD II and K-ULEV—and added that the FTA provides “some convergence to the U.S. standards.” He stated, however, that while the FTA addressed the current environment, the industry is ever changing, and each new model of vehicle presents an “opportunity for decisions that can keep the products out.” According to Mr. Biegun, to build a vehicle to a uniquely Korean emission standard would require sales in the tens of thousands to make sense from a business perspective, and that the low-volume exemption encourages foreign automakers to “take the bird in the hand, rather than make the huge expenditure to get into the bush and see what else is out there for you.” The combination of the low-volume exemption, the potential for future standards not addressed in the FTA, and the fact that the new tax structure will still place a higher burden on the vehicles that Ford sells in Korea will encourage U.S. automakers to prefer a low-volume strategy.

As noted earlier, Mr. Biegun reported that there is an anti-import bias in Korea, stating that, while it has been curtailed, “the fact that this agreement had to explicitly enshrine a commitment from the Korean government that it would cease and desist from such activity indicates that it is still a very real concern.” On dispute resolution, it is “practically impossible” for the U.S. government to recommend a snapback of U.S. tariffs, because U.S. and Korean government officials will be influenced by “exogenous factors while they are making the decision.”

In its posthearing submission, Ford agreed with Korean government estimates that the FTA could result in at least a \$1 billion increase in the U.S.-Korea bilateral automotive trade deficit. Mr. Biegun remarked that Ford understands that the provisions in the FTA for hybrid vehicles provide for immediate duty-free treatment in Korea for the types of hybrid vehicles Ford currently produces in the United States. He also provided information on the Korean market and nontariff barriers, a vehicle quality study, and the texts of the 1995 and 1998 U.S.-Korea automotive memoranda of understanding.

### ***Form Factor***<sup>38</sup>

In a written submission to the Commission, FormFactor stated that it is a company located in Livermore, CA, that is involved in the design, development, manufacture, sale, and support of semiconductor wafer-probe cards. The company said that it is involved in inventing and manufacturing Probe Cards, which are devices used to test semiconductor wafers before they are sliced and diced into chips. FormFactor reported that it has approximately \$500 million in sales, with 80 percent of its exports to Korea and other Asian countries. FormFactor expressed concern about infringement of its patents and intellectual property by a Korean company. Other high-tech U.S. companies have faced piracy of intellectual property in regard to Korea and how the FTA deals with this problem “is a matter of huge consequence” to FormFactor and the rest of the high-tech industry.

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<sup>38</sup> FormFactor, Inc., written submission, May 23, 2007.

### ***Hyundai Motor Company***<sup>39</sup>

In a written submission to the Commission, Hyundai Motor Company stated it is a Korea-based automaker that is the parent company of Hyundai Motor America and Hyundai Motor Manufacturing Alabama. Hyundai said it has been in the United States for 21 years, and has invested more than \$1.4 billion in the United States. In a submission to the Commission, Hyundai supports the FTA, stating that it believes “the benefits of vehicle tariff reduction under the KORUS FTA will be mutual and fair,” and that, as a result of tariff and nontariff provisions of the FTA, U.S. automakers should be able to improve their price competitiveness and market share in Korea. According to Hyundai, establishing manufacturing operations in major markets, including the United States, is part of its overall strategy to become one of the world’s leading automakers, in recognition of “the value of investing where we sell our vehicles.” Hyundai is engaged in the entire vehicle design, engineering, manufacturing, and testing process in the United States. It believes the FTA will create further opportunities for Hyundai to expand its market presence in the United States, to the benefit of the U.S. economy and the U.S. consumer. Hyundai added that it will benefit from the U.S. duty savings negotiated in the FTA, stating that tariff and other provisions in the FTA will “allow Hyundai and its dealers to provide U.S. consumers with more choice, more competitive products, and better service.” Hyundai added, however, that many of the vehicles it sells in the United States are made locally.<sup>40</sup>

### ***International Intellectual Property Alliance***<sup>41</sup>

In a written submission to the Commission, the International Intellectual Property Alliance (IIPA) stated that it is a coalition of seven trade associations each representing a significant segment of the U.S. copyright-dependent industries and collectively representing more than 1,900 companies producing and distributing materials protected by copyright laws throughout the world. These companies, IIPA noted, include firms producing all types of computer software; theatrical films, television programs, home videos, and digital representations of audiovisual works; music, records, CDs, and audio cassettes; and textbooks, trade books, reference and professional publications, and journals (in both electronic and print media). IIPA reported that the copyright-based industries are among the fastest-growing and most productive sectors of the U.S. economy. IIPA noted that the “core” U.S. copyright industries accounted for an estimated \$819 billion, or more than 6 percent, of U.S. GDP in 2005 and employed 5.38 million workers, and with estimated foreign sales and exports of more than \$110 billion in 2005.

IIPA supports the FTA and said that its potential for boosting the U.S. copyright sector and the overall U.S. economy is considerable. IIPA added that on the whole, the copyright industries consider the U.S.-Korea FTA to be “one of the strongest and most progressive FTAs ever negotiated.” IIPA stated that the IPR and market-access provisions of the FTA could further open the large Korean market to exports and foreign sales and address the major market barrier: piracy. IIPA added that Congressional approval of the FTA is important, along with Korea’s full and prompt implementation of its wide-ranging commitments.

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<sup>39</sup> Hyundai Motor Company, written submission, June 27, 2007.

<sup>40</sup> Shin, “Statement of Hyundai Motor Company.”

<sup>41</sup> IIPA, written submission, June 25, 2007.

## ***Information Technology Industry Council<sup>42</sup>***

In written testimony, the Information Technology Industry Council (ITI) stated that it is an association that represents the leading providers of information technology and services. ITI said that its 41 member companies account for a combined \$580 billion in annual U.S. revenue and have an estimated 1.7 million people. ITI said that it supports the overall agreement, and in hearing testimony, Mr. Rhett Dawson, president of ITI, said that the FTA is an important agreement for the technology industry. ITI identified the following sections of the FTA as especially beneficial to the U.S. high-technology industry: market access, services, e-commerce, IPR, competition-related matters, government procurement, TBTs, and customs matters and trade facilitation. ITI noted that the U.S.-Korea FTA sets a strong precedent for future FTAs and strengthens U.S. global competitiveness and creates a fair, level playing field for U.S. exporters.

ITI provided specific comments on the chapters of the FTA that it identified as especially beneficial to their members. ITI remarked that the tariff reductions in the market-access provisions will improve U.S. competitiveness in Korea for many products not covered by the WTO's Information Technology Agreement. For the services sector, it supports the FTA's use of the "negative list" approach, which it said would allow the greatest access possible to Korea's services market. With regard to e-commerce, the FTA assures nondiscriminatory treatment of digital products. For IPR, the IPR chapter of the US-Korea FTA is one of the strongest IPR agreements to be achieved in an FTA, and said that U.S. industry is very supportive of this section of the FTA." ITI stated that the "FTA creates strong IPR enforcement mechanisms and penalty provisions." The competition chapter is stronger and goes beyond requirements in previous agreements, and will push Korea toward greater transparency and fairness to U.S. industry and provide a strong precedent for future FTAs. It supports the government provisions of the FTA and said that the FTA greatly expands the benefits covered by the WTO's Government Procurement Agreement (GPA) by lowering the threshold for nondiscriminatory access by nearly 50 percent from the GPA. By creating a working group on government procurement to address related issues, the FTA will set a strong precedent for future FTAs, and said this element should be added to future FTAs. With regard to TBTs, the FTA improves conditions and increased transparency in the regulatory process, the development of technical standards, and the conformity assessment process. Finally, with respect to customs matters and trade facilitation, ITI remarked that the chapter meets the needs of its members and is consistent with previous FTAs.

## ***International Union, United Automobile, Aerospace and Agricultural Implement Workers of America (UAW)<sup>43</sup>***

In testimony before the Commission, Douglas Meyer of the International Union, United Automobile, Aerospace and Agricultural Implement Workers of America (UAW) said that the UAW represents over 1 million active and retired workers, many of whom are employed or receive retirement benefits from auto manufacturers and auto-parts companies in the United States. He stated that the UAW does not support the U.S.-Korea FTA. Korea is the

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<sup>42</sup> Rhett Dawson, president, Information Technology Industry Council, testimony before the U.S. International Trade Commission, June 20, 2007; and written submission, June 20, 2007.

<sup>43</sup> Douglas Meyer, deputy director, International and Government Affairs, International Union, United Automobile, Aerospace and Agricultural Implement Workers of America, testimony before the U.S. International Trade Commission, June 20, 2007.

fifth-largest vehicle producer and the third-largest vehicle exporter, but has the lowest level of import penetration of any major automotive-producing country in the world. The 1995 and 1998 MOUs were ineffective in opening the Korean market to imported vehicles, and U.S. automotive trade deficit with Korea grew particularly quickly after the 1998 MOU, even while the U.S. government was engaged in regular consultations with the Korean government. Mr. Meyer stated that the FTA will result in a surge of imports from Korea, a large loss of automotive jobs in the United States, and an abandoning of Korean automaker plans for future manufacturing expansion in the United States. Korea automakers have one manufacturing plant in the United States and one under construction, and said that these two plants will not be able to satisfy most of their sales in the U.S. market. With respect to the FTA provisions, Korea will be able “to continue the discriminatory taxes and other non-tariff barriers that it has used to keep its market closed. He also said that the special auto dispute resolution process is structured in a manner that would make it extremely difficult for the U.S. to prevail in any case against Korean non-tariff barriers.” With respect to the agreement’s side letter on autos, “Korea agreed to delay the application of selected non-tariff barriers and to allow limited volume exemptions for others. But the agreement does not require Korea to eliminate all current non-tariff barriers, nor does it establish effective and enforceable mechanisms for addressing future non-tariff trade barriers.”

The Automotive Working Group created in the agreement has no enforcement power to address barriers, and that the dispute resolution procedures would do little more than “expedite slightly the usual joint committee review and arbitration process.” With respect to dispute resolution, “the burden should be on the Korean government to prove that its discriminatory taxes and other non-tariff barriers are not responsible for keeping out our products.” He also added that the snapback remedy provision, which does not apply to the 25 percent truck tariff, is “toothless,” and that it will do nothing to provide redress to the automakers and their employees. At the Commission’s hearing, Mr. Meyer stated that the FTA allows Korea to maintain its own emission standards that are “essentially equivalent” to U.S. standards in certain instances, calling into question the effectiveness with which a dispute could be resolved.

### ***National Association of Manufacturers<sup>44</sup>***

In a written submission to the Commission, the National Association of Manufacturers (NAM) reported that it is the nation’s largest industry trade association, representing small and large manufacturers in every industrial sector in every state. NAM said that the FTA is not perfect, but on an overall basis is strongly beneficial to a majority of manufacturers and provides significant access to the Korean market. NAM noted concerns that U.S. automakers have voiced regarding some tariff and nontariff provisions that they believe will continue to block commercial access to the Korean market and the U.S. steel industry’s concerns regarding trade rules and other barriers. NAM stated that among the primary reasons for the U.S. trade deficit with Korea are the tariff and nontariff barriers that U.S. manufacturers face in the Korean market. Further, NAM noted that it believes that the FTA would provide U.S. manufacturers with strong market access and substantially reduce barriers that companies face.

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<sup>44</sup> International Trade Policy, National Association of Manufacturers, written submission, June 27, 2007.

With respect to tariff and nontariff provisions of the FTA, while Korea has relatively low applied tariff rates, they are significantly higher than those in the United States. NAM remarked that the FTA's TBT provisions should assist the competitiveness of U.S. exporters in the Korean market and noted that the TBT working group established by the FTA is of special interest to the cosmetics, household electrical appliances, motor vehicles, and noise/emissions sectors of their membership. NAM added, however, it continues to be concerned about the ability to identify nontariff barriers and the ability to deal with them before they emerge as new barriers to trade after the implementation of the agreement.

With regard to competition policy, the provisions extend beyond those of previous FTAs and will assist in promoting the competitive process. The specific obligation requiring each party to publish rules of procedure for administrative hearings and including rules for introducing evidence is particularly useful in addressing concerns regarding fair and transparent procedures in enforcement actions. NAM stated that both the investment and IPR chapters contain strong provisions. In particular, NAM noted that the IPR provisions are among the strongest ever, and the IPR chapter "addresses problems associated with Korea's lack of effective enforcement mechanisms." Finally, in addressing customs procedures, the FTA sets forth proof of origin procedures that are simple and easy to use, which is a key achievement.

### ***The National Cattlemen's Beef Association***<sup>45</sup>

In written and hearing testimony, the National Cattlemen's Beef Association (NCBA) stated that it is the national trade association representing U.S. cattle producers, ranchers, and farmers and the marketing organization for the largest segment of the nation's food and fiber industry with more than 25,000 individual members and sixty-four state affiliate, breed, and industry organization members. NCBA added that it represents more than 230,000 cattle breeders, producers, and feeders.

The NCBA reported that the U.S.-Korea FTA is one of the most significant bilateral trade agreements to date for the U.S. beef industry; however, its support of the FTA is dependent upon complete market restoration and normalization of U.S.-Korea beef trade. According to NCBA, the reduction of the tariff on most U.S. beef exports to Korea from 40 percent to zero, as well as the tariff reduction on beef-variety meat exports from 18 percent to zero makes the FTA one of the most historic, important, and valuable to the competitiveness of the United States in the marketplace. While noting that the phaseout period for duties is 15 years, the NCBA said it is pleased that schedule is linear instead of back-loaded. The NCBA added that the quantity-based safeguard measure on beef, while not ideal, is more conducive to trade than a tariff-rate quota (TRQ), and the quantities allocated are sufficient.

NCBA noted that it can only fully support the FTA with the full reopening of the Korean beef market, as well as resolution of SPS and plant-equivalency issues. It would like to see Korea, as well as other trading partners, follow the internationally recognized guidelines set forth by the World Organization for Animal Health (OIE). NCBA noted that the recent OIE designation classified the United States as a "controlled risk" country for bovine spongiform encephalopathy (BSE), which allows for beef trade with no product or age restrictions as long as specified risk materials (SRM) are removed. It stated that it will support the FTA and

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<sup>45</sup> Jay H. Truitt, vice president, Government Affairs, testimony before the U.S. International Trade Commission, June 20, 2007; and written submission, June 20, 2007.

will work with the U.S. Congress to pass the agreement upon full restoration and normalization of commercially viable beef trade into the Korean market.

### ***National Corn Growers Association<sup>46</sup>***

In a written submission to the Commission, the National Corn Growers Association (NCGA) stated that it is an association representing more than 32,000 U.S. corn growers from 48 states and 26 affiliated state corn organizations. The association said that Korea is one of the United States' largest corn markets, and a potentially large market for corn coproducts, such as DDGS.

The NCGA stated that the U.S.-Korean FTA would remove trade barriers and create new export opportunities for U.S. corn growers. It remarked that improvements in market access in Korea for U.S. corn and corn co-products are positive. While it would not address the Korean market access for U.S. meat products, any gains in additional U.S. meat market access to Korea would also benefit U.S. corn growers as significant amount of corn ends up as livestock feed.

### ***National Council of Textile Organizations<sup>47</sup>***

In hearing testimony, the National Council of Textile Organizations (NCTO), stated that it represents the entire spectrum of the textile sector, from fibers to finished products and from machinery manufacturers to power suppliers. It stated that the FTA would pose a real threat to the domestic industry, particularly in man-made fiber yarns and fabrics, knit fabrics, socks, sweaters, shirts, and trousers. The NCTO added that it could significantly harm existing U.S. business and trade flows, particularly with the CAFTA, NAFTA, and Andean regions. It noted that the FTA is the first agreement since NAFTA where the FTA party has a large and developed vertically integrated textile sector that exports significant quantities of textile goods to the United States. NCTO expressed concern about the vulnerability of key U.S. textile sectors to dumped and undervalued goods from Korea, given the overexpansion of Korean textile manufacturing capacity, and to transshipments from China, a country in which Korean textile firms have made significant investments.

NCTO stated that the FTA would give Korea immediate duty-free access to the U.S. market for many sensitive goods, including sweaters, brassieres, swimwear, man-made fiber shirts and socks, certain man-made fiber filament and staple fiber yarns and fabrics, and carded cotton yarn. According to NCTO, the FTA would provide longer tariff phaseouts for goods in most heavily traded rate lines that provide for products of a kind subject to U.S. safeguards on imports from China. NCTO stated, however, that 422 rate lines subject to the China safeguard categories would receive immediate duty-free market access, thereby creating opportunities for Chinese transshipments in these sensitive goods.

NCTO reported that the FTA would include a strict yarn-forward rule of origin with no loopholes, as well as strong customs enforcement language that is an essential element in

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<sup>46</sup> National Corn Growers Association, written submission, June 27, 2007.

<sup>47</sup> Cass Johnson, president, National Council of Textile Organizations, testimony before the U.S. International Trade Commission, June 20, 2007.



deterring illegal transshipments. It expressed concern, however, over whether Customs' management has the willingness and determination to properly enforce textile agreements. NCTO noted that, while the U.S. government did not allow goods from the industrial zones in Kaesong, North Korea to gain U.S. market access under the FTA, the agreement would allow for consultations with Korea on future access. NCTO noted that textile production is a major component of these industrial zones, where, according to Korean projections, more than 300,000 people will work within 5 years of FTA passage. NCTO remarked that, even if these zones were never granted FTA status, the likelihood exists of significant transshipments from the zones to the United States.

### ***National Electrical Manufacturers Association<sup>48</sup>***

The National Electrical Manufacturers Association (NEMA) stated in a written submission to the Commission that it represents 430 companies that manufacture products used in generation, transmission, distribution, control, and use of electricity. NEMA stated that it supports the U.S.-Korea FTA and asks for legislators to ratify it as soon as possible. NEMA reported that Korea is one of the U.S. electrical equipment industry's top ten export markets and that the United States currently runs a trade surplus with Korea in electrical equipment despite current Korean tariffs in the 5–8 percent range. Despite concerns regarding nontariff barriers and intellectual property protection in Korea, they believe that the overall FTA would improve access to the Korea market, particularly the elimination (mostly immediate) of tariffs on products covered by their association's scope. NEMA estimates that over \$30 million of imports of U.S. products in Korea within their scope would be eliminated upon implementation of the Agreement.

### ***The National Pork Producers Council<sup>49</sup>***

In written and hearing testimony, the National Pork Producers Council (NPPC) stated that it is a national association representing 44 affiliated state members that conducts public policy outreach to enhance opportunities for U.S. pork producers and other industry stakeholders. The NPPC reported that it works to pass and implement laws and regulations that are conducive to the production and sale of pork in both domestic and international markets, as well as to establish the U.S. pork industry as a consistent and responsible supplier of high-quality pork to the domestic and world market.

The NPPC stated that it strongly supports the U.S.-Korea FTA. The NPPC noted that most tariffs on frozen pork are to be phased out by 2014, while those for chilled pork will be phased out in 10 years with a quantity-based safeguard that is acceptable. It added that the FTA is expected to add nearly \$825 million dollars in additional pork exports and represents the most economically important FTA for the U.S. pork industry since NAFTA. It expects the FTA, when fully implemented, will cause live U.S. hog prices to be \$10 higher than would otherwise have been the case and that Korea will absorb 5 percent of total U.S. pork production. The NPPC commented that Korea also provides an important market for many

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<sup>48</sup> National Electrical Manufacturers Association, written submission, June 18, 2007.

<sup>49</sup> Brian Buhr, economist, University of Minnesota, on behalf of the National Pork Producers Council, testimony before the U.S. International Trade Commission, June 20, 2007; written submission, June 20, 2007; and posthearing submission, June 27, 2007.

pork cuts that are underutilized in the U.S. market, often at a premium price, that will increase U.S. producer value at lower tariff rates.

### ***National Potato Council***<sup>50</sup>

In a written submission to the Commission, the National Potato Council (NPC), composed of potato growers throughout all major U.S. potato-growing regions, stated that it strongly supports the implementation of the U.S.-Korea FTA. The NPC reported that South Korea is currently the fifth-largest foreign market for U.S. frozen french fry sales and is considered an important and growing market for fresh potatoes and dehydrated potato products as well. The NPC noted that the FTA will result in significant increases in U.S. exports of all potato products and will enable U.S. firms to maintain market share vis-à-vis their major global competitors. The NPC added that the immediate implementation of the FTA will provide a continued competitive advantage over such competitors as Australia, Canada, and New Zealand, which are also currently negotiating FTAs with Korea.

The NPC stated that its industry members played an active advisory role to USDA and USTR negotiators throughout the FTA dialogues, which it believes helped the industry achieve major concessions for many of its products. Of major importance, NPC noted, was the immediate elimination of the 18-percent tariff on frozen french fries, which it expects will lead to significant growth in U.S. exports. As a result of the FTA it expects to see significant growth in exports of dehydrated potato products with the establishment of a 5,000-mt quota, which will increase slightly each year until it ends in the eleventh year after enactment, together with a declining over-quota tariff rate. Further, in the fastest-growing area of potato trade, fresh potatoes, the NPC commented that the FTA provides a 5-month, duty-free entry period for fresh potatoes intended for chipping and a 3,000-mt duty-free quota for table-stock potatoes.

### ***Pharmaceutical Research and Manufacturers of America***<sup>51</sup>

In written and hearing testimony, the Pharmaceutical Research and Manufacturers of America (PhRMA) stated that it represents pharmaceutical research and biotechnology firms. PhRMA expresses support for what it calls “one of the most economically significant FTAs in recent years.”

PhRMA reported that tearing down market access barriers and improving protection and enforcement of intellectual property rights in Korea will have significant, positive effects for patients in the United States and Korea. According to PhRMA’s written statement, U.S. pharmaceutical companies face a range of market access impediments in Korea, including shifting standards of review for having new, innovative products listed on the national reimbursement list and lax enforcement of intellectual property rights. PhRMA added that the FTA makes significant strides forward in addressing these long-standing intellectual property and market access issues in Korea.

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<sup>50</sup> National Potato Council, written submission, June 19, 2007.

<sup>51</sup> Jeffrey A. May, assistant general counsel, Pharmaceutical Research and Manufacturers of America, written submission, June 6, 2007; and testimony before the U.S. International Trade Commission, June 20, 2007.

PhRMA identified what it views as the key provisions of the FTA relating to pharmaceuticals: (1) agreement on a general set of principles related to patients' access to pharmaceutical products, economic incentives and competitive markets for drugs, government support for research and development and intellectual property rights, and transparency in governmental procedures; (2) agreement upon principles for the pricing and reimbursement of innovative medicines; (3) extensive transparency provisions that should help eliminate problems that U.S. companies are currently facing in the pricing and reimbursement for their products; (4) the right of manufacturers to disseminate information about drugs over the Internet; (5) an article on ethical business practice that would ensure that both countries have appropriate measures in place to prohibit improper inducements by pharmaceutical manufacturers to health-care professionals and institutions; (6) creation of a Medicines and Medical Devices Committee that would support the implementation of the provisions of the Pharmaceutical Products and Medical Devices chapter; and (7) provisions to ensure adequate protection of intellectual property through a patent linkage system, data exclusivity, and compensation for delays in the patent and marketing application processes.

According to PhRMA, the FTA will be beneficial to the biopharmaceutical industry and the U.S. economy as a whole. It said that it supports the full and timely implementation of the agreement by Korea so that the benefits that are expected from the agreement can be fully realized.

### ***Rubber and Plastic Footwear Manufacturers Association***<sup>52</sup>

In a written submission to the Commission, the Rubber and Plastic Footwear Manufacturers Association (RPFMA), stated that it is a trade association representing the principal domestic producers of protective footwear and rubber-sole, fabric-upper footwear. It reported that its members do most of their manufacturing in the United States, but many of them do a significant amount of importing. RPFMA stated that it is "satisfied" with the phaseout of U.S. tariffs under the FTA on the core products of these domestic producers. RPFMA noted that, under the FTA, U.S. tariffs on its core products would receive a nonlinear phaseout over 12 years; that is, the tariffs would remain unchanged during years one through eight, followed by a succession of 25 percent duty cuts in each of the following 4 years, becoming free at the beginning of year 12. It noted that Korean wage rates are significantly higher than those of other Far Eastern rubber footwear competitors and said that the domestic industry is satisfied that the extended and nonlinear phaseout of U.S. tariffs will not pose a threat to the continued operation of domestic production of the specified rubber footwear.

### ***Semiconductor Industry Association***<sup>53</sup>

In a written submission to the Commission, the Semiconductor Industry Association (SIA) stated that it has been a leading voice of the U.S. semiconductor industry for 30 years. The SIA said that it supports Congressional approval of the U.S.-Korea Free Trade Agreement. The SIA stated that it "favors free and open markets" and that "U.S. trade agreements have served the U.S. industry, and, when multilateral, the world semiconductor industry." The

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<sup>52</sup> Rubber and Plastic Footwear Manufacturers Association, written submission, May 17, 2007.

<sup>53</sup> Market Research, International Affairs and Finance, Semiconductor Industry Association, written submission, June 25, 2007.

SIA also said that the U.S.-Korea Free Trade Agreement is important for the U.S. semiconductor industry as a “precursor to further trade-liberalizing initiatives in Asia.”

The SIA provided specific comments on five provisions of the agreement: tariffs, trade remedies, intellectual property, competition-related matters, and TBT. Regarding tariffs, the SIA noted that the reason why the agreement does not contain further market access benefits for the semiconductor industry is because these benefits have already been obtained. The SIA added, however, that the agreement does not provide duty-free treatment for “MCP-like” devices. Second, with regard to trade remedies, the agreement would make the use of the antidumping law potentially more difficult, but that access to safeguards is currently not likely a major concern for the semiconductor industry. Changes to trade-remedy rules and processes should be made through the WTO. Third, it appreciates that the agreement addresses comprehensively what it describes as Korea’s lack of effective enforcement mechanisms regarding intellectual property. The SIA noted, however, that the meaning of the term “inequitable conduct” used in the intellectual property chapter of the agreement should be further clarified. Fourth, regarding competition-related matters in chapter 16 of the agreement, many of the provisions will contribute to fairer treatment by the Korean Fair Trade Commission of U.S. firms and that this chapter provides a solid precedent for other Asian countries whose antitrust laws could be applied against foreign investors in a discriminatory way. Finally, the TBT chapter of the agreement is a good model for achieving similar protections through FTAs with other Asian nations with similar issues.

### ***Society of the Plastics Industry***<sup>54</sup>

The Society of the Plastics Industry (SPI) stated in a written submission to the Commission that it represents U.S. companies operating in all segments of the plastics supply chain, including plastics processors and manufacturers of machinery, molds, and raw materials. The SPI stated that it strongly supports the U.S.-Korea FTA.

The SPI added that its support of the FTA is based on its 5- to 10-year phaseouts of U.S. tariffs on plastic products that it considers “highly sensitive” to competition from Korean imports and the FTA’s reciprocal market access for molds, machinery, and raw materials. The SPI noted that Korean tariffs for over 65 percent of plastic products would be eliminated within 3 years of the implementation of the FTA, and within 5 years, Korean tariffs on over 99 percent of U.S. exports would be eliminated. Conversely, a vast majority of U.S. tariffs on plastic products will be phased out over 10 years. The duty phaseouts for the raw materials (polymers/resins), molding machinery, and molds provide reciprocal benefits for both countries. As a result of the tariff eliminations, SPI says the FTA offers significant opportunity for the plastics industry.

### ***Telecommunications Industry Association***<sup>55</sup>

In a written submission to the Commission, the Telecommunications Industry Association (TIA) stated that it is the leading trade association representing the information and communications technology (ICT) industry, with approximately 600 member companies that manufacture or supply the products and services used in global telecommunications. Overall,

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<sup>54</sup> Society of the Plastics Industry, written submission, June 21, 2007.

<sup>55</sup> Telecommunications Industry Association, written submission, June 27, 2007.

the TIA stated that it supports the telecommunications provisions contained in the U.S.-Korea FTA. Specifically, U.S. firms will benefit from commitments related to access to and use of public telecommunications networks, interconnection, number portability, resale, unbundling, and access to submarine-cable landing stations. The TIA noted that many of the FTA's provisions expand upon commitments contained in the WTO's Agreement on Basic Telecommunications, citing provisions on number portability and dialing parity, as well as expanded language related to the independence of the telecommunications regulator. Similarly, the TIA singled out provisions related to technological neutrality, stating that the FTA's strong language goes beyond other trade agreements by limiting the conditions under which parties can specify the use of certain technologies. The TIA also expressed support for FTA provisions that eliminate the 49 percent foreign investment ceiling in Korean telecommunication services providers 2 years after the FTA enters into force, although it noted that investment ceilings would remain for KT Corporation and SK Telecom.

### ***Time Warner Inc.***<sup>56</sup>

Time Warner stated in a written submission to the Commission that it is a leading entertainment and media company, whose businesses include interactive services, cable systems, filmed entertainment, television networks, and publishing. It stated that, within Korea, it is primarily involved in the licensing and distribution of content for pay television, motion pictures, home entertainment products (such as DVDs), and the licensing of intellectual property for product promotions. Time Warner stated that it strongly supports the U.S.-Korea FTA and stated that the agreement's IPR and market-access provisions will benefit the U.S. media and entertainment industry.

According to Time Warner, under the FTA, Korea will relax several important market access barriers. For example (1) the annual screen quota requiring theaters to show Korean films will be locked in at 73 days (down from 146 days); (2) television broadcasting content quotas will be reduced for films and animation programs; (3) U.S. investment will be allowed in the Korean IPTV market; and (4) 3 years after entry into force of the FTA, foreign investors will be able to own 100 percent of the equity in local program providers. Time Warner added that it welcomed these changes and highlighted that market preferences rather than national quotas should determine what is available to audiences.

Additionally, the IPR provisions of the FTA will bring significant benefits to U.S. content producers. According to Time Warner, the FTA will implement "gold standard" provisions, which includes commitments by Korea to (1) authorize customs officials to seize pirated goods, (2) enact anticircumvention legislation, (3) include language committing Korea to WIPO digital treaty implementation, and (4) extend the term of copyright protection for films to 70 years.

### ***Travel Goods Association***<sup>57</sup>

In a written submission to the Commission, the Travel Goods Association (TGA) stated that it represents the manufacturers, distributors, retailers, promoters, sales representatives, and suppliers of luggage and other products for people who travel. The TGA added that it

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<sup>56</sup> Time Warner Inc., written submission, June 21, 2007.

<sup>57</sup> Travel Goods Association, written submission, June 27, 2007.

strongly supports the U.S.-Korea FTA, and particularly praises provisions that would treat both textile and nontextile travel goods the same, with both receiving immediate and reciprocal duty-free entry under flexible rules of origin. The TGA noted that with the exception of CAFTA-DR and the Panama TPA, every trade agreement in recent years has applied different rules of origin to textile and nontextile travel goods. The more restrictive fabric-forward rule of origin for textile travel goods in these agreements have essentially rendered those agreements useless to U.S. travel goods firms. The language of the U.S.-Korea FTA provides a strong precedent to ensure that all future agreements provide equal, flexible, and reciprocal treatment for all travel goods. According to TGA, incorporating these rules into an FTA with a major trading partner like Korea, one of the fastest-growing markets for imported travel goods, will make the FTA a “landmark agreement” for the U.S. travel goods industry and be of potential benefit to the domestic industry.

### ***U.S.-Korea Business Council***<sup>58</sup>

In written and hearing testimony, the U.S.-Korea Business Council (Council) stated that it is a private-sector organization run by the U.S. Chamber of Commerce and composed of U.S. companies that are significant investors in Korea. The Council supports the U.S.-Korea Free Trade Agreement (FTA). It reported that the FTA will provide substantial new protections and opportunities to U.S. producers and investors with the elimination or reduction of both U.S. and Korean barriers to imports and other cross-border business. Further, it added that the agreement is comprehensive and satisfactorily addresses a significant number of nontariff barriers that have long presented challenges to doing business in Korea.

The Council stated that the agreement “includes some of the strongest chapters yet negotiated within a U.S. FTA on intellectual property, financial services, competition, transparency, and other rules that set important new precedents for future bilateral and multilateral agreements.” With respect to the investment provisions, the Council believes that “by strengthening investor protections and enhancing the transparency and predictability of Korea’s regulatory process, the agreement is expected to draw more U.S. investors to Korea.” The agreement would secure a preferential position in Asia for U.S. businesses and farmers.

The Council said that it welcomes the “strong commitment” by the Korean government to promote transparency in Korea’s regulatory process. It is pleased that “the transparency chapter commitments by the Korean government to publish proposed regulations in advance, allow a reasonable opportunity to comment on the proposed regulations, address significant substantive comments received and publish final regulations in an official journal of national circulation.” The Council also supports the transparency provisions in other key areas.

With regard to services trade, the Council welcomes the Korean government’s commitment in audiovisual services to lock in a reduced 73-day local screen quota and existing access for foreign broadcasters, and the expansion of the level of “permissible foreign content on television.” Furthermore, the FTA would provide U.S. express service companies increased

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<sup>58</sup> Robert C. Reis, Jr., executive vice president, U.S.-Korea Business Council, testimony before the U.S. International Trade Commission, June 20, 2007; written submission, June 20, 2007; and Sean Connell, executive director, U.S.-Korea Business Council, posthearing submission, June 27, 2007. The views are represented by the U.S.-Korea Business Council and their affiliates, the U.S. Chamber of Commerce and the American Chamber of Commerce in Korea.

access to the market. The Council also cited industries such as pharmaceuticals, medical equipment, and telecommunications and information technology that it views as likely to benefit from specific FTA provisions.

### ***U.S.-Korea FTA Business Coalition<sup>59</sup>***

In a written submission to the Commission, the U.S.-Korea FTA Business Coalition (Coalition) stated that it is a broad-based group of over 400 U.S. companies, trade associations, and business organizations. The Coalition strongly supports the U.S.-Korea Free Trade Agreement (FTA) and believes that this FTA is the “most commercially significant U.S. trade agreement in over a decade.” The Coalition noted that the FTA will provide economic benefits by creating substantial new opportunities for U.S. businesses and farmers with the elimination of high tariffs and nontariff market-access barriers in Korea. It added that geopolitical benefits will result from providing the United States with the opportunity to promote U.S. interests beyond bilateral trade with Korea.

The Coalition cited a number of FTA provisions that it views as positive. The Coalition stated that the FTA will increase trade and investment flows between the United States and Korea through the elimination of tariffs on manufactured goods and agriculture and provide new opportunities in virtually all sectors and stronger protections in Korea. Cross-border trade in services will increase with provisions such as allowing 100 percent foreign ownership of telecommunications in Korea. The Coalition added that the FTA’s investment, intellectual property, competition policy, and transparency provisions are strong. It added that the FTA will promote Korea as a destination for U.S., investors, reduce intellectual property damage to both U.S. and Korean firms, and streamline customs procedures that would facilitate trade between the United States and Korea.

The Coalition stated that Korea is an important market for the U.S. financial services, and for U.S. services sectors. It noted that Korea is the second-largest services market for the United States in Asia. The Coalition described the financial services chapter as “one of the strongest ever” in a U.S. FTA, and said that it would likely expect to generate significant new business and benefits for U.S. firms by establishing a more competitive market environment. Overall, the FTA is a “gold standard” agreement.

### ***United States Council for International Business<sup>60</sup>***

In written testimony, the U.S. Council for International Business (USCIB) stated that its members include 300 multinational companies, law firms, chambers of commerce, and business associations, and that it promotes an open system of world commerce in which business can flourish and contribute to economic growth, human welfare, and protection of the environment. USCIB strongly supports the agreement, although it expressed reservations regarding several of the agreement’s provisions. USCIB stated that the investment provisions of the agreement will assist U.S.-owned firms operating in Korea to achieve their full commercial potential. The USCIB noted that Korea is a party to bilateral investment agreements with 80 foreign countries, but had not concluded such an agreement with the U.S. prior to the FTA.

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<sup>59</sup> U.S.-Korea FTA Business Coalition, posthearing submission, June 27, 2007.

<sup>60</sup> U.S. Council of International Business, written submission, June 25, 2007.

In particular, USCIB expressed support for a number of aspects of the investment chapter of the agreement including establishment of a broad definition of investment; limits on expropriation; and international dispute settlement between investors and the government. USCIB expressed reservations, however, regarding a number of investment provisions and exceptions included in the agreement. These included provisions allowing Korea to impose limited restrictions on certain capital flows; an exception to national treatment and performance requirements when a measure is necessary to protect the public order; and the lack of investor-state arbitration for financial institutions regarding prudential measures.

### ***Welch Foods Inc., a Cooperative***<sup>61</sup>

Welch Foods Inc., a Cooperative (Welch's), stated in a written submission to the Commission that it is the processing and marketing subsidiary of the National Grape Cooperative Inc. (National), which consists of approximately 1,333 members who grow Concord and Niagara grapes in the states of New York, Pennsylvania, Ohio, Michigan, and Washington. Welch's reported that National has processing plants in New York, Michigan, Pennsylvania, and Washington state. Welch's added that its signature product is Concord purple grape juice, and that it also produces other fruit juices, juice cocktails, jellies, jams, preserves, juice bars, and fruit-flavored carbonated beverages. Welch's products are sold in the United States and about thirty countries throughout the world, and that it exports primarily Concord grape juice concentrate to Korea. Welch's sells its white grape/peach 100 percent juice in Korea made from U.S.-origin Thompson grape juice concentrate and U.S.-origin peach concentrate. Welch's stated that the principal barrier to increasing its exports to Korea is Korea's 45 percent tariff on grape juice concentrate.

Welch's supports the quick implementation of the U.S.-Korea FTA agreement, which will immediately and completely remove tariffs on U.S. exports of grape juice concentrate. Korea is a good market for its grape juice exports and that with duty-free access Korea has the potential to become a more important and profitable market for Welch's and other U.S. grape juice producers and exporters. The U.S.-Korea FTA, once implemented, will have a positive economic effect on its grape growers, Welch's and other U.S. grape juice producers, Korea's grape juice processing and distribution sectors, and Korean consumers. Welch's also stated that it is interested in sections of the FTA agreement that deal with strengthening Korea's trademark rules to protect U.S. trademarked products such as the Welch's trademarked name.

Welch's has exported U.S.-origin Concord grape juice products to Korea for 12 years. From 1995 to 2002, it exported only finished grape juice products manufactured in Welch's processing plant in Washington state; since 2003, it has exported bulk Concord grape juice concentrate to Korea to be manufactured and bottled in Korea under the Welch's trademark under an exclusive agreement with its Korean partner, Nong Shim, one of the largest food companies in Asia. Welch's reported that all of its products presently sold in Korea are locally manufactured in Korea by Nong Shim. As a result, between 2002 and 2006, retail sales in Korea of its finished Concord grape juice increased fourfold from a relatively low base. This, Welch's added, was due to the in-country manufacturing of Welch's concentrate in Korea, the wide distribution offered by Nong Shim, and the active promotional efforts. Welch's noted, however, that total U.S. exports of grape juice to Korea fell from over \$9 million in 2002 to about \$6.5 million in 2006 as the composition of U.S. exports changed from higher-valued finished product to lower-valued bulk product. Welch's noted that Korea's grape juice market is almost exclusively supplied by imported product from the

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<sup>61</sup> Welch Foods Inc., a Cooperative, written submission, June 14, 2007.



United States, Spain, Chile, Brazil, and Argentina. Welch's commented that Chilean grape juice began to benefit on January 1, 2007, from preferential tariff treatment under the Korea-Chile FTA, and will become duty-free on January 1, 2011, and that immediate implementation of the U.S.-Korea FTA would allow U.S. grape juice exports to benefit from immediate duty-free access.

### ***Wellman, Inc.***<sup>62</sup>

In written and hearing testimony, Wellman, Inc., Fort Mill, SC, a large integrated producer of polyester staple fibers (PSF) with manufacturing facilities in Alabama and Mississippi, stated that the immediate elimination of the U.S. tariff on PSF (4.3 percent ad valorem) under the FTA would "severely damage Wellman" and "the entire national base" of PSF producers. It added that the FTA "disregards, and in effect obviates, a standing antidumping order" on imports of PSF from Korea and that it "disregards" the U.S. International Trade Commission's 2006 sunset review finding on the industry's continuing vulnerability.<sup>63</sup> According to Wellman, the FTA would augment Korea's targeting of the U.S. market for its excess PSF capacity, particularly because all other significant export markets maintain effective restraints against these Korean exports.<sup>64</sup> Wellman remarked that the FTA would create a tariff inversion that carries significantly negative, discriminatory effects for U.S. producers, whereby the FTA would immediately eliminate the U.S. tariff on PSF but phase out the 6.5 percent U.S. tariff on certain raw materials used in domestic production of PSF over 10 years (the FTA would eliminate the 5.9 percent Korean tariff on these raw materials immediately upon its implementation).

### ***The Wine Institute and the California Association of Winegrape Growers***<sup>65</sup>

In a written submission to the Commission, the Wine Institute stated it is the public policy advocacy association of California wineries and that it brings together the resources of over 1,000 wineries and affiliated businesses to support legislative and regulatory advocacy, international market development, media relations, scientific research, and education programs that benefit the entire California wine industry. It noted that California represents more than 90 percent of U.S. wine production and 95 percent of wine exports. The California Association of Winegrape Growers (CAWG) stated that it is an advocate for farmers, providing leadership on public policies, research and education programs, sustainable farming practices, and trade policy to enhance the California winegrape growing business and its communities.

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<sup>62</sup> Michael Bermish, director, Strategic Planning, Wellman, Inc., testimony before the U.S. International Trade Commission, June 20, 2007; and posthearing submission, June 26, 2007.

<sup>63</sup> In March 2006, the Commission completed its sunset review of the antidumping orders on certain PSF from Korea and Taiwan, finding that "the domestic industry is vulnerable to the continuation or recurrence of material injury were the orders to be revoked" (USITC Publication 3823).

<sup>64</sup> According to Wellman, Korea's PSF is currently subject to antidumping duties of 6.0–13.5 percent in Japan; 5.7–10.6 percent in the European Union; 3.4–32 percent in Mexico; and up to 34.7 percent in China. Hearing transcript and attachment to hearing testimony.

<sup>65</sup> Wine Institute and the California Association of Winegrape Growers, written submission, June 27, 2007.

The Wine Institute and the CAWG stated that they supported throughout the negotiation process the immediate duty-free access to the South Korean market upon implementation for wine (HTS 2204, 2205, and 2206) and grape juice concentrate (HTS 2009.61 and 2009.69). Overall, the FTA will greatly enhance the competitive position of U.S. winemakers in South Korea's extremely promising market, leading to large potential gains for the U.S. wine industry. The Wine Institute and the CAWG estimate that within a year of implementation of the FTA, exports will have grown by 150 percent relative to 2006 levels, and sales will total over \$31 million, and that by 2012, 5 years after the agreement, exports will have grown by 480 percent, and sales will total over \$72 million.

They described Korea as a rapidly developing market for U.S. wine exports, and said it has potential for substantial growth. The market for wine in South Korea has grown by 283 percent in the past 5 years, and that wine consumption is growing by about 19 percent per year. They noted that U.S. wine exports to Korea currently face a tariff rate of 15 percent for wine and 45 percent for grape juice concentrate. The Chilean share of Korea's wine market has grown from about 4 percent in 2004, when the Chile-South Korea FTA was signed, to 17 percent, while the U.S. share has remained constant at about 14 percent. They added that Chile is also increasing its share of the Korean grape juice market at the expense of U.S. producers as a result of its preferential duty treatment in the Korean market. The U.S. duty rates on both wine and grape juice concentrate would immediately fall to free upon implementation of the FTA, making U.S. exports more competitive in the Korean market.

The Wine Institute and the CAWG stated that the effect of the FTA on the U.S. wine industry will be significant and extremely positive and that the FTA will help U.S. wine exporters compete with their Chilean counterparts. This will improve the competitive position of U.S. wines in the Korean market and enable the U.S. wine and grape juice concentrate industries to solidify their positions in Asian markets.

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**APPENDIX A**  
**Request Letter from USTR**

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EXECUTIVE OFFICE OF THE PRESIDENT  
THE UNITED STATES TRADE REPRESENTATIVE  
WASHINGTON, D.C. 20508

DOCKET NUMBER
2537
Office of the Secretary Int'l Trade Commission

The Honorable Daniel R. Pearson  
Chairman  
U.S. International Trade Commission  
500 E Street, S.W.  
Washington, D.C. 20436

APR 01 2007

RECEIVED  
OFFICE OF THE SECRETARY  
U.S. INTERNATIONAL TRADE COMMISSION  
2007 APR -2 PM 2:35

Dear Chairman Pearson:


As you know, the United States and Korea are nearing the conclusion of negotiations on a comprehensive bilateral free trade agreement (FTA). The advice that the United States International Trade Commission ("Commission") has provided over the course of these negotiations has contributed significantly to their advancement.

The President has notified Congress of his intention to enter into an FTA with Korea. Pursuant to authority delegated to me by the President and in accordance with section 2104(f) of the Trade Act of 2002 (Trade Act), I request that the Commission prepare a report, as specified in section 2104(f)(2)-(3) of the Trade Act, assessing the likely impact of the FTA on the United States economy as a whole and on specific industry sectors and the interests of U.S. consumers.

Along with this letter, I am providing you an electronic copy of the confidential negotiating text as it exists at this time. USTR staff will keep the Commission current with respect to the details of the FTA and will also be available to answer questions or provide additional information on the FTA. I would greatly appreciate it if the Commission could issue its report as soon as possible after the FTA is signed.

Thank you for your continued cooperation and assistance in this matter.

Sincerely,

  
Susan C. Schwab

Enclosure



**APPENDIX B**  
***Federal Register* Notices**

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*Participation in the proceeding.* Only those persons who were interested parties to the original investigation (i.e., persons listed on the Commission Secretary's service list) and were parties to the appeal may participate in the remand proceeding. Such persons need not make any additional appearance filings with the Commission to participate in the remand proceeding. Business proprietary information ("BPI") referred to during the remand proceeding will be governed, as appropriate, by the administrative protective order issued in the original investigation.

*Written submissions.* The Commission is reopening the record for the limited purpose of collecting data pertinent to its analysis called for under *Bratsk Aluminum Smelter v. United States*, 444 F.3d 1369 and 1375 (Fed. Cir. 2006). In addition, the Commission will permit the parties to file comments pertaining to the inquiries that are the subject of the CIT's remand instructions, but no new factual information may be submitted with these comments. Comments should be limited to no more than twenty (20) double-spaced and single-sided pages of textual material. The parties may not submit any new factual information and may not address any issue other than the inquiries that are the subject of the CIT's remand instructions. Any such comments must be filed with the Commission no later than May 31, 2007.

All written submissions must conform with the provisions of section 201.8 of the Commission's rules; any submissions that contain BPI must also conform with the requirements of sections 201.6, 207.3, and 207.7 of the Commission's rules. The Commission's rules do not authorize filing of submissions with the Secretary by facsimile or electronic means, except to the extent permitted by section 201.8 of the Commission's rules, as amended, 67 FR 68036 (Nov. 8, 2002).

In accordance with sections 201.16(c) and 207.3 of the Commission's rules, each document filed by a party to the investigation must be served on all other parties to the investigation (as identified by either the public or BPI service list), and a certificate of service must be timely filed. The Secretary will not accept a document for filing without a certificate of service.

Parties are also advised to consult with the Commission's Rules of Practice and Procedure, part 201, subparts A through E (19 CFR part 201), and part 207, subpart A (19 CFR part 207) for provisions of general applicability concerning written submissions to the Commission.

By order of the Commission.

Issued: May 1, 2007.

**Marilyn R. Abbott,**

*Secretary to the Commission.*

[FR Doc. E7-8615 Filed 5-4-07; 8:45 am]

BILLING CODE 7020-02-P

## INTERNATIONAL TRADE COMMISSION

[Investigation No. TA-2104-24]

### U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects

**AGENCY:** United States International Trade Commission.

**ACTION:** Institution of investigation and scheduling of public hearing.

**SUMMARY:** Following receipt of a request from the United States Trade Representative (USTR) on April 1, 2007, the Commission instituted investigation No. TA-2104-24, *U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects*, under section 2104(f) of the Trade Act of 2002 (19 U.S.C. 3804(f)), for the purpose of assessing the likely impact of the U.S. Free Trade Agreement (FTA) with the Republic of Korea (Korea) on the United States economy as a whole and on specific industry sectors and the interests of U.S. consumers.

**DATES:**

April 1, 2007: Receipt of request.

May 24, 2007: Deadline for receipt of requests to appear at hearing.

May 24, 2007: Deadline for filing pre-hearing briefs and statements.

June 7, 2007, 9:30 a.m.: Public hearing.

June 21, 2007: Deadline for filing post-hearing briefs and statements and all other written submissions.

September 20, 2007: Anticipated date for transmitting report to USTR and the Congress.

**ADDRESSES:** All Commission offices, including the Commission's hearing rooms, are located in the United States International Trade Commission Building, 500 E Street, SW., Washington, DC. All written submissions, including requests to appear at the hearing, statements, and briefs, should be addressed to the Secretary, United States International Trade Commission, 500 E Street, SW., Washington, DC 20436. The public record for this investigation may be viewed on the Commission's electronic docket (EDIS) at <http://edis.usitc.gov>.

**FOR FURTHER INFORMATION CONTACT:** Project Leader Nannette Christ (202-205-3263; [nannette.christ@usitc.gov](mailto:nannette.christ@usitc.gov)) or Deputy Project Leader Queena Fan (202-205-3055; [queena.fan@usitc.gov](mailto:queena.fan@usitc.gov)).

For information on legal aspects, contact William Gearhart of the Office of the General Counsel (202-205-3091; [william.gearhart@usitc.gov](mailto:william.gearhart@usitc.gov)). The media should contact Margaret O'Laughlin, Office of External Relations (202-205-1819; [margaret.olaughlin@usitc.gov](mailto:margaret.olaughlin@usitc.gov)). General information concerning the Commission may also be obtained by accessing its Internet address (<http://www.usitc.gov>). Hearing impaired individuals are advised that information on this matter can be obtained by contacting the TDD terminal on 202-205-1810. Persons with mobility impairments who will need special assistance in gaining access to the Commission should contact the Secretary at 202-205-2000.

**SUPPLEMENTARY INFORMATION:** As requested by the USTR, the Commission will prepare a report as specified in section 2104(f)(2)-(3) of the Trade Act of 2002 assessing the likely impact of the U.S. FTA with Korea on the U.S. economy as a whole and on specific industry sectors, including the impact the agreement will have on the gross domestic product, exports, and imports; aggregate employment and employment opportunities; the production, employment, and competitive position of industries likely to be significantly affected by the agreement; and the interests of U.S. consumers. In preparing its assessment, the Commission will review available economic assessments regarding the agreement, including literature concerning any substantially equivalent proposed agreement. The Commission will provide a description of the analyses used and conclusions drawn in such literature, and a discussion of areas of consensus and divergence between the Commission's analyses and conclusions and other economic assessments reviewed.

Section 2104(f)(2) requires that the Commission submit its report to the President and the Congress not later than 90 days after the President enters into the agreement, which he can do 90 days after he notifies the Congress of his intent to do so. On April 1, 2007, the President notified the Congress of his intent to enter into a FTA with Korea. The USTR requested that the Commission provide the report as soon as possible after the FTA is signed.

*Public Hearing:* A public hearing in connection with the investigation is scheduled to begin at 9:30 a.m. on June 7, 2007, at the U.S. International Trade Commission Building, 500 E Street, SW., Washington, DC. All persons shall have the right to appear, by counsel or

in person, to present information and to be heard. Requests to appear at the public hearing should be filed with the Secretary no later than 5:15 p.m., May 24, 2007. Any pre-hearing briefs or statements should be filed no later than 5:15 p.m., May 24, 2007, and any post-hearing briefs or statements should be filed no later than 5:15 p.m., June 21, 2007; all such briefs and statements must be submitted in accordance with the requirements below under "written submissions." In the event that, as of the close of business on May 24, 2007, no witnesses are scheduled to appear at the hearing, the hearing will be canceled. Any person interested in attending the hearing as an observer or nonparticipant may call the Secretary to the Commission (202-205-2000) after May 24, 2007 for information concerning whether the hearing will be held.

**Written Submissions:** In lieu of or in addition to participating in the hearing, interested parties are invited to submit written statements concerning the matters to be addressed by the Commission in its report on this investigation. Submissions should be addressed to the Secretary. To be assured of consideration by the Commission, written statements related to the Commission's report should be submitted to the Commission at the earliest practical date and should be received no later than 5:15 p.m., June 21, 2007.

All written submissions must conform with the provisions of section 201.8 of the Commission's Rules of Practice and Procedure (19 CFR 201.8). Section 201.8 of the rules requires that a signed original (or copy designated as an original) and fourteen (14) copies of each document be filed. In the event that confidential treatment of the document is requested, at least four (4) additional copies must be filed, in which the confidential business information must be deleted (see the following paragraph for further information regarding confidential business information). The Commission's rules do not authorize filing submissions with the Secretary by facsimile or electronic means, except to the extent permitted by section 201.8 of the rules (see Handbook for Electronic Filing Procedures, [http://www.usitc.gov/secretary/fed\\_reg\\_notices/rules/documents/handbook\\_on\\_electronic\\_filing.pdf](http://www.usitc.gov/secretary/fed_reg_notices/rules/documents/handbook_on_electronic_filing.pdf)). Persons with questions regarding electronic filing should contact the Secretary (202-205-2000 or [edis@usitc.gov](mailto:edis@usitc.gov)).

Any submissions that contain confidential business information must also conform with the requirements of

section 201.6 of the Commission's Rules of Practice and Procedure (19 CFR 201.6). Section 201.6 of the rules requires that the cover of the document and the individual pages be clearly marked as to whether they are the "confidential" or "nonconfidential" version, and that the confidential business information be clearly identified by means of brackets. All written submissions, except for confidential business information, will be made available in the Office of the Secretary to the Commission for inspection by interested parties.

The Commission intends to prepare only a public report in this investigation. The report that the Commission sends to the President and the Congress and makes available to the public will not contain confidential business information. Any confidential business information received by the Commission in this investigation and used in preparing the report will not be published in a manner that would reveal the operations of the firm supplying the information.

By order of the Commission.

Issued: April 30, 2007.

**Marilyn R. Abbott,**

*Secretary to the Commission.*

[FR Doc. E7-8622 Filed 5-4-07; 8:45 am]

**BILLING CODE 7020-02-P**

## INTERNATIONAL TRADE COMMISSION

[USITC SE-07-007]

### Government in the Sunshine Act Meeting Notice

**AGENCY HOLDING THE MEETING:** United States International Trade Commission.

**TIME AND DATE:** May 11, 2007 at 11 a.m.

**PLACE:** Room 101, 500 E Street, SW., Washington, DC 20436, Telephone: (202) 205-2000.

**STATUS:** Open to the public.

#### MATTERS TO BE CONSIDERED:

1. Agenda for future meetings: none.
2. Minutes.
3. Ratification list.
4. Inv. Nos. 731-TA-1111-1113 (Preliminary) (Glycine from India, Japan, and Korea)—briefing and vote. (The Commission is currently scheduled to transmit its determination to the Secretary of Commerce on or before May 14, 2007; Commissioners' opinions are currently scheduled to be transmitted to the Secretary of Commerce on or before May 21, 2007.)

5. Outstanding action jackets: none. In accordance with Commission policy, subject matter listed above, not

disposed of at the scheduled meeting, may be carried over to the agenda of the following meeting.

By order of the Commission.

Issued: April 30, 2007.

**Marilyn R. Abbott,**

*Secretary to the Commission.*

[FR Doc. E7-8625 Filed 5-4-07; 8:45 am]

**BILLING CODE 7020-02-P**

## DEPARTMENT OF JUSTICE

### Antitrust Division

#### Notice Pursuant to the National Cooperative Research and Production Act of 1993—AAF Association, Inc.

Notice is hereby given that, on March 21, 2007, pursuant to Section 6(a) of the National Cooperative Research and Production Act of 1993, 15 U.S.C. 4301 *et seq.* ("the Act"), AAF Association, Inc. has filed written notifications simultaneously with the Attorney General and the Federal Trade Commission disclosing changes in its membership. The notifications were filed for the purpose of extending the Act's provisions limiting the recovery of antitrust plaintiffs to actual damages under specified circumstances. Specifically, Disk Stream, Inc., Waterloo, Ontario, CANADA; Microsoft Corporation, Redmond, WA; and Virorum Consulting LLP, Brighton, East Sussex, UNITED KINGDOM have withdrawn as parties to this venture.

No other changes have been made in either the membership or planned activity of the group research project. Membership in this group research project remains open, and AAF Association, Inc. intends to file additional written notifications disclosing all changes in membership.

On March 28, 2000, AAF Association Inc. filed its original notification pursuant to Section 6(a) of the Act. The Department of Justice published a notice in the **Federal Register** pursuant to Section 6(b) of the Act on June 29, 2000 (65 FR 40127).

The last notification was filed with the Department on December 21, 2006. A notice was published in the **Federal Register** pursuant to Section 6(b) of the Act on January 25, 2007 (72 FR 3414).

**Patricia A. Brink,**

*Deputy Director of Operations, Antitrust Division.*

[FR Doc. 07-2227 Filed 5-4-07; 8:45 am]

**BILLING CODE 4410-11-M**



Bands of the Yakama Nation, Washington; Confederated Tribes of the Colville Reservation, Washington; Confederated Tribes of the Umatilla Reservation, Oregon; Confederated Tribes of the Warm Springs Reservation of Oregon; Nez Perce Tribe of Idaho; and Wanapum Band, a non-federally recognized Indian group that this notice has been published.

Dated: May 14, 2007

**Sherry Hutt,**

*Manager, National NAGPRA Program.*

[FR Doc. E7-10012 Filed 5-22-07; 8:45 am]

**BILLING CODE 4312-50-S**

## INTERNATIONAL TRADE COMMISSION

[Investigation No. TA-2104-24]

### U.S.-Korea Free Trade Agreement: Potential Economy-Wide and Selected Sectoral Effects

**AGENCY:** United States International Trade Commission.

**ACTION:** Rescheduling of public hearing.

**SUMMARY:** The Commission has rescheduled the public hearing in this investigation from June 7, 2007, to June 20, 2007. As announced in the notice of institution of the investigation published in the *Federal Register* on May 7, 2007 (72 FR 25779), the hearing will be held at the U.S. International Trade Commission building, 500 E Street, SW., Washington, DC; it will begin at 9:30 a.m. Certain dates relating to the filing of written statements and other documents have been changed; the revised schedule of dates is set out immediately below. All other requirements and procedures set out in the May 7, 2007, notice continue to apply. In the event that, as of the close of business on June 7, 2007, no witnesses are scheduled to appear at the hearing, the hearing will be canceled. Any person interested in attending the hearing as an observer or nonparticipant may call the Secretary to the Commission (202-205-2000) after June 7, 2007 for information concerning whether the hearing will be held.

**DATES:** April 1, 2007: Receipt of request.

June 6, 2007: Deadline for receipt of requests to appear at hearing.

June 6, 2007: Deadline for filing pre-hearing briefs and statements.

June 20, 2007, 9:30 a.m.: Public hearing.

June 27, 2007: Deadline for filing post-hearing briefs and statements and all other written submissions.

September 20, 2007: Anticipated date for transmitting report to USTR and the Congress.

**FOR FURTHER INFORMATION CONTACT:** Project Leader Nannette Christ (202-205-3263; [nannette.christ@usitc.gov](mailto:nannette.christ@usitc.gov)) or Deputy Project Leader Queena Fan (202-205-3055; [queena.fan@usitc.gov](mailto:queena.fan@usitc.gov)). For information on legal aspects, contact William Gearhart of the Office of the General Counsel (202-205-3091; [william.gearhart@usitc.gov](mailto:william.gearhart@usitc.gov)). The media should contact Margaret O'Laughlin, Office of External Relations (202-205-1819; [margaret.olaughlin@usitc.gov](mailto:margaret.olaughlin@usitc.gov)). General information concerning the Commission may also be obtained by accessing its Internet address (<http://www.usitc.gov>). Hearing impaired individuals are advised that information on this matter can be obtained by contacting the TDD terminal on 202-205-1810. Persons with mobility impairments who will need special assistance in gaining access to the Commission should contact the Secretary at 202-205-2000.

By order of the Commission.

Issued: May 17, 2007.

**Marilyn R. Abbott,**

*Secretary to the Commission.*

[FR Doc. E7-9871 Filed 5-22-07; 8:45 am]

**BILLING CODE 7020-02-P**

## DEPARTMENT OF LABOR

### Employment and Training Administration

#### Appointments to the Advisory Committee on Apprenticeship (ACA)

**AGENCY:** Employment and Training Administration, Labor.

**ACTION:** Notice of ACA appointments.

**SUMMARY:** The Employment and Training Administration hereby announces the appointment of 32 members to fill vacancies on the Advisory Committee on Apprenticeship (ACA), an advisory board to the Secretary. The ACA, which is authorized by Section 2 of the National Apprenticeship Act (29 U.S.C. 50), complies with the requirements of the Federal Advisory Committee Act (5 U.S.C., App.). The Committee will be an effective instrument for providing assistance, advice, and counsel to the Secretary of Labor and the Assistant Secretary for the Employment and Training Administration in the development and implementation of Administration policies and programs regarding apprenticeship.

Members are appointed for one-year or two-year terms. The membership of

the Committee shall include equal representation of employers, labor organizations, and the public. The National Association of State and Territorial Apprenticeship Directors (NASTAD) and the National Association of Government Labor Officials (NAGLO) will both be represented by their current President on the public group of the Committee. The Secretary shall appoint one of the public members as Chairperson of the Advisory Committee. **FOR FURTHER INFORMATION CONTACT:** Mr. Anthony Swoope, Administrator, Office of Apprenticeship, Employment and Training Administration, U.S. Department of Labor, Room N-5311, 200 Constitution Avenue, NW., Washington, DC 20210. Telephone: (202) 693-2796, (this is not a toll-free number).

**SUPPLEMENTARY INFORMATION:** The following is a list of the Committee members by group:

#### Represents: Employers

Mr. Robert W. Baird, Vice President, Apprenticeship and Training, Standards and Safety, Independent Electrical Contractors, Inc., Alexandria, Virginia.

Ms. Linda Bien, President and CEO, North East Medical Services, San Francisco, California.

Ms. Phyllis Eisen, Vice President, Manufacturing Institute, Washington, DC.

Ms. Julie A. Flik, Executive Vice President, Compass Group, North American Division, Bion Island, Mamaroneck, New York.

Mr. Fred Haag, Senior Vice President—Electrical, Infrasource Inc., Madison, Mississippi.

Mr. Kelvin D. Harrison, Technical Training Manager, Caterpillar, Inc., Peoria, Illinois.

Mr. Neill J. Hopkins, Vice President of Skills Development, Computing Technology Industry Association, Oakbrook Terrace, Illinois.

Mr. Frederick N. Humphreys, President & CEO, Home Builders Institute, Washington, DC.

Mr. Stephen C. Mandes, Executive Director, National Institute for Metalworking Skills, Fairfax, Virginia.

Ms. Karen T. Soehner, Corporate Compliance Officer, Family Senior Care, Saint Augustine, Florida.

Mr. Robert Piper, Vice President of Workforce Development, Associated Builders and Contractors, Inc., Arlington, Virginia.

#### Represents: Labor

Mr. John T. Ahern, Business Manager, International Union of Operating Engineers Local 30, Richmond Hill, New York.



**APPENDIX C**  
**Hearing Participants**

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## CALENDAR OF PUBLIC HEARING

Those listed below appeared as witnesses at the United States International Trade Commission's hearing:

**Subject:** U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects

**Inv. No.:** TA-2104-024

**Date and Time:** June 20, 2007 - 9:30 a.m.

Sessions were held in connection with this investigation in the Main Hearing Room (room 101), 500 E Street, S.W., Washington, D.C.

### CONGRESSIONAL APPEARANCE:

**The Honorable Sander Levin, U.S. Congressman, 12<sup>th</sup> District, State of Michigan; and Chair of the Subcommittee of Trade, Committee of Ways and Means**

### EMBASSY APPEARANCE:

**Embassy of the Republic of Korea  
Washington, D.C.**

**His Excellency Lee Tae-sik, Ambassador to the United States of America, Embassy of the Republic of Korea**

### ORGANIZATION AND WITNESS:

#### PANEL 1

U.S.-Korea Business Council  
U.S. Chamber of Commerce  
Washington, D.C.

**Robert C. Reis, Jr.**, Executive Vice President,  
U.S.-Korea Business Council; *and*  
Senior Director, Japan and Korea, U.S.  
Chamber of Commerce

**ORGANIZATION AND WITNESS:**

**PANEL 1 (continued)**

U.S.-Korea FTA Business Coalition  
Washington, D.C.

**Laura Lane**, Corporate Co-Chair, U.S.-Korea  
FTA Business Coalition; *and* Senior  
Vice President, International Government  
Affairs, Citigroup, Inc.

Express Delivery & Logistics Association (“XLA”)  
Falls Church, VA

**T. James Min II**, Chair of the Trade Subcommittee, XLA;  
*and* Senior Attorney, FedEx Express

Coalition of Services Industries  
Washington, D.C.

**John Goyer**, Vice President, International Trade  
Negotiations & Investment

Entertainment Industry Coalition for Free Trade  
Washington, D.C.

**Greg Frazier**, Executive Vice President, Motion  
Picture Association of America

American Council of Life Insurers (“ACLI”)  
Washington, D.C.

**Brad Smith**, Vice President, International  
Relations

Information Technology Industry Council (“ITI”)  
Washington, D.C.

**Rhett Dawson**, President and CEO

**ORGANIZATION AND WITNESS:**

**PANEL 2**

Wellman, Inc.  
Fort Mill, SC

**Michael Bermish, PhD**, Director of Strategic  
Planning

National Council of Textile Organizations (“NCTO”)  
Washington, D.C.

**Cass Johnson**, President

Pharmaceutical Research and Manufacturers of America (“PhRMA”)  
Washington, D.C.

**Jeffrey A. May**, Assistant General Counsel

National Cattlemen’s Beef Association  
Washington, D.C.

**Jay H. Truitt**, Vice President, Government Affairs

National Pork Producers Council  
Washington, D.C.

**Brian Buhr**, Economist, University of Minnesota

Ford Motor Company (“Ford”)  
Washington, D.C.

**Stephen E. Biegun**, Vice President, International  
Government Affairs

International Union, United Automobile, Aerospace  
& Agricultural Implement Workers of America (“UAW”)  
Washington, D.C.

**Douglas S. Meyer**, Deputy Director, International  
and Governmental Affairs

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## **APPENDIX D**

### **U.S.-Korea FTA: Chapter-by-Chapter Summary**



# **U.S.-Korea FTA**

## **Chapter-by-Chapter Summary**

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### **FTA Chapter 1—Initial Provisions and Definitions**

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The text provides that the parties agree to set up a free trade area that is consistent with the 1994 General Agreement on Tariffs and Trade (GATT). Each party affirms all existing rights and obligations with respect to the previous agreements to which both are parties, and states that the FTA shall not be construed as affecting any bilateral international legal obligation that provides for more favorable treatment of goods, services, investments, or persons than that provided for by the FTA. Among the general definitions in the FTA, the term “territory” is defined with respect to Korea as the land, maritime, and airspace over which that country exercises sovereignty, including the seabed and subsoil adjacent to and beyond its territorial sea over which it exercises sovereign rights under international and domestic law. With respect to the United States, “territory” is defined as including the customs territory (the 50 states, the District of Columbia, and Puerto Rico), foreign trade zones in the United States and Puerto Rico, and any areas beyond its territorial seas within which it may exercise sovereign rights over the seabed and subsoil and their natural resources in accordance with international and domestic law.

### **FTA Chapter 2—National Treatment and Market Access for Goods**

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The FTA commitments on national treatment and market access are based upon and similar in legal form to the corresponding provisions of the GATT 1994. Under the chapter, the parties agree to eliminate their customs duties on originating goods as provided in the attached schedules, and to refrain from increasing any duty rate, imposing a new rate, or adopting or maintaining import- or export-related prohibitions or restrictions relating to bilateral trade, except as authorized by GATT 1994. Further, the parties may agree to accelerate the elimination of any duty set out in their schedules. Duty-level ceilings are provided in the event that a concession must be withdrawn; a party can impose a duty authorized by the WTO Dispute Settlement Body or return to a higher FTA scheduled duty rate after a unilateral duty reduction.

Other provisions in this chapter are similar to those of other FTAs and deal with temporary importations, reentry of repair or altered goods, and other customs procedures. Article XI of GATT 1994 controls whether a specific measure is allowed under the FTA. No new waiver of customs duties, expansion of a waiver, or continuation of an existing waiver that is conditioned on fulfilling a performance requirement can be allowed. Import licensing must comply with the WTO agreement on that subject, and no duties can be charged on the entry of commercial samples or related advertising materials. Other provisions ban consular transactions and export duties along with the imposition or continuation of merchandise-processing fees on originating goods. Other administrative fees and charges that are not duties or their equivalent must be directly related to the cost of services being rendered; all

fees and charges on trade in goods must be published on the Internet. Korea must recognize Bourbon Whiskey and Tennessee Whiskey as distinctive U.S. products, and the United States must recognize Andong Soju and Gyeongju Beopju as distinctive Korean products. Korea is required to amend its Special Consumption Tax and Annual Vehicle Tax to exempt certain goods and reduce the taxes on other goods; it is barred from amending its Subway Bond and Regional Development Bond (specified in a footnote) to increase the existing disparity in purchase rates over categories of vehicles as of the time the FTA enters into force. A Committee on Trade in Goods is established to consider all matters arising under this chapter, chapter 6 (rules of origin), or chapter 7 (customs administration and trade facilitation). It would also promote bilateral trade in goods, review changes to the Harmonized System 2007 nomenclature,<sup>1</sup> and carry out certain consultations between the parties.

## **FTA Chapter 3—Agriculture**

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Chapter 3 of the U.S.-Korea FTA would dictate the administration of agricultural tariff-rate quotas (TRQs), the application of agricultural safeguard measures, and the establishment of a Committee on Agricultural Trade.

The chapter is intended to ensure that the administration of TRQs occurs in a fair, reasonable, and transparent manner. Categories of products covered by TRQs would range from immediate duty-free access for most in-quota quantities to an 18-year TRQ phaseout period for most over-quota quantities. A few U.S. exports would always have duty-free in-quota access limited by expanding TRQs. There would be no change in treatment for Korean imports of rice and rice products from the United States under the FTA.<sup>2</sup>

Additionally, chapter 3 would define the application of quantity-based agricultural safeguard measures on originating agricultural goods. Provisions would require that any safeguard under the FTA not coincide with other safeguards, and that safeguard duties not exceed relevant MFN rates. Once applied, each country must implement the safeguard in a transparent manner and provide the other party notification and relevant data within 60 days. Agricultural products originating in either country would be exempt from any safeguards taken under the WTO Agreement on Agriculture. No safeguard duty could be applied to in-quota shipments. Phaseout periods for safeguards on U.S. agricultural exports would range from 8 to 24 years.

Chapter 3 also would establish the Committee on Agricultural Trade as an annual forum for monitoring implementation, mutual consultation, and any additional work the committee deems necessary. Committee decisions would be taken by consensus.

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<sup>1</sup> The Harmonized Commodity Description and Coding System (HS) of the World Customs Organization (WCO) serves as the basis of both parties' national tariff schedules; the 2007 revision of the HS serves as the basis of interpretation for classification purposes in future. The WCO conducts a regular review of the HS every 5 years with a view toward updating and simplifying the nomenclature structure and attaining consistent classifications of goods in trade.

<sup>2</sup> Rice would continue to follow minimum market access commitments established in the 2005 WTO *Certification of Modifications and Rectifications to Schedule LX—Republic of Korea*.

## FTA Chapter 4—Textiles and Apparel

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Chapter 4 of the FTA sets out the rules of origin and other provisions specifically applicable to textiles and apparel.<sup>3</sup> Tariff staging for textiles and apparel is included in FTA chapter 2, which would eliminate tariffs on textiles and apparel that meet the FTA rules of origin (“originating goods”) either immediately or within 10 years.

FTA chapter 4 includes authority to apply temporary bilateral textile safeguard measures, under which either party may suspend further duty reductions or reinstate MFN tariffs if imports from the other party that receives FTA benefits are being imported in such increased quantities as to cause serious damage or actual threat of serious damage to the domestic industry (Article 4.1). In addition, it sets out the general legal principles on origin, including a consultation provision for the parties to consider whether to revise the rules of origin to address availability of fibers, yarns, or fabrics; transitional procedures for goods containing fibers, yarns, and fabrics not available in commercial quantities; a de minimis foreign content rule;<sup>4</sup> and rules for the treatment of textile and apparel sets (Article 4.2).

FTA chapter 4 also includes detailed customs enforcement and cooperation provisions to ensure accuracy of the claims of origin, to prevent circumvention of the agreement, and to enforce measures affecting trade in textiles and apparel (Article 4.3). It would require that Korea obtain and maintain detailed information on all entities engaged in the production of textiles and apparel in Korea. The FTA authorizes U.S. and Korean customs authorities to conduct unannounced site visits to producers in the FTA region where the importing party has a reasonable suspicion that a person of the exporting party is engaging in unlawful activity relating to trade in textiles or apparel. The FTA authorizes the parties to undertake a variety of enforcement actions, up to and including denying preferential tariff treatment for suspect goods.

Annex 4-A sets out the rules of origin for textiles and apparel similar to recent U.S. FTAs, which are based on changes in tariff classification from third-country inputs to goods processed or made in one or both FTA parties. The U.S.-Korea FTA applies a “yarn-forward” rule of origin to most textile and apparel articles, including most woven fabrics, carpets, and home textiles, whereby imports of such goods from the FTA party must be made from inputs produced in the FTA region from the yarn stage forward to qualify for tariff preferences. For example, for a garment to qualify for FTA preferences under a yarn-forward rule, the production of the yarn and fabric used in the garment, as well as cutting and sewing, must occur in the FTA region.

The yarn-forward rule of origin generally applies only to the component that determines the tariff classification of the garment (i.e., the component that gives the garment its “essential character”), rather than to all fabric components of the garment. For example, a garment subject to the yarn-forward rule is eligible for FTA preferences if the component that

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<sup>3</sup> FTA chapter 4 includes all textiles and apparel listed in the annex of the Agreement on Textiles and Clothing, which is contained in Annex 1A to the WTO Agreement. The products include, but are not limited to, textile and apparel articles in HS chapters 50–63 except raw cotton, wool, and certain other textile fibers; textile travel goods (e.g., luggage) in HS heading 4202; glass fibers, yarns, and fabrics in HS heading 7019; and comforters in HS subheading 9404.90.

<sup>4</sup> Under the de minimis foreign-content rule for textiles and apparel, up to 7 percent of the total weight of a good can consist of fibers or yarns that do not change tariff provisions in the prescribed way and are used in the component that determines the tariff classification of the good.

determines the tariff classification of the good is made of originating yarns and fabrics, without regard to the origin of any collar or cuffs incorporated into the garment, and the garment is cut and sewn in the FTA region. As in past FTAs, the U.S.-Korea FTA requires that certain visible linings in suits, skirts, jackets, coats, and similar articles originate in the FTA region.<sup>5</sup> In addition, the FTA contains a *de minimis* foreign content rule that permits up to 7 percent of the total weight of the component that determines the tariff classification of the good to consist of nonoriginating fibers or yarns, except for elastomeric yarns, which must be made in the FTA region.

Annex 4-A applies a more restrictive “fiber-forward” rule of origin to a number of mostly cotton and man-made fiber textile articles, whereby imports of such goods from the FTA party must be made from inputs produced in the FTA region from the fiber stage forward to qualify for tariff preferences. A fiber-forward rule applies to yarns and knit fabrics of cotton and most man-made fibers.<sup>6</sup> A fiber-forward rule of origin also applies to all goods of man-made fibers (filaments or staple fibers) classified in HS chapter 56 (nonwovens and cordage), HS chapter 58 (specialty fabrics), HS heading 5902 (tire cord fabrics), and HS heading 5910 (belts and belting), and to all goods of man-made filaments classified in HS chapter 57 (carpets and rugs) and HS heading 5909 (tubing).

The main exceptions to the yarn-forward rule of origin in FTA chapter 4 that would grant duty preferences to imports of goods made in the FTA region from nonoriginating inputs are the “fabric-forward” and “single transformation” rules of origin. The fabric-forward rule applies to apparel, home textiles, and other made-up textiles of viscose rayon filament yarns, whereby imports of such goods from the FTA party must be made from inputs produced in the FTA region from the fabric stage forward to qualify for FTA preferences. Under the single-transformation rule, certain finished goods can be made of nonoriginating fabrics and still qualify for FTA preferences, provided that the goods are cut and sewn in the FTA region. This “cut and sew” rule applies to textile luggage; apparel of silk, linen, nonwoven, and coated fabrics; and women’s and girls’ knit-suit-type jackets and blazers of man-made and certain other fibers.<sup>7</sup> It also applies to knit cotton pajamas and women’s and girls’ knit cotton briefs and panties of certain nonoriginating circular-knit cotton fabrics, provided that these garments, exclusive of collars, cuffs, waistbands, or elastic, are wholly of such fabrics and the garments are cut and assembled in the FTA region.<sup>8</sup>

The cut and sew rule also applies to apparel made from woven fabrics designated in the FTA as being in short supply in the FTA region. As in past U.S. FTAs, the U.S.-Korea FTA would grant duty preferences to apparel classified in HS chapter 62 (apparel and apparel

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<sup>5</sup> The only commercially significant visible linings permitted by the U.S.-Korea FTA to be nonoriginating when used in the specified originating garments are those of silk and cuprammonium rayon.

<sup>6</sup> FTA chap. 4 permits the use of nonoriginating acrylic and modacrylic staple fibers (HS subheading 5503.30) and artificial staple fibers (such as rayon and acetate [HS heading 5504]), as well as nonoriginating silk, wool, flax, and similar vegetable fibers, in FTA-qualifying yarns. It applies a yarn-forward rule of origin to knit fabrics made from yarns of such fibers, except those of silk and flax, which can be nonoriginating. FTA chap. 4 also permits the use of nonoriginating rayon filament yarns in FTA-qualifying knit fabrics.

<sup>7</sup> The single transformation rule applies to women’s or girls’ knit-suit-type jackets and blazers of synthetic fibers (HTS subheading 6104.33), and certain other textile materials (6104.39), including artificial fibers (annex 4-A to FTA chap. 4).

<sup>8</sup> The knit cotton pajamas are classified in HTS subheadings 6107.21 (men’s or boys’) and 6108.31 (women’s or girls’); the women’s and girls’ knit cotton briefs and panties are classified in HTS subheading 6108.21. The circular knit fabrics are wholly of cotton yarns exceeding 100 metric number per single yarn and can be bleached or unbleached (HTS subheading 6006.21.10), dyed (6006.22.10), of yarns of different colors (6006.23.10), or printed (6006.24.10).

accessories, not knitted or crocheted) and made from certain nonoriginating cotton velveteen and corduroy fabrics, handwoven wool Harris Tweed, combed wool or fine-animal-hair fabrics, and polyester batiste fabrics, provided that the outer shells of the garments, exclusive of collars or cuffs, are wholly of such fabrics and that the garments are cut and assembled in the FTA region. The FTA would also grant duty preferences to men's and boys' woven shirts made from nonoriginating fine-count woven fabrics of cotton or man-made fibers.

FTA chapter 4 also contains a temporary provision that would grant duty preferences to specified quantities of imports of fabrics and apparel that are made in the FTA region from fibers, yarns, or fabrics not commercially available in the United States or Korea (Article 4.2 and Annex 4-B). It would require an importing party to grant duty preferences to such nonoriginating fabrics and apparel on the same basis as originating goods, but not to exceed an aggregate of 100 million square meters equivalent for fabrics and an identical amount for apparel in each of the first 5 calendar years of the FTA, unless the parties agree to extend the period for application of the annex. Annex 4-B contains each party's list of fibers, yarns, and fabrics not available in commercial quantities in a timely manner in its territory (Appendix 4-B to Annex 4-B) and sets out procedures that allow each party to add or delete a fiber, yarn, or fabric from its list (neither party's list currently contains any fibers, yarns, or fabrics not available in commercial quantities).<sup>9</sup>

## **FTA Chapter 5—Pharmaceuticals and Medical Devices**

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The pharmaceutical products and medical devices chapter of the U.S.-Korea FTA (FTA chapter 5) would require each party to promote access to both innovative (patented) and generic pharmaceuticals and medical devices through transparent and accountable pricing and reimbursement procedures,<sup>10</sup> regulatory cooperation, and ethical business practices.

With respect to transparency, the chapter provisions would require both parties to ensure that their laws, regulations, and general procedures related to pricing, reimbursement, and regulation are promptly published or otherwise made available so that interested persons and the other party may become familiar with them.<sup>11</sup> Further, each party would be required to publish in advance any such measures it proposes to adopt and provide interested persons and the other party a reasonable opportunity to comment on them and to have their comments taken into account in the final regulations.<sup>12</sup>

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<sup>9</sup> A side letter to FTA chap. 4 of June 30, 2007, from the U.S. Special Textile Negotiator to the Korean Deputy Minister for Major Manufacturing Industries states that Korea expressed interest in adding certain cotton sheeting fabrics, man-made fiber knit fabrics, polyester and other synthetic filament fabrics, and wool fabrics to the U.S. list in app. 4-B. The letter further states that the United States will, upon receipt of a request from the Government of Korea or another interested entity after the date of entry into force of the FTA, consider the request in accordance with the procedures set out in annex 4-B of the FTA, under which the United States will make its decision on the request within 30 business days of receiving the request unless it has insufficient information, in which case it will make its decision within an additional 30 business days.

<sup>10</sup> This FTA would be the second, after the U.S.-Australia FTA, to include a section on the pricing and reimbursement of pharmaceutical products. Chap. 5 of the U.S.-Korea FTA expands and clarifies many of the provisions of Annex 2-C of the U.S.-Australia FTA and includes medical devices in addition to pharmaceutical products.

<sup>11</sup> USTR, "Final - United States - Korea FTA Text," 2007, Article 5.3.1–5.3.4.

<sup>12</sup> With respect to regulations of its central level of government, respecting pricing, reimbursement, or regulation, each party would publish the proposed regulations, including their purpose, in a single national journal, not less than 60 days before the comment due date in most cases; address in writing significant,

The transparency provisions would also require each party's central government health authorities to have procedures in place, within a reasonable and specified time, to allow consideration of all formal requests for pricing and reimbursement of pharmaceutical products and medical devices, to disclose to applicants all rules and criteria used to determine their pricing or reimbursement, and to provide applicants with detailed written information regarding the basis for their determinations.<sup>13</sup> Further, the authorities are to afford applicants meaningful opportunities to comment at relevant points in the pricing and reimbursement decision-making processes; to make all reimbursement decision-making bodies open to all stakeholders, including manufacturers of both innovative (patented) and generic products; and to establish an independent review process that may be invoked at the request of an applicant directly affected by a reimbursement decision or recommendation.<sup>14</sup>

With regard to regulatory cooperation, and in accordance with provisions in the TBT chapter,<sup>15</sup> each party would give positive consideration to requests to recognize the results of conformity assessment<sup>16</sup> procedures for marketing approval purposes by bodies in the other party's territory.<sup>17</sup> The positive consideration would apply to requests for marketing approval of medical devices, and patented and generic pharmaceutical products.

To ensure ethical practices by pharmaceutical and medical device manufacturers or suppliers, the chapter states that each party shall prohibit "improper inducements" by manufacturers to health-care professionals or health care institutions for listing, purchasing, or prescribing drugs or devices eligible for reimbursement by central government health-care programs.<sup>18</sup> Further, it would require each party to adopt appropriate penalties and procedures to enforce measures discouraging such action.

With regard to disseminating product information on company Internet Web sites, the chapter would also permit pharmaceutical manufacturers in one of the territories to disseminate through their Internet Web sites truthful and not misleading information regarding their products that are approved for sale in the other party's territory.<sup>19</sup> Such information must include a balance of the pharmaceutical products' risks and benefits.

The chapter would establish a Medicines and Medical Devices Committee co-chaired by health and trade officials of each party to monitor and support the implementation of the

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substantive comments received from interested parties during the comment period; and explain any substantive revision made with respect to the proposed regulations at the time it adopts the final regulations. To the extent possible, each party would allow reasonable time between publication of final regulations in all matters related to pricing, reimbursement, and regulation of pharmaceutical products and medical devices and their effective date.

<sup>13</sup> USTR, "Final - United States - Korea FTA Text," 2007, Article 5.3.5.

<sup>14</sup> To ensure the independence of the review process, a side letter dated April 4, 2007 to the USTR from Korea's trade minister establishes a review body to be made up of professionals with relevant expertise and experience who are not employees or members of Korea's central government health-care authorities and have no interest in the outcome of their reviews. Such board members are appointed for a set period of time and may not be removed by the health-care authorities at Korea's central level of government.

<sup>15</sup> See chap. 5 discussion of the TBT chapter of the U.S.-Korea FTA.

<sup>16</sup> Conformity assessment refers to any procedure used, directly or indirectly, to determine that relevant requirements in standards or technical regulations are fulfilled. They may include procedures for sampling, testing, and inspection; evaluation, verification, and assurance of conformity; and registration, accreditation, and approval, as well as combinations thereof.

<sup>17</sup> USTR, "Final - United States - Korea FTA Text," 2007, Article 5.6.

<sup>18</sup> *Ibid.*, Article 5.5.

<sup>19</sup> *Ibid.*, Article 5.4.



pharmaceutical products and medical-devices-related obligations in the chapter.<sup>20</sup> Comprising members of the central government health-care programs, the committee would promote discussion and mutual understanding of the issues related to the chapter and collaboration on such issues. As such, the Medicines and Medical Devices Committee could establish working groups to address technical aspects of issues related to pricing and reimbursement, transparency, regulatory cooperation, and ethical business practices.

## **FTA Chapter 6—Rules of Origin and Origin Procedures**

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As noted above, the FTA’s tariff benefits would apply to “originating goods” unless otherwise provided in a particular provision. Such goods fall into two categories—those comprising only inputs (materials, components, and processing) from the parties and those complying with rules of origin based largely on stated changes in tariff classification from foreign inputs to finished goods. For the first category, a definition sets forth a list of goods that will qualify as being “wholly obtained or produced” in one or both parties; for the second, an annex sets forth individual rules by tariff heading or subheading. Eligibility for some goods containing third-party inputs is determined based on the level of value contributed by the parties (known as regional value content) or other specified requirements. Goods containing de minimis foreign content that does not undergo the requisite tariff shifts (limited in the aggregate for all such materials to 10 percent of the adjusted value of the good, with textile and apparel products covered by a component-based formula described in chapter 3 of the FTA) can also qualify as originating, though the value of the foreign content will still be counted as “nonoriginating” when a regional value content test applies to the good. A limited number of products—all in the agricultural sector and primarily more sensitive products such as dairy goods and certain fruits—cannot use the de minimis rule to become originating goods. In general, the principles used parallel the rules in other U.S. FTAs.

The procedural provisions set forth in this chapter are also similar to those set forth in recent FTAs. An originating material of one party that is used in the other party to make a good will be considered to originate in the latter party; a good involving production in one or both parties by multiple firms within the region will be deemed to originate if it meets the specific tests set out for that good. Rules and formulas for computing regional value content are provided, with two types of computations—the build-down method (based on the value of nonoriginating materials) and the build-up method (based on the value of originating materials)—designed to take into account all nonoriginating content. As is true under existing U.S. FTAs and preference programs, direct shipment is required, and a good that undergoes subsequent production or other operations outside the parties (not counting minor preservation or loading operations) will not be considered originating. Rules for goods classified as sets pursuant to Harmonized System (HS) general interpretive rule 3 are provided; the value requirements of all of these rules are quite technical in nature.

Other provisions of the chapter deal with consultations between the parties and the verification and documentation of origin needed under the FTA. Benefits of the FTA are to be given unless the party “issues a written determination that the claim [for preferential treatment] is invalid as a matter of law or fact” under article 6.19:1. Importers who make errors are not to be punished if they act in good faith or correct the entry documents and pay

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<sup>20</sup> Ibid., Article 5.7.

necessary duties within 1 year of importation. Written or electronic certifications of origin can be required and are valid for 4 years from the date of issuance; records establishing the origin of goods are to be kept for a minimum of 5 years after entry. The parties are to meet within 6 months of the FTA's date of entry into force to discuss whether "common guidelines for the interpretation, application, and administration" of the rules of origin and customs administration chapters of the FTA should be developed.

## **FTA Chapter 7—Customs Administration and Trade Facilitation**

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The Chapter 7 commitments of the U.S.-Korea FTA are largely the same as those negotiated in recent agreements that the United States has concluded with Peru, Colombia, and the Dominican Republic and CAFTA countries.<sup>21</sup> The chapter supports many of the General Agreement on Tariffs and Trade (GATT) goals in the areas of fees and formalities<sup>22</sup> and publication and administration of trade regulations<sup>23</sup> (table 5-1). The provisions of the FTA are intended to facilitate the goods clearance process<sup>24</sup> through greater use of information technology, to establish procedures for resolving disputes, and to improve risk management and cooperation among parties. The parties would commit to immediate cooperation in the areas of information exchange, technical advice and assistance for trade facilitation, and enforcement of customs rules and regulations. Additionally, chapter 7 calls for the immediate implementation of articles that provide for simplified release procedures,<sup>25</sup> advance publication of customs regulations,<sup>26</sup> confidential information guidelines,<sup>27</sup> review and appeal of customs matters,<sup>28</sup> and penalties for customs violations.<sup>29</sup> The agreement also includes a provision for cooperation in the implementation and operation of the Customs Valuation Agreement.<sup>30</sup> Moreover, with respect to advance rulings, the parties would commit to a 90-day period for the issue of advance rulings following request,<sup>31</sup> compared to the standard 150-day period found in previous agreements.

In the case of express shipments, such shipments would not be limited by a maximum weight or customs value, and express shipments valued at \$200 or less would not be assessed duties or taxes or be required to have any formal entry documents, except when expressly identified by each party's laws and regulations. Moreover, the period for release of express shipments would be lowered to within 4 hours of the submission of the necessary documents, compared

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<sup>21</sup> The implementation language in the U.S.-Korea FTA is stronger than that for recent agreements, in recognition of the greater capabilities of the Korean Customs Service.

<sup>22</sup> See Article VIII of the GATT.

<sup>23</sup> See Article X of the GATT.

<sup>24</sup> Parties are committed to release goods from port within 48 hours, to the extent possible.

<sup>25</sup> USTR, "Final - United States - Korea FTA Texts," 2007, Article 7.2.

<sup>26</sup> *Ibid.*, Article 7.1.3.

<sup>27</sup> *Ibid.*, Article 7.6.

<sup>28</sup> *Ibid.*, Article 7.8.

<sup>29</sup> *Ibid.*, Article 7.9.

<sup>30</sup> "The Customs Valuation Agreement of the World Trade Organization sets out a fair, uniform and neutral system for determining the value of imported goods on which customs officials levy duties. This system bars the use of arbitrary or fictitious customs values." USDOC, Trade Compliance Center, "WTO Agreement on Customs Valuation."

<sup>31</sup> USTR, "Final - United States - Korea FTA Texts," 2007, Article 7.10.

to 6 hours in recent agreements.<sup>32</sup> Like the U.S.-Peru and CAFTA-DR agreements, the U.S.-Korea FTA would require each party to adopt separate customs administration measures for express shipments. To facilitate express shipment processing, these measures would allow (1) electronic submission of documents; (2) prearrival processing of information; and (3) submission of a single manifest covering all goods in an express shipment, as well as minimized release documentation, where possible.

## **FTA Chapter 8—Sanitary and Phytosanitary Measures**

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This chapter covers the protection of human, animal, or plant life or health in the parties' territories, insofar as they directly or indirectly affect trade between them, and the enhancement of the World Trade Organization (WTO) Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement). The FTA mandates no changes to either parties SPS rules. The United States and Korea would agree to establish a Committee on Sanitary and Phytosanitary Matters to coordinate administration of the chapter (Article 6.3). The Committee would provide a forum to help each party implement the SPS Agreement, enhance mutual understanding of each government's SPS measures, resolve future bilateral SPS matters, coordinate technical assistance programs, and consult on issues and positions in the WTO, various codex committees, and in other fora. The chapter specifies that no party has recourse to dispute settlement under the FTA for any matter arising under the chapter. Any SPS issue that may require formal dispute resolution would be resolved through the formal process established under the WTO SPS Agreement.

## **FTA Chapter 9—Technical Barriers to Trade**

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Chapter 9 of the U.S.-Korea FTA would require both parties to intensify efforts to improve transparency, enhance bilateral cooperation on standards-related issues, increase mutual acceptance of one another's regulations and procedures, and reduce or eliminate unnecessary technical trade barriers.<sup>33</sup> The chapter would establish a Committee on Technical Barriers to Trade, comprising representatives of each party, to monitor the implementation and administration of the chapter and to address any issues arising from the other's standards, technical regulations, or conformity-assessment procedures.<sup>34</sup>

To improve transparency,<sup>35</sup> the chapter would require each party to allow persons from the other party to participate in the development of its standards, technical regulations, and conformity assessment procedures; to transmit proposals for new technical regulations and conformity assessment procedures electronically to the other party at the same time they are transmitted to the WTO pursuant to the TBT agreement; to allow the other party at least 60 days to review and comment on such proposals; and to publish or otherwise make available to the public its responses to significant comments no later than the date it publishes the final

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<sup>32</sup> UPS endorses the agreement, citing its "vital provisions for the express delivery industry, including enhanced market access and improved customs clearance times." United Parcel Service, "UPS Applauds New Trade Deal with South Korea (April 5, 2007)."

<sup>33</sup> USTR, "Final-United States - Korea FTA Text," 2007, Articles 9.4–9.6.

<sup>34</sup> *Ibid.*, Article 9.8.

<sup>35</sup> The transparency provisions of the U.S.-Korea FTA TBT chapter are consistent with overall U.S. trade negotiating objectives of increased transparency, public access, and timely publication.

technical regulation or conformity assessment procedure.<sup>36</sup> The FTA provisions would encourage each party to consider a broad range of alternatives for accepting the results of the other's conformity-assessment procedures and technical regulations, and, when this is not possible, to explain why.<sup>37</sup>

The TBT chapter would also include unique provisions to address standards- and regulatory-related issues specifically affecting the automotive industry, such as automotive emissions standards, safety standards, and onboard diagnostics requirements.<sup>38</sup> Further, the chapter would establish an Automotive Working Group<sup>39</sup> to, among other things, resolve issues that either party raises with respect to developing and enforcing standards, technical regulations, and conformity-assessment procedures for the automotive sector.<sup>40</sup>

## **FTA Chapter 10—Trade Remedies**

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Section A of Chapter 10 contains a bilateral safeguard provision similar to bilateral safeguard provisions in other free trade agreements that the United States has entered into in recent years. It would allow a party to increase a rate of duty or suspend further reductions in the rate of duty if its designated competent authority finds, as a result of the reduction or elimination of a duty under the agreement, that imports of a good are in such increased quantities as to be a substantial cause of serious injury, or a threat of serious injury, to a domestic industry producing a like or directly competitive good. No duty could be increased to an amount that exceeds the lesser of the current MFN rate of duty or the rate in effect immediately preceding the date of entry into force of the agreement. The duration of any measure could not exceed 2 years, except that the period could be extended by up to 1 year if certain conditions are found to be present. A measure that exceeds 1 year must be progressively liberalized at regular intervals. A party could not apply a bilateral safeguard measure more than once against the same good, and a measure could not be applied beyond the transition period except with the consent of the other party.

A party applying a measure must provide compensation to the other party in an amount mutually agreed upon; if the parties are unable to agree on compensation, the other party could suspend concessions with respect to originating goods of the party applying the safeguard measure that have trade effects substantially equivalent to the safeguard measure. The FTA allows a party to apply a measure on a provisional basis (for up to 200 days) when critical circumstances are found to exist. The agreement defines terms and sets out certain procedural requirements, including notification consultation requirements. Each party would retain its rights and obligations under Article XIX of the GATT 1994 and the WTO

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<sup>36</sup> USTR, "Final-United States - Korea FTA Text," 2007, Article 9.6.

<sup>37</sup> *Ibid.*, Article 9.5.

<sup>38</sup> Lee, testimony before the USITC, June 20, 2007, 15.

<sup>39</sup> The Automotive Working Group is to provide an "early warning system" to address standards, certification, and other regulatory issues that could develop in the future. When Korea develops new regulatory requirements, it is obligated to provide such information to the working group as soon as the information becomes available. The working group is to analyze potential new regulations and provide its views to the Korean government for purposes of promoting good regulatory practices. *U.S.-Korea FTA*, Annex 9-B; USTR, "Trade Facts: Fact Sheet on Auto-Related Provisions in the U.S.-Korea Free Trade Agreement," April 3, 2007, 1–2; and USTR, "Fact Sheet: Free Trade with Korea, Brief Summary of the Agreement," April 2007, 1.

<sup>40</sup> For additional information on the specific automotive standards issues to be addressed, see the sector-specific assessment for this industry in chap. 3 of this report.

Safeguards Agreement. The chapter, however, would provide that a party applying a (global) safeguard measure under the WTO Safeguards Agreement could exclude imports of a good from the other party if such imports from the other party are not a substantial cause of serious injury or threat thereof.

Section B states that each party would retain its rights and obligations under the WTO agreement with regard to the application of antidumping and countervailing duties. It states that, with the exception of paragraphs 3 and 4 of Article 10.7 (which relate to notification and consultations and certain “undertakings”), no provision of the agreement should be construed as imposing any rights or obligations on a party with respect to antidumping or countervailing duty measures. In a departure from previous FTAs, paragraph 3 would require that a party, upon receipt of an application and before initiating an investigation, provide notice to the other party and opportunity for a meeting.<sup>41</sup> Also new in this FTA, paragraph 4 of Article 10.7 would require the parties, after making a preliminary affirmative determination of dumping or subsidization and injury caused by such dumping or subsidization, to consider “undertakings” with respect to price and, in countervailing duty investigations, quantity, which may result in suspension of the investigation without the imposition of antidumping or countervailing duties.<sup>42</sup>

In another departure from previous FTAs, section C would provide for the establishment of a Committee on Trade Remedies, comprising representatives from each party who have responsibility for trade remedies matters, including antidumping, subsidies and countervailing measures, and safeguard issues. The functions of the Committee would include enhancing knowledge of each other’s trade remedy laws, policies, and practices; overseeing implementation of the chapter, including compliance with paragraphs 3 and 4 of Article 10.7; improving cooperation between the parties’ agencies having responsibilities for trade remedies matters; providing a forum for the parties to exchange information on issues relating to antidumping, subsidies and countervailing measures, and safeguards; establishing and overseeing development of educational programs related to the administration of trade remedy laws for officials of both parties; and providing a forum for the parties to discuss other relevant topics of mutual interest. These relevant topics would include international issues related to trade remedies (e.g., issues relating to the WTO Doha Round rules negotiations), practices by the parties’ competent authorities in antidumping and countervailing duty investigations (such as application of “facts available” and verification

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<sup>41</sup> More specifically, paragraph 3 of Article 10.7 requires that a party, upon receipt of a properly documented antidumping or countervailing duty application with respect to imports from the other party, and before initiating an investigation, provide written notification to the other party of its receipt of the application and afford the other party a meeting or similar opportunity regarding the application, consistent with the party’s law.

<sup>42</sup> Paragraph 4 lists three “undertakings.” First, after initiation of an antidumping or countervailing duty investigation, a party agrees to transmit to the other party’s embassy or competent authorities written information regarding their procedures for requesting consideration of an undertaking on price or, as appropriate, quantity, including the time frames for offering and concluding any such undertaking. Second, in an antidumping investigation in which a party’s authorities have made a preliminary affirmative determination of dumping and injury, the party must afford “due consideration, and adequate opportunity for consultations” to exporters of the other party regarding proposed price undertakings, which, if accepted, may result in suspension of the investigation without imposition of antidumping duties, through the means provided for in the party’s laws and procedures. Third, in a countervailing duty investigation in which party authorities have made a preliminary affirmative determination of subsidization and injury, the party must afford “due consideration and adequate opportunity for consultations” to the other party, and exporters of the other party regarding proposed undertakings on price, or, as appropriate, on quantity, which, if accepted, may result in suspension of the investigation without imposition of countervailing duties, through the means provided for in the party’s laws and procedures.

procedures), and practices of a party that may constitute industrial subsidies. Section C would require that the Committee meet at least once per year.

## **FTA Chapter 11—Investment**

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The two principal objectives of the FTA investment chapter are to create a welcoming environment for investors from each party by outlining the rights of investors and the rules that govern new cross-border investment, and to provide a clear outline of the investor-state dispute settlement process. Section A of the chapter outlines the rules that would govern new investments, and would set forth the types of investments to which these rules apply.<sup>43</sup> Specifically, the FTA would require each party to give national and MFN treatment to investors and covered investments of the other party. The treatment of investors under the FTA must comply with but need not go beyond customary international law. Other provisions include:

1. Expropriation could be only for a public purpose; it must be nondiscriminatory and accompanied by payment of prompt, adequate, and effective compensation in accordance with due process of law.
2. All financial transfers relating to covered investments, including, but not limited to, contributions to capital, payment of interest, and payments under contracts, could cover the full value of the investment and must be permitted freely and without delay.
3. Neither party could impose or enforce performance requirements as a condition of investment.<sup>44</sup>
4. Neither party could require that senior management or boards of directors be of any particular nationality.

The benefits of this chapter could only be denied in limited, delineated instances involving persons of a nonparty to the FTA. This section of the chapter also deals with NCMs, and special formalities and information requirements.

Section B of this chapter would provide for consultation and negotiation of disputes under the investor-state dispute settlement process, and provides detailed information and procedures for pursuing dispute settlement, including submission of claims to arbitration, selection of arbitrators, conduct of the arbitration, transparency of the arbitral proceedings, governing law, and awards of monetary damages (not including punitive damages) or restitution. Under the terms of the provisions of Section B, each party would consent to claims being submitted to arbitration under specified rules according to the process outlined in the FTA. The awards made by any arbitration tribunal would have binding force only between the disputants and with regard to the particular case. Transparency would be required, along with public hearings.

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<sup>43</sup> Investment related to financial services is covered separately in the financial services chapter (FTA Chap. 13).

<sup>44</sup> Such provisions may include requirements to export a given level or percentage of goods or services, to purchase goods produced in a party's territory, or to transfer a certain technology or other proprietary information.

Section C of the chapter contains definitions of terms and relevant conventions for use in the resolution of investment disputes. Annex 11-A defines “customary international law” for purposes of the chapter, while Annex 11-B deals with expropriation (direct and indirect) in some detail. To be considered expropriation, a party’s action or series of actions would be required to interfere “with a tangible or intangible property right or property interest in an investment.” Under a side letter to the FTA, the parties would agree that such property rights would include rights under contract and all other property rights in an investment, as defined in Article 11.28. Other annexes deal with the service of documents in such matters and the establishment of a possible future appellate body.

Annex 11-E—known as the “fork in the road provision”—would require a U.S. investor to choose to pursue an investment claim either in the Korean court system or under the FTA’s investor-state dispute settlement process. Annex 11-F deals with taxation and expropriation. Specifically, the annex lists factors to be considered in determining whether a taxation measure can be considered an expropriation, clarifying that most tax measures are not instances of expropriation. Annex 11-G lays out the conditions under which Korea could restrict capital transfers through its Foreign Exchange Transactions Act, so that those restrictions will not be subject to dispute settlement through arbitration.

### ***Nonconforming Measures Related to Investment***

Provisions for the treatment of existing or future measures that are inconsistent with the agreement’s investment disciplines are included in each party’s Annexes I, II, and III of the FTA. Annex I lists exemptions for existing laws or regulations, maintained at the central or regional government level, that might violate the provisions of the agreement. NCMs at the local government level would be exempted without requiring any notation in an annex.<sup>45</sup> Annex II lists reservations to ensure that a party maintains flexibility to adopt or maintain measures that would be inconsistent with FTA disciplines. The actual content of the reservations in Annexes I and II varies widely. Some reservations are horizontal in nature, meaning that they address general policy provisions that affect all investment, whereas others only apply to investment in specific industries. Annex III lists NCMs specific to financial services relating to both existing and potential laws and regulations.<sup>46</sup>

Korea has not included any investment-related horizontal reservations under Annex I. Five horizontal reservations (reservations that pertain to investment in any sector) are listed by Korea under Annex II. Under the first, Korea would reserve the right to adopt any measure deemed necessary for the maintenance of public order, provided that such measures are applied in accordance with Korean law, and not applied in an arbitrary manner or as a disguised restriction on investment. The second reservation states that Korea would be able to impose any measure related to the transfer or disposition of equity interests or assets held by state-owned enterprises or governmental authorities. The third reservation specifies the conditions under which foreign persons would be permitted to purchase land. In particular, Korea would reserve the right to adopt any measure related to the acquisition of farmland by foreign persons. The fourth reservation would accord differential treatment to countries that have signed any other bilateral or multilateral international agreements with Korea, prior to the entry into force of the U.S.-Korea FTA, and specifically those agreements involving

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<sup>45</sup> USTR, “Final - United States - Korea FTA Texts,” 2007, Article 11.12(1)(a)(iii).

<sup>46</sup> Annex III is discussed in app. I, in the discussion of financial services.

aviation, fisheries, or maritime matters. Under the fifth reservation, Korea would maintain the right to impose restrictions on investment in services supplied by the government, such as law enforcement and correctional services. This measure would not apply to investors that supply such services through agreements with the Korean government, or to financial services. Other reservations are limited to specific industries or sectors.

Horizontal reservations taken by the United States under Annex I would address the programs of the Overseas Private Investment Corporation and the registration of public offerings of securities, as well as existing NCMs at the regional (state) level. Appendix I-A of Annex I for the United States provides an illustrative list of NCMs maintained at the regional (state) level.<sup>47</sup> Under Annex II, the only horizontal reservation listed by the United States that applies to investment mirrors the reservation taken by Korea, which would accord differential treatment to countries under international agreements that have been signed prior to the entry into force of the U.S.-Korea FTA.

The specific sectors for which investment-related reservations are listed in Annex I are presented in table 6-1, and potential measures listed in Annex II are presented in table 6-2.<sup>48</sup> In several cases, the reservation indicates a potential constraint on foreign investment that may not have a significant effect on investors' activities or business results. Consequently, the inclusion of a sector in an annex does not mean that the entire sector has been exempted from coverage by the investment disciplines of the FTA.

## **FTA Chapter 12—Cross-Border Trade in Services**

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Chapter 12 of the FTA covers measures of the parties that affect cross-border services other than financial services, air transport, and gambling and betting services.<sup>49</sup> The FTA would guarantee national and MFN treatment for providers of the covered services, and it includes measures adopted or maintained by all levels of government, as well as certain nongovernmental bodies. Commercial presence is not required, and regulation of services and qualification requirements may not be unduly burdensome. Chapter 12 also includes regulatory transparency provisions beyond those delineated in the transparency chapter,<sup>50</sup> which would lay out requirements for the publication of proposed regulations and the input of interested parties.<sup>51</sup> The parties would be permitted, but not required, to recognize education, experience, licenses, or certifications obtained in particular nonparty countries. As to market access, the chapter would bar measures that impose specific limitations, such as numerical limits on the number of suppliers of a service.

The parties would commit to permit unfettered transfers and payments relating to the cross-border supply of services, and must allow such transactions to occur in a freely usable currency at the prevailing exchange rate on the date of transfer, subject to explicit

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<sup>47</sup> This list is provided for transparency purposes only, and is not meant to be binding on the U.S. government or any state government.

<sup>48</sup> Investment-related reservations related to financial services, including insurance, are listed in Annex III, and are presented in appendix I of this report.

<sup>49</sup> Gambling and betting services are excluded due to provisions included in a side letter. Air transportation is covered by a separate bilateral "open skies" agreement. See <http://www.state.gov/e/eeb/tra/c661.htm> for additional information.

<sup>50</sup> For additional information on the FTA chap. 21 covering transparency, see chap. 6 of this report.

<sup>51</sup> USTR, "Final - United States - Korea FTA Texts," 2007, Chap. 12 Article 12.8, 12-4.



exceptions. The benefits of this chapter may be denied under limited circumstances if the service supplier is controlled by persons of a nonparty.

FTA chapter 12 includes specific language on express delivery services that defines the scope of coverage, confirms the desire to maintain market access no less favorable than that in effect when the FTA was signed, and delineates the relationship between covered services and each party's postal monopoly.<sup>52</sup> Additionally, two side letters express Korea's intention to reform its postal system to reduce the number of services, including international delivery, that may be provided solely by the Korean Postal Authority. The side letters also state that Korea would, over time, ensure independent regulation of the postal and express delivery systems.

Annex 12-C of the agreement would provide for consultations between the parties regarding NCMs maintained by regional levels of government. Finally, a side letter included would clarify that various regulations currently maintained by the parties are not inconsistent with the agreement. These regulations include the prohibition of holding more than one license to provide multiple services and various regulations governing educational institutions and rail transportation.

### ***Professional Services***

Provisions of the FTA related to cross-border trade in professional services are not included in a separate chapter, but instead Annex 12-A to chapter 12 covers measures related to licensing and certification of the other party's professional services suppliers. The annex would commit each party, upon request, to provide information including the appropriate regulatory or other bodies to consult on standards and criteria<sup>53</sup> for licensing and certification of professional services suppliers. Upon agreement, each party must encourage relevant bodies to develop mutually acceptable standards and criteria for licensing and certification of professional services suppliers, to make recommendations on mutual recognition, and to develop procedures for the temporary licensing of the other party's professional service suppliers, in particular those supplying engineering, architectural, and veterinary services.

To facilitate these activities, the annex would commit the parties to establish a Professional Services Working Group,<sup>54</sup> comprising representatives of both parties, which is to meet by mutual consent within 1 year of the FTA's entry into force. The Working Group would consider issues pertaining to professional services generally as well as individual professional services. The scope of work would include developing procedures to encourage mutual recognition arrangements and model procedures for licensing and certification, addressing regional-level government measures inconsistent with market access and national treatment, and discussing other mutual interests affecting the supply of professional services.

The Working Group must consider bilateral, plurilateral, and multilateral agreements related to professional services. Within 2 years after the FTA's entry into force, the Working Group must report on progress, including any recommendations on promoting mutual recognition

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<sup>52</sup> Ibid., Chap. 12 Annex 12-B, 12-11.

<sup>53</sup> Such standards and criteria may address education, examinations, experience, conduct and ethics, professional development and recertification, scope of practice, local knowledge, and consumer protection.

<sup>54</sup> USTR, "Final Text of the U.S.-Australia Free Trade Agreement." The U.S.-Australia Free Trade Agreement provided for a similar working group on professional services.

of standards and criteria and on temporary licensing, as well as a preview of its future work program. The parties must review such recommendations within a reasonable time frame to determine consistency with the FTA. Upon a favorable review, each party commits to work with and encourage its respective bodies to implement the recommendations within a mutually agreed time. The annex would further require parties to review implementation of the provisions of the annex at least once every 3 years.

The FTA includes Korean NCMs that apply to cross-border trade in professional services supplied by foreign lawyers, accountants, architects and engineers, and by others in numerous occupations identified by Korea as professional services. The most prevalent NCMs would require licensing and registration by Korean authorities and reserve the establishment of and investment in prescribed professional services entities solely to Korean-licensed professionals. For example, only a registered Korean-licensed lawyer may supply legal services and establish and/or invest in any of four categories of legal entities.<sup>55</sup>

Three categories of accounting and auditing entities in Korea, each able to be established only by a Korean certified public accountant (CPA), are the sole authorized suppliers of accounting and auditing services in Korea.<sup>56</sup> Suppliers of labor-affairs consulting services or customs-clearing services in Korea must be licensed in Korea and establish an office there. Another Korean NCM would require local presence in order to supply architectural, engineering, integrated engineering, urban planning, and landscape architectural services in Korea, except for a foreign architect in a joint contract with a Korean-licensed architect.<sup>57</sup>

Korea's NCMs would also preserve the right to adopt or maintain restrictions on foreign legal consultants (FLCs), CPAs, and certified tax accountants to a greater extent than in other free trade or trade preference agreements negotiated by the United States. Under the exception for FLCs, Korea can place any requirements on foreign-country-licensed lawyers or foreign law firms supplying any type of legal service in Korea, entering into any relationship with Korean law firms, or entering such relationships or hiring Korean-licensed lawyers, other legal practitioners, CPAs, certified tax accountants, and customs brokers. Korea would commit to a three-phase removal of certain restrictions on the activities of FLCs in Korea. Upon the FTA's entry into force, Korea would allow a U.S. law firm to establish an FLC office in Korea and allow U.S.-licensed lawyers to supply legal advisory services on home-country law and international law as FLCs in Korea. Within 2 more years, Korea would allow FLC offices to conclude a cooperative agreement with a Korean law firm, to include profit sharing, in cases with mixed Korean and non-Korean legal affairs. Within 5 years of the FTA's entry into force, Korea would allow the creation of joint ventures between U.S. and Korean law firms, which may include employing Korean-licensed lawyers as partners or associates, although Korea would preserve the right to impose restrictions on voting shares or equity interests.

Similarly, Korea reserves the right to restrict the hiring of Korean-registered CPAs by foreign CPAs or non-Korean-registered accounting corporations, or the supply of auditing services in Korea by foreign CPAs. By or before the FTA's entry into force, Korea would allow U.S.-registered CPAs or accounting corporations constituted under U.S. law to

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<sup>55</sup> Moreover, certified judicial scriveners and notaries public must establish in the jurisdiction of the court or public prosecutor's office, respectively, in which they practice.

<sup>56</sup> Only Korean-authorized CPAs working in one of two categories of establishment may provide auditing services on public companies in Korea. Similar requirements exist for certified tax accountants in Korea.

<sup>57</sup> Local presence requirements also apply to the supply of safety and health management or diagnostic services, or related consulting services, to industrial workplaces.

establish offices in Korea to provide accounting consultancy services on U.S. or international accounting laws and standards. U.S. CPAs could also work in Korean accounting corporations. U.S. CPAs would be allowed to invest in a Korean accounting corporation within 5 years of the FTA's entry into force, although a single U.S. CPA will be limited to less than 10 percent of voting shares or equity interests and Korean-registered CPAs would hold at least 51 percent. Korea included similar exceptions for restrictions and gradual, limited opportunities for participation with respect to foreign certified tax accountants.

### ***Audiovisual Services***

The provisions that directly address audiovisual services are found in the NCMs for services and investment in Annexes I and II and also in two side letters under chapter 18 (intellectual property rights) of the FTA. Under Annex I, Korea has included two current NCMs relating to broadcasting services and motion picture services. Under the detailed broadcasting services reservation, foreign or Korean nationals may not serve as a principal senior officer for both a foreign enterprise and a terrestrial, satellite, or cable broadcasting operator or a similar type of program provider in Korea. All members of the boards of directors of public broadcasters Korea Broadcasting System and Educational Broadcasting System must be Korean nationals, and licenses to operate terrestrial, cable, or satellite broadcasts may only be granted to or held by the Government of Korea or local Korean governments or persons. Additionally, Korea stipulates various foreign equity limits for broadcasting and cable operators and sets varying local content quotas for their programming. Examples of such requirements include the following: no foreign government or person may hold an equity interest in a terrestrial broadcaster, cable operator, or program provider that is engaged in multigenre programming<sup>58</sup> or news reporting; 80 percent of quarterly programming hours for terrestrial broadcasters or program providers must be Korean content; 45 percent of a terrestrial broadcaster's annual animation programming hours must be Korean content; and 20 percent of a cable system or satellite operator's annual movie programming must be Korean content. Under the motion picture services reservation, Korea would require that Korean motion pictures must be projected for at least 73 days per year at each Korean screen.

Under Annex II, Korea has included broad NCMs for potential future measures relating to audiovisual services. For example, Korea has reserved the right to adopt or maintain any measure that accords differential treatment to persons of other countries involving the sharing of direct-to-home and direct broadcasting satellite television services.<sup>59</sup> Korea has likewise reserved the right to limit cross-ownership across media sectors and to adopt or maintain any measure with respect to a supplier of subscription-based video services. Korea has also listed potential reservations with regard to coproduction arrangements for film or television productions, criteria to determine whether audiovisual programs are "Korean," measures dealing with digital audio or video services, and measures with respect to motion picture promotion, advertising, or postproduction. Lastly, the U.S. and Korean governments would also agree to two relevant side letters under chapter 18 (intellectual property rights)

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<sup>58</sup> Multigenre programming refers to a program provider that offers a combination of news, entertainment, drama, movies, music programming, etc. USTR, "Final - United States - Korea FTA Texts," 2007.

<sup>59</sup> The United States also made this reservation under Annex II. In addition, under Annex I, the United States made a single reservation, which restricts investment in U.S. radiocommunications firms by foreign governments. These were the only two NCMs the United States specified with regard to audiovisual services in the FTA.

of the FTA that impose unilateral obligations on the Korean government to prevent online piracy, whether by amending its law or dedicating additional resources.

## **FTA Chapter 13—Financial Services**

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Chapter 13 of the FTA would generally require each party to allow cross-border trade in financial services, accord national treatment and MFN treatment to investors of the other party, and provide market access without limitations on the number of financial institutions, value of transactions, number of service operations, or number of persons employed.

As in previous bilateral U.S. FTAs, cross-border trade would be limited to certain segments of the financial services industry, as outlined in Annex 13-A. For insurance, FTA coverage of cross-border trade would be limited to marine, aviation, and transit (MAT) insurance; reinsurance and retrocession,<sup>60</sup> services auxiliary to insurance, such as consultancy, risk assessment, actuarial and claim settlement services; and insurance intermediation services such as brokerage and agency services. For banking and securities, FTA coverage of cross-border trade would be limited to the provision and transfer of financial information and financial data processing, advisory, and other auxiliary financial services as defined in the text of the chapter. The provision regarding financial data processing, however, does not go into effect until two years following entry into force of the agreement. Cross-border intermediation services (i.e., deposit taking and lending) would be excluded from the agreement.

Each party would be required to permit a financial institution of the other party to provide new financial services on the same basis that it permits its own domestic institutions to provide, without additional legislative action. The chapter would not require either party to furnish or allow access to information related to individual customers or confidential information, the disclosure of which would impede law enforcement, be contrary to the public interest, or prejudice legitimate commercial concerns.

Under chapter 13, neither party could require financial institutions of the other party to hire individuals of a particular nationality as senior managers or other essential personnel, nor could a party require more than a minority of the board of directors to be nationals or residents of the party. The parties would agree that transparent regulations and policies are important, commit to publishing in advance all regulations of general application, and agree to maintain or establish mechanisms to respond to inquiries from interested persons. Where a party requires membership in a self-regulatory organization, the chapter would provide that such organizations will be subject to the national treatment and MFN obligations of this chapter.

The FTA would establish a Financial Services Committee to implement the provisions of chapter 13. Chapter 13 would also provide for consultations and dispute resolution, and includes cross references to the provisions covering dispute settlement procedures. Under the FTA, parties may retain specific financial services measures that do not conform to the FTA by including the measures in Annex III of the agreement. For example, Korea included

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<sup>60</sup> Retrocession is defined as risk accepted by a reinsurer, which is then transferred to another reinsurance company.

as an NCM a regulation<sup>61</sup> that requires a branch of a bank or securities company constituted under the laws of another country to bring and maintain operating funds within Korea.<sup>62</sup>

## **FTA Chapter 14—Telecommunications**

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The provisions of Chapter 14 would require each party to ensure that enterprises of the other party have access to and use of any public telecommunication service offered in its territory and/or across its borders on reasonable and nondiscriminatory terms and conditions. Specifically, the chapter would obligate suppliers of public telecommunications services to provide network interconnection, number portability, and dialing parity to telecommunication service providers of the other party on reasonable and nondiscriminatory terms and conditions. In addition, major suppliers of one party would be required to offer telecommunication services to suppliers of the other party on terms and conditions no less favorable than those accorded to their own subsidiaries, affiliates, and nonaffiliated service suppliers, particularly regarding the availability, provisioning, rates, and quality of such services. Major suppliers would also be subject to specific additional obligations related to competitive safeguards, services resale, network unbundling, interconnection, leased circuits, colocation,<sup>63</sup> and access to rights-of-way and submarine cable systems.

Chapter 14 would commit the governments of the United States and Korea to ensure the independence of their respective telecommunications regulatory bodies and bestow such entities with the authority to enforce compliance with FTA obligations. The parties to the agreement also would be required to maintain transparent and nondiscriminatory procedures related to licensing, allocation and use of scarce resources, and dispute resolution. A variety of exclusions for mobile services providers, nonfacilities-based providers, and rural telecommunication services are contained in Annex 14-A and Annex 14-B, while Annex 1 to the FTA would establish several restrictions on foreign investment in Korea's telecommunications sector.<sup>64</sup>

## **FTA Chapter 15—Electronic Commerce**

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The provisions relating to electronic commerce within the U.S.-Korea FTA are similar to those of previous FTAs. In general, the U.S.-Korea FTA (1) would provide for nondiscriminatory and duty-free treatment of all digital products, whether delivered electronically or in physical form; (2) contains commitments by both parties to facilitate the

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<sup>61</sup> This regulation is based on Korean legislation, namely The Banking Act and the Securities and Exchange Act.

<sup>62</sup> U.S. industry representatives contend that this requirement is reasonable. U.S. industry representative, telephone interview with Commission staff, June 1, 2007.

<sup>63</sup> Colocation is defined as physical access to space in order to install, maintain, and repair equipment at premises owned, controlled, or used by a supplier of public telecommunications services.

<sup>64</sup> Annex 1 to the FTA states that foreign ownership may not exceed 49 percent of the total voting shares of facilities-based suppliers of public telecommunications established in Korea. Similarly, a license for facilities-based telecommunication services will not be granted to entities in which foreign owners control more than 49 percent of total voting shares. In addition, foreign owners may not be the largest shareholder in Korea Telecom, unless foreign owners hold less than 5 percent of total voting shares. Two years after the FTA enters into force, Korea shall permit foreign ownership of 100 percent of the total voting shares of a facilities-based supplier of public telecommunication services (except for KT and SK Telecom), which in turn may hold a license for facilities-based public telecommunication services.

use of electronic authentication in their respective markets; and (3) includes principles that ensure consumers' reasonable access to the Internet to conduct electronic commerce.

First, under the U.S.-Korea FTA, the parties would commit to nondiscriminatory treatment of digital products and agree not to impose customs duties, fees, or other charges on such products, whether traded in physical form or electronically over the Internet. In addition, the parties would agree not to accord less favorable treatment to some digital products than are accorded to other like products because they were created, stored, transmitted, published, or first made commercially available outside its territory, or because of the nationality of the author, performer, producer, developer, or distributor of such digital products.

Second, the U.S.-Korea FTA is aimed at ensuring that the parties accept the validity of electronic authentication and electronic signatures. Neither party, for example, may deny the legality of a signature solely because it is in electronic form.

Finally, the U.S.-Korea FTA includes provisions that are intended to promote and maintain online consumer protection, including those that foster cooperation in enforcing laws against fraudulent and deceptive e-commerce practices. The FTA introduces principles not included in previous FTAs that would promote consumer access to the Internet to conduct electronic commerce, and that would emphasize the importance of maintaining unrestricted cross-border information flows. Such principles likely reflect the rapid growth of both business-to-business and business-to-consumer electronic commerce in Korea in recent years.<sup>65</sup>

## **FTA Chapter 16—Competition-Related Matters**

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Chapter 16 of the FTA would address competition policy, designated monopolies, and state enterprises, with the objective of proscribing anticompetitive business conduct in order to promote economic efficiency and consumer welfare.<sup>66</sup> The chapter would obligate the United States and Korea to maintain competition laws that protect and promote competitive business conditions by proscribing anticompetitive business conduct that might hinder bilateral trade and investment, to maintain authorities responsible for enforcement of these laws on terms of national treatment and MFN treatment, and to provide transparent and nondiscriminatory due-process means to remedy disputes under the FTA concerning violations of these competition laws.

The chapter would permit either party to establish or maintain a designated monopoly or state enterprise, but would obligate each party to ensure that such designated enterprises operate in accordance with normal commercial practices that do not abuse their special status, which might otherwise, as a result, create obstacles to bilateral trade and investment.<sup>67</sup> Under the agreement, designated monopolies and state enterprises would be permitted to charge different prices in the marketplace where such differences are based on normal commercial considerations such as supply and demand conditions. The chapter's provisions governing designated monopolies do not apply to government procurement. Upon request, a party would need to provide public information on designated monopolies and state enterprises at any government level, or on exemptions and immunities to its competition

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<sup>65</sup> KIEC, Republic of Korea, "Korea e-Commerce: Infrastructure."

<sup>66</sup> USTR, "Final - United States - Korea FTA Texts," 2007, Article 16.1.

<sup>67</sup> *Ibid.*, Article 16.2, and Article 16.4.

laws, if furnished with specifics regarding particular products and markets as well as indications that an entity’s business behavior or exemption from competition laws may be hindering bilateral trade or investment.<sup>68</sup>

The chapter includes provisions covering transparency, cross-border consumer protection, consultations, dispute settlement, and definitions of terms.<sup>69</sup> The chapter’s cross-border consumer protection provisions would require the United States and Korea to cooperate on matters of mutual concern concerning consumer protection laws to enhance consumer welfare.<sup>70</sup>

The United States Federal Trade Commission, Korea Fair Trade Commission (KFTC), and Korea Ministry of Finance and Economy are to “endeavor to strengthen cooperation” through the exchange of information related to new and current consumer protection laws, including consultations on how to reduce and prevent fraudulent and deceptive commercial practices, and violations of consumer protection laws with significant cross-border aspects. The parties are to aim at identifying obstacles to effective cross-border cooperation in the enforcement of their own consumer protection laws, and are to consider modifying their domestic frameworks to overcome such obstacles.

Upon request, the parties would meet to consult on specific matters raised under the provisions of the chapter, when the requestor indicates how the matter affects bilateral trade or investment.<sup>71</sup> Under the agreement, neither party may challenge through dispute settlement the chapter’s core goals and obligations regarding national competition laws or proscribing anticompetitive business conduct, the chapter’s provisions on cross-border consumer protection, or the chapter’s obligations concerning consultations.<sup>72</sup>

## **FTA Chapter 17—Government Procurement**

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Chapter 17 of the FTA would address procurement of goods and services by any contractual means—purchase, lease, rental, hire, etc.—where the value of the contract reaches or exceeds the threshold level for procurement contracts issued by the government entities listed in the annex to the chapter. The procurement covered under the chapter is government procurement and may not involve commercial sale, resale, or use in commercial production. Exclusions would include (1) noncontractual agreements or assistance in the form of grants, loans, fiscal incentives and guarantees, equity infusions, and the like; (2) procurement by a fiscal or similar agency, services related to regulated financial institutions, and matters related to public debt, government bonds, notes, and other securities; and (3) procurement specifically for the provision of international assistance, including development aid. Procurement under the chapter would cover digital/information technology products, although the FTA chapter on electronic commerce imposes no further obligation regarding procurement of digital products.

Both the United States and Korea are signatories to the WTO Agreement on Government Procurement (GPA), and the FTA chapter on government procurement reaffirms both

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<sup>68</sup> Ibid., Article 16.5.

<sup>69</sup> Ibid., Article 16.5, Article 16.6, Article 16.7, Article 16.8, and Article 16.9.

<sup>70</sup> Ibid., Article 16.6.

<sup>71</sup> Ibid., Article 16.7.

<sup>72</sup> Ibid., Article 16.8.

parties' rights and obligations under the GPA.<sup>73</sup> The chapter would also affirm both parties' determination to apply the Asia-Pacific Economic Cooperation (APEC) Non-Binding Principles on Government Procurement for government procurement that falls outside the scope of the GPA and FTA chapter 17.<sup>74</sup> As a consequence, the FTA would follow the GPA provisions concerning most government procurement matters, including national treatment and market access for goods, cross-border trade in services, and financial services and investment.<sup>75</sup> For all government procurement covered in the FTA, chapter 17 would apply the GPA provisions concerning unlisted entities, contract valuation, national treatment and nondiscrimination, rules of origin, technical specifications, and many tendering procedures such as supplier qualification, participation, documentation, awards, limited tendering, offsets, and challenge procedures.<sup>76</sup> The FTA would incorporate the GPA articles covering such subjects, as well as the GPA notes and appendices, including GPA rules governing technical specifications to promote the conservation of natural resources or to protect the environment.<sup>77</sup>

Chapter 17 would further address the use of electronic means for conducting government procurement covered under the FTA, and clarify the GPA provisions on contract valuation to include the estimated maximum total value of the procurement over its entire duration, including all forms of fees, commissions, premiums, or other revenue streams that the procurement may generate.<sup>78</sup> The chapter provisions also aim to ensure that suppliers may qualify and participate in a procurement tender less on narrowly drawn criteria—such as previously awarded procurement contracts or previous work undertaken in Korea—and more on principles aimed at allowing broader participation.<sup>79</sup>

The chapter provisions would require notice of intended procurement in the appropriate electronic medium, and would require that sufficient, common periods be provided, taking into account issues such as the complexity of the procurement, the likely extent of subcontracting required, and time to transmit tenders from foreign locations when electronic means are not used.<sup>80</sup> A number of minimum tender periods are set out in the chapter that depend on various factors such as procurement in urgent situations or selective procurement, but in no case can the period for tendering be less than 10 days from published notice of an intended procurement to final date for tender submission, with periods usually ranging from 35 to 40 days.<sup>81</sup>

The agreement would provide for consultations and possible compensatory adjustments if modifications are made to the coverage under the chapter's annex.<sup>82</sup> The chapter also establishes a Working Group on Government Procurement that would meet to consider issues regarding government procurement and to exchange information.<sup>83</sup>

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<sup>73</sup> Ibid., Article 17.1.

<sup>74</sup> Ibid., Article 17.1.

<sup>75</sup> Ibid., Article 17.2.

<sup>76</sup> Ibid., Article 17.3.

<sup>77</sup> Ibid., Article 17.3 and Article 17.7.

<sup>78</sup> Ibid., Article 17.4.

<sup>79</sup> Ibid., Article 17.5.

<sup>80</sup> Ibid., Article 17.6.

<sup>81</sup> Ibid., Article 17.8.

<sup>82</sup> Ibid., Article 17.9.

<sup>83</sup> Ibid., Article 17.10.



The government procurement annex contains each party's schedule listing the entities at the central level of government to which the estimated threshold of the procurement value applies.<sup>84</sup> A \$100,000 or 100 million Korean won threshold is set out in the annex for the procurement of goods and services, and a Special Drawing Rights of 5 million (stated in the text as \$7,407,000, or 7.4 billion Korean won) threshold is set out for procurement of construction services.<sup>85</sup> Adjustments concerning the former threshold that may arise in the future would be worked out through consultations between the parties as necessary, and for the latter threshold through conversion to national currencies as provided for in the WTO GPA.<sup>86</sup> For Korea, only certain categories of goods involving the Ministry of National Defense would be open to foreign procurement tendering, as listed in the annex.<sup>87</sup>

## **FTA Chapter 18—Intellectual Property Rights**

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The IPR chapter contains detailed provisions governing the protection and enforcement of major forms of intellectual property including trademarks, copyrights, and patents. The chapter begins with general provisions that would require ratification or accession to specified international conventions, and reasonable effort to ratify or accede to others.<sup>88</sup> The general provisions also contain national treatment and transparency obligations, as well as an exception to national treatment for particular analog communications.<sup>89</sup>

### ***Trademarks, Geographical Indications, and Domain Names***

The trademark section of the FTA would broaden the scope of trademarks to be protected to include marks that are not visually perceptible, certification marks, and geographical indications,<sup>90</sup> and would establish broader protections for well-known marks. It would provide for the automation of trademark services with online databases and electronic means of communication and eliminate the requirement that trademark licenses be recorded. This section also sets forth procedures for the protection of geographical indications and prohibits recognition of a geographical indication that is confusingly similar to a prior trademark or a well-known trademark.<sup>91</sup> In the area of Internet domain names, the FTA would require the

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<sup>84</sup> USTR, "Government Procurement Annex 17-A," *Draft—Free Trade Agreement Between the United States of America and the Republic of Korea*.

<sup>85</sup> USTR, "Final - United States - Korea FTA Texts," 2007.

<sup>86</sup> *Ibid.*

<sup>87</sup> *Ibid.* For the United States, certain categories of goods involving the Department of Defense are exempt from the chapter's provisions, including particular ships and ship-related equipment; certain "specialty metals" such as certain steels, titanium, or zirconium and their alloys; and a number of types of weapons and ordnance, aircraft and ships and related components, as well as other categories involving related electronic, fiber optic, and communication components. Various exemptions on the U.S. schedule also include certain items procured by the Departments of Agriculture, Commerce, Energy, Homeland Security, and Transportation, and the General Services Administration. The parties also list particular limitations on coverage, including the U.S. set-asides for small and minority-owned business. USTR, "Final - United States - Korea FTA Texts," 2007, "Notes to United States Schedule."

<sup>88</sup> USTR, "Final - United States - Korea FTA Texts," 2007, Article 18.1.3 and 18.1.4.

<sup>89</sup> *Ibid.*, Article 18.16. A similar-carve out also is contained in the U.S.-Australia FTA.

<sup>90</sup> Examples of geographical indications from the United States include "Idaho" for potatoes and "Florida" for oranges.

<sup>91</sup> USTR, "Final - United States - Korea FTA Texts," 2007, Articles 18.2.6–18.2.8, 18.2.10, and 18.2.13–18.2.15.

establishment of Uniform Domain-Name Dispute-Resolution procedures for the settlement of disputes.<sup>92</sup>

### ***Copyrights and Related Rights and Protection of Certain Satellite Signals***

The copyright and related rights sections contain detailed provisions that would require implementation of the obligations of the WIPO Internet Treaties, including the treatment of temporary copies (including those made in a computer's random access memory) as regular copies, establishment of the copyright owner's right to control any technological manner of transmitting works, and the protection of technological protection measures that owners use to control access to their works. Korea would also agree to extend its term of copyright protection to life of the author plus 70 years for most works, subject to a 2-year transition period. The section also contains a requirement that the two governments issue decrees mandating the use of noninfringing software in government agencies.<sup>93</sup>

The FTA would require Korea to bring all means of digital dissemination of sound recordings within the scope of the exclusive rights of recording producers and would obligate Korea to allow right holders to exercise economic rights in their own names.<sup>94</sup> The FTA also includes provisions similar to those in NAFTA that protect against the theft of encrypted satellite and cable signals and the manufacture of, and trafficking in, tools to steal those signals.<sup>95</sup>

### ***Patents and Measures Related to Certain Regulated Products***

The patents section would provide that patents shall be available for any invention if it is new, involves an inventive step, and is capable of industrial application, including new uses of known products. Exclusions from patentability would be recognized where necessary to protect public order or morality and for diagnostic, therapeutic, and surgical procedures and inventions. The patents section identifies permissible grounds for revocation of a patent and precludes opposition proceedings that occur before the patent is granted.<sup>96</sup>

The patents section also includes limitations on how a third party may use a patented invention to generate data needed for the marketing approval of a generic pharmaceutical. It would provide for extension of the patent term beyond 20 years to compensate for "unreasonable delays," defined as the later of 4 years from the filing of an application or 3 years after a request for examination, or delays in the marketing approval of a new pharmaceutical product. The patents section also includes procedural definitions that facilitate patent examination and establish a framework for cooperation between patent offices in the United States and Korea.<sup>97</sup>

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<sup>92</sup> Ibid., Article 18.3.1.

<sup>93</sup> Ibid., Articles 18.4.1, 18.4.7, 18.4.4, and 18.4.9.

<sup>94</sup> Ibid., Articles 18.6.3 and 18.4.6.

<sup>95</sup> Ibid., Article 18.7.

<sup>96</sup> Ibid., Articles 18.8.1, 18.8.2, and 18.8.4.

<sup>97</sup> Ibid., Articles 18.8.5, 18.8.6, and 18.8.8-18.8.11.

The section on measures related to regulated products contains provisions that govern the regulatory approval and marketing of pharmaceutical or agricultural chemical products. The data exclusivity provisions would preclude reliance by another person, without consent of the submitter, on safety or efficacy information provided in support of a new pharmaceutical product, or evidence of the marketing approval of that product, for a period of at least 5 years from the date of marketing approval. The data exclusivity period for an agricultural chemical product would be at least 10 years from marketing approval. In cases where new clinical information, or evidence of marketing approval based on new information, is submitted in support of a pharmaceutical product containing a previously approved chemical entity, the data exclusivity period would be at least 3 years.<sup>98</sup> The section contains a new provision, which clarifies that a party may take measures to protect public health in accordance with the Declaration on the Trade-Related Aspects of Intellectual Property Rights (TRIPS) Agreement and Public Health (the Doha Declaration), notwithstanding these data exclusivity provisions. Later in the IPR chapter, the parties affirm their commitment to the Doha Declaration and confirm that the obligations of the IPR chapter would not prevent a party from taking measures to protect public health by promoting access to medicine for all.<sup>99</sup>

The section on measures related to regulated products also would require the implementation of measures in the marketing approval process to prevent the approval of generic drugs during the term of the patent without the patent owner's consent (a "patent linkage" provision), including a requirement that the patent owner be notified of the identity of a person seeking marketing approval during the patent term.<sup>100</sup>

## ***Enforcement***

The enforcement section of the FTA contains detailed measures intended to promote full and effective IPR enforcement. It contains general obligations, civil and administrative procedure and remedies provisions, provisional measures, special requirements related to border measures, criminal procedures and remedies, and provisions on liability of Internet service providers. In particular, Korea agrees to supplement its civil remedies with a regime of statutory damages, costs, and attorney's fees and to provide criminal remedies for trafficking in counterfeit labels and the illegal recording of audiovisual works (so-called "camcording").<sup>101</sup>

## ***Side Letters***

The IPR chapter includes a series of side letters addressing Internet service provider obligations, copyright infringement on university campuses, enforcement against online piracy, and patent linkage. More specifically, the first side letter contains detailed provisions for an effective "notice and takedown" process for Internet service providers when online materials are claimed to be infringing and when it is asserted that online materials should not have been removed from the Internet. The second side letter would require the Korean

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<sup>98</sup> Ibid., Article 18.9.1-2.

<sup>99</sup> Ibid., Articles 18.9.3 and 18.11. These new provisions are the result of a "Bipartisan Trade Deal" between the Office of the U.S. Trade Representative and certain Members of Congress. USTR, "Bipartisan Trade Deal," May 2007, 3.

<sup>100</sup> Ibid., Article 18.9.5.

<sup>101</sup> Ibid., Articles 18.10.6, 18.10.28, and 18.10.29.

government to take appropriate measures—such as the training of personnel, public education campaigns, and increased enforcement—to control infringement of books on or near school campuses. The third letter would confirm the commitment of the parties to shut down Internet sites that permit the unauthorized downloading and distribution of copyrighted works. Korea would further agree, within 6 months of entry in force of the Agreement, to issue a policy directive establishing clear jurisdiction for effective enforcement against online piracy. In the fourth side letter the parties would agree not to invoke the dispute-settlement provisions of the FTA during the first 18 months after the FTA enters into force if a problem arises in the implementation of the patent linkage provision.

Although the first side letter is similar to side letters contained in other FTAs, the other side letters are unique to the U.S.-Korea FTA. The side letter on copyright infringement near university campuses and the letter on online infringement would address particular IPR protection and enforcement challenges noted in the USTR's Special 301 review of Korea. The fourth side letter was added to the FTA as a result of the Bipartisan Trade Deal.

## **FTA Chapter 19—Labor**

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As with the labor chapters of several previous FTAs, chapter 19 of the U.S.-Korea FTA would commit each party to effectively enforce its respective labor laws while providing for the reasonable exercise of discretion regarding such enforcement. In addition, the parties would reaffirm their obligations as members of the International Labour Organization (ILO). Much like the labor chapter of the U.S.-Panama TPA, however, chapter 19 of the U.S.-Korea FTA would also commit the parties to maintain the rights specified in the ILO Declaration in their regulations and statutes. Further, whereas the labor provisions in many previous FTAs were subject to a separate dispute settlement mechanism, the provisions in chapter 19 of the FTA would be subject to the same dispute settlement procedures as the agreement's other obligations.

Each party would agree to provide access to domestic tribunal proceedings, allowing persons with a recognized interest under its law in a particular matter to seek enforcement of its labor laws. Such proceedings must be fair, equitable, and transparent; adhere to due process of the law; and provide an opportunity for persons involved in such proceedings to support or defend their positions. Each party also would agree to ensure independent review of tribunal actions, provide legal remedies to ensure enforcement, and promote public awareness of its labor laws. The FTA defines labor laws as statutes or regulations at the central level of government that directly relate to internationally recognized labor rights, including the right of association, the right to organize and bargain collectively, a ban on forced or compulsory labor, the protection of children and other young laborers, and standards on conditions of work, including minimum wages, hours of work, and occupational health and safety.

As with previous U.S. FTAs, the U.S.-Korea FTA would establish a Labor Affairs Council that would oversee the implementation of chapter 19 provisions. Each party would be required to designate an office within its labor ministry to serve as a contact with the other party and the public and to be responsible for, inter alia, the review of communications from persons of a party. A side letter clarifies that the parties would not be required to establish discrete procedures for the review of such communications if there are existing procedures for other communications relating to chapter 19, and that parties could consider whether a particular communication has merit, substantively resembles another communication, or is being addressed in another domestic or international forum. The FTA would allow each

party to call together a national labor advisory committee, which may include representatives of business and labor, members of the public, and others. Annex 19-A would also create a Labor Cooperation Mechanism to further advance common commitments on labor matters, including the ILO Declaration of Fundamental Principles and Rights at Work and Its Follow-up and ILO Convention No. 182 Concerning the Prohibition and Immediate Action for the Elimination of the Worst Forms of Child Labour, and to enhance opportunities to improve labor standards.

Under Article 19.7, a party could request consultations with the other party on matters under this chapter with a view toward finding a mutually acceptable resolution. Failing to find a mutually acceptable resolution, a party could call upon the Labor Affairs Council to consider the matter. If a matter is not resolved within 60 days of a request for labor consultations, the complaining party could ask for consultations or refer the issue to the Joint Committee under the provisions established in Articles 22.7 and 2.8 of the FTA, following which, the party could seek to settle the dispute under the other provisions included in chapter 22 of the agreement.

## **FTA Chapter 20—Environment**

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Chapter 20 of the FTA would commit each party to strive to ensure that its environmental protection laws provide for high levels of protection and to strive to improve those laws, to provide appropriate and effective remedies and sanctions for violations of environmental protection laws, to not fail to effectively enforce its laws, to provide opportunities for public participation, and to promote public awareness of its environmental laws. The parties would agree that trade or investment will not be encouraged by weakening or reducing domestic environmental laws, although there is a provision for a waiver or a derogation that is not inconsistent with a party's obligations under a covered agreement. The two parties would also agree to ensure that domestic judicial, quasi-judicial, or administrative proceedings will be available to sanction or remedy violations of environmental laws. Such proceedings would be required to be fair, open, and equitable; to comply with due process of law; and to provide access to persons with recognizable legal interests. An Environmental Affairs Council would be established that would meet to consider the implementation of the provisions contained in chapter 20 as well as the separate Environmental Cooperation Agreement (ECA), and to strive to resolve any controversies that may arise regarding these environmental provisions. They would also agree to pursue cooperative environmental activities and provide for environmental consultations. The parties will also commit to work in multilateral fora to enhance the mutual supportiveness of multilateral environmental and trade agreements.

The FTA would incorporate a specific list of multilateral environmental agreements (MEAs), collectively referred to as “covered agreements,” under which the United States and Korea have assumed obligations, including the Convention on International Trade in Endangered Species (CITES), the Montreal Protocol on Ozone Depleting Substances, the Convention on Marine Pollution, the Inter-American Tropical Tuna Convention (IATTC), the Ramsar Convention on Wetlands, the International Whaling Convention (IWC), and the Convention on Conservation of Antarctic Marine Living Resources (CCAMLR) (Annex 20-A). In previous FTAs, environmental dispute settlement procedures have focused on the use of fines, as opposed to trade sanctions, and were limited to the obligation to effectively enforce

environmental laws.<sup>102</sup> In the U.S.-Korea FTA, all FTA environmental obligations would be enforced on the same basis as the commercial provisions of the agreements and would be subject to the same remedies, procedures, and sanctions.<sup>103</sup>

## **FTA Chapter 21—Transparency**

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Chapter 21 of the U.S.-Korea FTA is similar to the transparency chapters in recent FTAs. As in recent agreements, the U.S.-Korea FTA would require each party to make publicly available all laws, regulations, and procedures regarding any matter covered by the agreement. Further, under the chapter, each party must establish or maintain procedures to provide review and appeal capabilities to any entities that would be affected by actions, rulings, measures, or procedures under the FTA. The agreement would also require the adoption of transparency principles within specific industries, including financial and telecommunication services. Applicable provisions also cover protection for U.S. trademarks, procedures for government procurement contracts, and the administration and enforcement of environmental laws. The U.S.-Korea FTA contains a prior notice and comment period for all new laws and regulations. This chapter also includes anticorruption provisions relating to trade and investment that would require each party to make corruption a criminal offense and to establish penalty procedures for bribery and corruption.

## **FTA Chapter 22—Institutional Provisions and Dispute Settlement**

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The first section of the chapter deals with the administration of the FTA. It would require each party to designate one or more contact points to facilitate bilateral communication on matters under the FTA. Such contact points would, on request, identify other offices or officials responsible for the pertinent matter and assist in linking an official with a question to the person who might answer it. Article 22.2 would set up the Joint Committee comprising officials of each party and cochaired by the USTR and the Minister for Trade of Korea or their designees. This committee would have a wide range of functions in supervising the implementation and operation of the agreement, and play a part in dispute resolution for covered matters. It could delegate responsibilities to ad hoc bodies, seek input from outside experts, consider possible FTA amendments, interpret FTA provisions, and handle its own procedures. It would meet at least once per year in as transparent a manner as possible, seeking views of the public and taking into account the need for protection of confidential information.

Under the provisions in this chapter, although the parties commit to consult and cooperate on FTA matters, one party could invoke dispute settlement on a subject matter not excluded by any FTA provision if it believes that the other has an FTA-inconsistent measure or has failed to carry out an FTA obligation, or that a benefit it reasonably expected has not been given. Where a dispute arises, the complaining party could choose the forum for settling the matter. If a party requests consultations and the consultation fails to resolve the matter by a

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<sup>102</sup> USTR, “Bipartisan Trade Deal,” May 2007, 2.

<sup>103</sup> For additional information on such remedies, procedures, and sanctions, see the section on Dispute Settlement in this chapter of the report.

prescribed deadline, either party could refer the matter to the Joint Committee, followed by a request for a dispute settlement panel, if necessary. Once a panel constituted under the chapter has supplied its final report, the report must be made public and the parties would be obliged to agree on the resolution of the dispute in question, normally in a manner which conforms with the determinations of the panel. If parties are unable to agree on a resolution, compensation could be negotiated, payable in either party's currency. If the parties fail to agree on the terms of compensation, or the report or agreed resolution is not implemented, an actual suspension of benefits of equivalent effect could be undertaken in accord with the panel's report, or the party complained against could pay a monetary assessment in U.S. dollars for an amount equal to 50 percent of the total benefit the panel deems to have been involved. The Joint Committee could decide that an assessment should be paid into a fund established by the Joint Committee and expended for appropriate initiatives to facilitate trade between the parties.

This chapter also contains provisions directing compliance reviews and a 5-year review for disputes under the FTA. Actions relating to measures subject to exception under Article 23.1 could not be taken. The chapter contains administrative procedures for requesting a panel, selecting panelists, and issuing reports. It would prohibit any private right of action related to the consistency of a national law with the FTA. The chapter also states that parties should facilitate the use of arbitration and alternate dispute resolution to settle international commercial disputes between private parties in the free trade area.

Unlike in previous FTAs, there are provisions in Annex B to this chapter outlining alternative, expedited dispute-settlement procedures for disputes concerning motor vehicles. The proceedings are similar to those for other FTA obligations as described above, except that the Joint Committee would submit the dispute to a panel if it could not resolve it within 30 days. The panel would have 120 days in which to draft a preliminary report and to determine whether an FTA-inconsistent measure materially affected the sale, offering for sale, purchase, transportation, distribution, or use of originating goods of a party. If the panel finds that the violating party has not conformed with its obligations, or that its actions materially injured the other party, the complaining party could increase the rate of customs duty on passenger cars of heading 8703 of the Harmonized System (HS) to a level not to exceed the prevailing MFN applied rate of duty on such goods, to be rescinded upon corrective action taken by the other party. If the panel determines that there is a nonconformity but that it did not materially injure the other party, the dispute-settlement rules and outcomes otherwise provided in chapter 22 as described above would apply. Unless a panel is convened and finds an NCM under these provisions, the procedures in the annex would expire 10 years after the date of entry into force of this agreement.

Annex C to this chapter would establish a Committee on Outward Processing Zones on the Korean Peninsula, comprising members from each party, to identify areas on the Korean Peninsula that may be designated outward processing zones. In making such a determination, the committee is to consider criteria such as progress toward denuclearization of the Korean Peninsula, the effect of the outward processing zones on intra-Korean relations, and the environmental and labor standards and wage and business practices prevailing in the outward processing zone. The committee would also determine the maximum threshold for the value of the total input of the originating final good that may be added within the outward processing zone.

The provisions of Annex D to this chapter would establish a Joint Fisheries Committee. This committee is to serve as a forum to discuss issues concerning fisheries matters, including but

not limited to, policies on commercial activities within the exclusive economic zones of the parties and scientific research on fisheries matters.

## **FTA Chapter 23—Exceptions**

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This chapter covers general exceptions to particular chapters of the FTA and mentions specific provisions of various WTO agreements providing exceptions, incorporating these provisions by reference. Such exceptions relate to national measures on such subjects as the protection of human, animal, or plant life or health. The chapter also exempts the disclosure of information on essential security, taxation, or law enforcement matters and provides that disclosure of information contrary to the public interest or prejudicial to legitimate commercial interests of public or private enterprises cannot be required.

## **FTA Chapter 24—Final Provisions**

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This chapter contains the legal mechanisms for acceding to the FTA and putting it into force, along with a provision making the agreement's annexes a part of its legal text. The parties agree to consult on any changes made to provisions of the WTO Agreement incorporated in this FTA to determine if the same obligations will apply under the FTA. If the parties each agree, any country or group of countries could accede to the FTA. The FTA would enter into force 60 days after an exchange of written notifications that each party has completed its legal requirements or procedures, or on a later agreed date. The agreement would terminate 6 months after either party advises the other in writing that it wishes to do so. The Korean and English texts of the FTA would be legally authentic.



## **APPENDIX E**

### **Korea Economic Profile and Trade Tables**

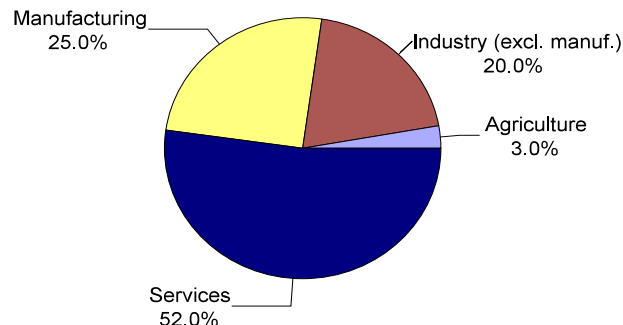


# KOREA

## ECONOMIC PROFILE



GDP by sector, 2006 (nominal GDP = \$888 billion)



Economic indicators	2002	2006
Population (mn)	47.6	48.7
GDP (US\$ bn)	546.9	888.0
GDP per capita (US\$)	11,489.5	18,234.1
Real GDP growth (%)	7.0	5.0
Goods exports (US\$ bn)	163.4	331.8
Goods imports (US\$ bn)	148.6	302.6
Trade balance (US\$ bn)	14.8	29.2

### Korea's main trade commodities, US\$ billion, 2006

Exports	Imports
Information & comm. equip. . .	Electrical machines . .
Machinery . . . . .	Crude petroleum . . . . .
Semiconductors . . . . .	Machinery . . . . .

### Korea's main trading partners, percent of total, 2006

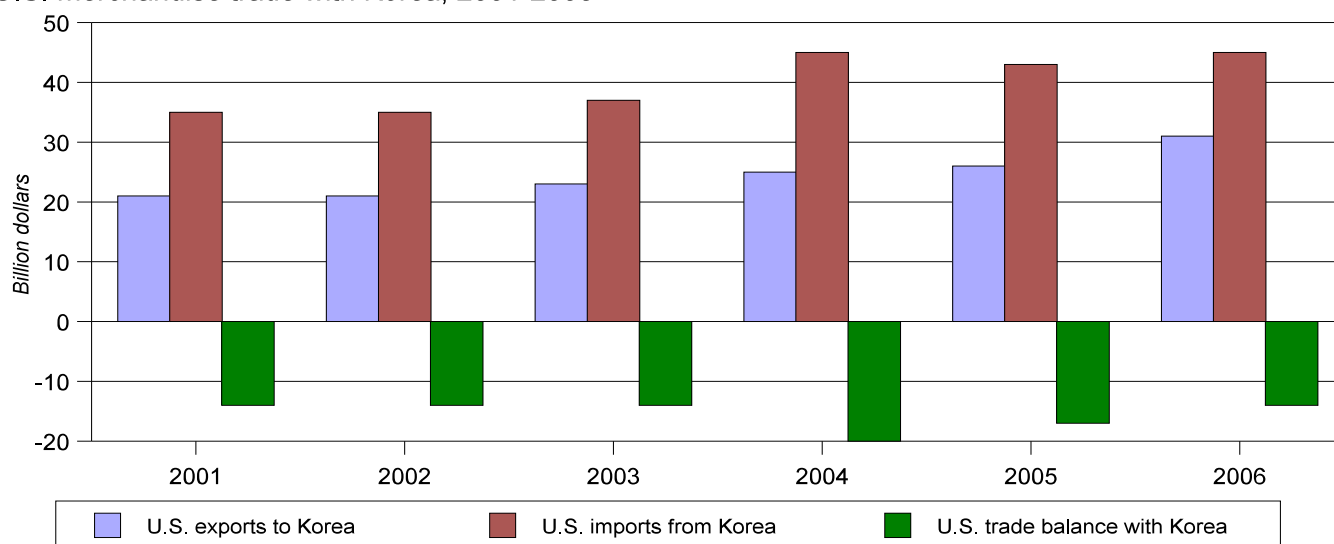
Markets	Sources
China . . . . .	Japan . . . . .
United States	China . . . . .
Japan . . . . .	United States . .
Hong Kong . .	Saudi Arabia . . .

### Economic Overview

- The Republic of Korea is a high-income, newly industrialized country. Its population of approximately 49 million is about one-sixth that of the United States. Its GDP of nearly \$900 billion is approximately 6 percent of the U.S. GDP.
- Korea's dynamic economic growth over the past 30 years has been very rapid. Korea's GNP per capita in 1963 was \$100 and in 2006 exceeded \$18,000, brought about by decades of government industrial policies carried out in cooperation with large industrial conglomerates known as "chaebols" that focused on export-led growth based largely on labor intensive light industrial manufactures. Prompted in large part by the 1997–98 Asian financial crisis, the government is presently instituting structural economic reforms, particularly of its financial and regulatory sectors, to move away from the past government-directed model toward a more market-oriented economy based on open private-sector competition designed to attract more foreign investment.
- Lacking abundant natural resources, the Korean economy is highly dependent on international trade, with foreign trade accounting for over 70 percent of GDP and government foreign exchange reserves reaching \$210 billion by 2006, the second-highest among OECD member countries. The Korean economy is divided fairly evenly between the service sector and the manufacturing sector, with a small agricultural sector of small farms contributing only 3 percent of GDP.
- Korea specializes in exports of advanced technology products, such as information technology and communications equipment, as well as related components such as semiconductors. The major markets for Korea's exports are its neighbors China and Japan, as well as the United States. Korea imports materials needed to manufacture its industrial goods, importing machinery, electric, electronic, and transport equipment, as well as food, base metals and crude oil, and chemicals and plastics. The major suppliers of Korea's imports are also its neighbors China and Japan, as well as the United States.

## KOREA—CONTINUED

U.S. merchandise trade with Korea, 2001-2006



Leading U.S. exports to Korea, US\$ million, 2006		Leading U.S. imports from Korea, US\$ million, 2006	
Integrated circuits .....	3,229.0	Certain passenger vehicles .....	9,095.0
Large civil aircraft .....	2,351.0	Transmission apparatus incorporating reception (including transceivers and cell phones) .....	5,334.0
Certain miscellaneous appliances and machinery .....	1,381.0	Integrated circuits .....	2,359.0
Aircraft parts .....	846.0	Other .....	27,927.0
Other .....	22,986.0	Total .....	44,714.0
Total .....	30,794.0		

### International Organization Membership and Trade Agreements

- Korea is a member of a number of multilateral institutions, including the World Trade Organization (WTO), Organization for Economic Cooperation and Development (OECD), and International Monetary Fund (IMF). In addition, Korea is a member of regional organizations, including the Asia-Pacific Economic Cooperation (APEC), and a dialogue partner with the Association of South East Asian Nations (ASEAN).
- Korea has implemented free trade agreements (FTAs) with Chile, the European Free Trade Area (EFTA), and Singapore. Korea is in the process of negotiating additional FTAs with Canada, the European Union, and Japan.
- Korea is a participant in the WTO Information Technology Agreement. Korea has also signed bilateral investment treaties with Austria, Bangladesh, Belgium-Luxembourg, China, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, India, Indonesia, Italy, Lithuania, Malaysia, Mongolia, Netherlands, Pakistan, Paraguay, Peru, Poland, Romania, Russia, Senegal, Spain, Sri Lanka, Switzerland, Tajikistan, Thailand, Tunisia, Turkey, United Kingdom, Uzbekistan, and Vietnam.

### U.S.-Korea Trade in Goods

- U.S. trade with Korea accounted for 3.3 percent of U.S. merchandise exports and 2.4 percent of U.S. merchandise imports in 2006. Korea ranked as the seventh-largest market for U.S. exports and the seventh-largest import supplier for the United States in 2006.
- The United States is one of Korea's largest trading partners, supplying 10.9 percent of Korea's imports and purchasing 13.3 percent of Korea's exports in 2006.

Sources: CIA *World Factbook*; EIU, "Country Profile 2006: South Korea"; USDOS, "Background Note: South Korea," May 2007; International Center for Settlement of Investment Disputes, the World Bank Group; Global Trade Information Services, World Trade Atlas Database; and official statistics of the U.S. Department of Commerce.

**Table E.1** Leading U.S. exports to Korea, total exports to the world, and Korean share of total, 2006

HTS subheading	Description	Exports to Korea	Exports to world	Korean share
		----- <i>Million dollars</i> -----		<i>Percent</i>
854221	Electronic monolithic digital integrated circuits . . . . .	3,229	23,359	13.8
880240	Airplanes and other aircraft NESOI, of an unladen weight exceeding 15,000 kg . . . . .	2,351	35,837	6.6
847989	Machines and mechanical appliances having individual functions, nesoi . . . . .	1,381	5,798	23.8
880330	Parts of airplanes of helicopters, nesoi . . . . .	846	17,649	4.8
100590	Corn (maize), other than seed corn . . . . .	723	7,157	10.1
845691	Machines tools for dry etching patterns on semiconductor materials . . . . .	609	2,369	25.7
854229	Electronic monolithic integrated circuits other than digital . . . . .	586	6,888	8.5
900190	Lenses (except contact and spectacle), prisms, mirrors and other optical elements, unmounted, other than elements of glass not optically worked . . . . .	383	1,475	26.0
292610	Acrylonitrile . . . . .	316	1,114	28.4
271019	Petroleum oils and oils (not light) from bituminous minerals or preps nesoi 70%+ by wt. from petroleum oils or bitum. min. . . . .	298	16,034	1.9
988000	Estimate of non-Canadian low-value export shipments; complied low-value shipments to Canada; and shipments not identified by kind to Canada . . . . .	284	22,910	1.2
854210	Cards incorporating an electronic integrated circuits ("smart" cards) . . . . .	281	618	45.5
270730	Xylenes . . . . .	280	370	75.7
841191	Parts of turbojets or turbopropellers . . . . .	261	9,204	2.8
760200	Aluminum waste and scrap . . . . .	258	2,448	10.5
	Subtotal . . . . .	12,086	153,230	7.9
	Other . . . . .	18,708	776,406	2.4
	Total . . . . .	30,794	929,636	3.3

Source: Compiled from Official statistics of the U.S. Department of Commerce.

Note: nesoi = "not elsewhere specified or included."

**Table E.2** Leading U.S. imports from Korea, total imports from the world, and Korean share of total, 2006

HTS subheading	Description	Imports from Korea	Imports from world	Korean share
		-----Million dollars-----		Percent
870323	Passenger motor vehicles with spark-ignition internal combustion reciprocating piston engine, cylinder capacity over 1,500 cc but not over 3,000 cc . . . . .	6,121	54,419	11.3
852520	Transmission apparatus incorporating reception apparatus for radiotelephony, radiotelegraphy, radio broadcasting, or television . . . . .	5,334	27,246	19.6
870324	Passenger motor vehicles with spark-ignition internal combustion reciprocating piston engine, cylinder capacity over 3,000 cc . . . . .	2,974	75,525	3.9
854221	Electronic monolithic digital integrated circuits . . . . .	2,359	15,652	15.1
847330	Parts and accessories for automatic data processing machines and units thereof, magnetic or optical readers, transcribing machines, etc. nesoi . . . . .	2,076	31,320	6.6
271019	Petroleum oils and oils (not light) from bituminous minerals or prep nesoi 70%+ by wt. from petroleum oils or bitum. min. . . . .	1,438	42,821	3.4
870899	Parts and accessories for motor vehicles, nesoi . . . . .	723	15,554	4.7
980100	Imports of articles exported and returned, not advanced in value or condition; imports of animals exported and returned within 8 months . . . . .	635	36,245	1.8
401110	New pneumatic tires of rubber, of a kind used on motor cars (including station wagons and racing cars) . . . . .	502	3,905	12.9
847160	Automatic data processing input or output units, whether or not containing storage units in the same housing, nesoi . . . . .	487	16,907	2.9
290220	Benzene . . . . .	438	2,302	19.0
842952	Mechanical shovels, excavators, and shovel loaders with 360-degree revolving superstructure, self-propelled . . . . .	436	3,109	14.0
854229	Electronic monolithic integrated circuits other than digital . . . . .	430	5,712	7.5
841810	Combined refrigerator-freezers fitted with separate external doors . . . . .	400	2,282	17.5
271011	Light oils and preparations from petroleum oils and oils from bituminous min. or preps 70%+ by wt. from petroleum oils or bitum. min . . . . .	383	32,105	1.2
	Subtotal . . . . .	24,735	365,104	6.8
	Other . . . . .	19,979	1,479,949	1.4
	Total . . . . .	44,714	1,845,053	2.4

Source: Compiled from Official statistics of the U.S. Department of Commerce.

Note: nesoi = "not elsewhere specified or included."

# **APPENDIX F**

## **GTAP Model**

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## The GTAP Model

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The discussion that follows focuses on the quantitative analysis incorporated in this report—the CGE analysis presented in chapter 2. This appendix details the procedures used to adapt the standard GTAP model in order to assess the likely effects of the U.S.-Korea FTA. In the first section, the basic features of the static GTAP model are introduced. In the second section, the adjustments made to the standard database are discussed. The third and fourth sections present various aspects of the baseline construction and model-solution techniques. The fifth section discusses the estimation of the likely economic effects of the U.S.-Korea FTA and model limitations.

## The Standard GTAP Model<sup>1</sup>

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The GTAP project consists of a documented global database on international trade, economy-wide interindustry relationships, and national income accounts (the GTAP database), and a standard modeling framework to organize and analyze the data (the GTAP model). It allows for comparisons of the global economy in two environments: one in which the base values of policy instruments such as tariffs, TRQs, or export restrictions are unchanged, and one in which these measures are changed, or “shocked,” to reflect the policies that are being studied. A change in policy makes itself felt throughout the economies depicted in the model. The static model by design does not produce information about the speed with which changes occur or about what happens to various dimensions of the economies in the meantime. Rather, the simulation finds the new equilibrium of prices and quantities within the model that result in response to the change in policy.

Results from the GTAP model are based on established global trade patterns. This means that the model is unable to estimate changes in trade in commodities that historically have not been traded. That is to say, if a particular commodity is not traded between two economies, no model simulation will imply such a trade flow under any circumstance. Furthermore, patterns of trade may exist for such reasons as the distance between countries, the presence or absence of transport infrastructure, or cultural preferences, which are all imperfectly captured by the model. The GTAP model does not directly account for historical or cultural factors as determinants of trade patterns. The model assumes that these factors are unaffected by the trade policy change.

In the GTAP model, domestic products and imports are consumed by firms, governments, and households. Product markets are assumed to be perfectly competitive (implying zero economic profit for the firm), with imports as imperfect substitutes for domestic products (i.e., consumers are aware of the source of the products and may distinguish between them based on the foreign or domestic origin), and sectoral production determined by global demand and supply of the output.

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<sup>1</sup> For further information, see Hertel, ed., *Global Trade Analysis*.

## Updating the GTAP Database

The current version of the GTAP database (release 6.1) covers trade in 56 commodity and service aggregates, or GTAP sectors, among 92 economies. For the purpose of the present analysis, the database has been aggregated into ten economies and 54 sectors (table F.1).

**Table F.1** GTAP commodity and regional aggregation

Commodities and Services		Regions (Economies)	
No.	Description	No.	Description
1	Paddy and processed rice	28	Wood products
2	Wheat	29	Paper products, publishing
3	Cereal grains n.e.c.	30	Petroleum and coal products
4	Vegetables, fruit, nuts	31	Chemical, rubber, plastic products
5	Oilseeds	32	Mineral products n.e.c.
6	Sugarcane, sugar beet	33	Ferrous metals
7	Plant-based fibers	34	Metals n.e.c.
8	Crops n.e.c.	35	Metal products
9	Bovine cattle, sheep and goats, horses	36	Motor vehicles and parts
10	Animal products n.e.c.	37	Transport equipment n.e.c.
11	Raw milk	38	Electronic equipment
12	Wool	39	Machinery and equipment n.e.c.
13	Forestry	40	Manufactures n.e.c.
14	Fishing	41	Electricity
15	Coal	42	Gas manufacture and distribution
16	Oil and gas	43	Water
17	Minerals n.e.c.	44	Construction
18	Bovine meat products	45	Trade
19	Meat products n.e.c.	46	Transport n.e.c.
20	Vegetable oils and fats	47	Water transport
21	Dairy products	48	Air transport
22	Sugar	49	Communication
23	Food products n.e.c.	50	Financial services n.e.c.
24	Beverages and tobacco products	51	Insurance
25	Textiles	52	Business services n.e.c.
26	Wearing apparel	53	Recreational and other services
27	Leather products	54	Public administration, defense, education, health

*Note:* The abbreviation “n.e.c.” stands for “not elsewhere classified.”

In addition to the data on bilateral trade in each of the sectors in the model, data are incorporated on the domestic production and use of each sector (including use in the production of other commodities and services); the supply and use of land, labor, and capital; population; and GDP. The database also contains information on tariffs, some nontariff barriers, and other taxes. An additional component of the data is a set of parameters which, in the context of the model's equations, determine economic behavior. These are principally a set of elasticity values that determine, among other things, the extent to which imports and domestically produced goods are substitutes for one another.

The standard GTAP data are based on the year 2001—i.e., trade flows and barriers and other data refer to the world in that year. For the purpose of the present study, the standard data were projected to reflect 2008; the benchmark update incorporates actual increases in U.S. and Korean trade flows, as well as U.S. trade flows with the world at large, through 2005.<sup>2</sup> The model is then projected to 2008 using estimates of regional and global GDP growth through 2008.<sup>3</sup> Data are drawn from the U.S. Department of Commerce (U.S. imports and exports, as well as U.S.-Korea bilateral trade) and the World Bank (GDP projections). Observed GDP growth rates for all the regions of the model are targeted using the data above, as are population growth rates. Labor supply is assumed to grow in line with population growth rates, and no shift in the relative composition of skilled and unskilled labor is assumed. Capital stocks are assumed to grow at the same rate as real GDP over the period 2001–05.

Trade flows within the model are adjusted to reflect key observable trade in the real world. The strategy employed is to match all broad measures of international trade and then selectively match more disaggregated trade flows that are critical to the results of the policy simulation. At the broadest level, total imports for each of the ten regions are benchmarked to observed 2005 trade flows. Select bilateral total trade flows are also adjusted, including bilateral total trade between the United States and Korea, Japan, China, and Chile. Korea's total imports from Chile are also adjusted to align with 2005 trade. Bilateral trade in merchandise sectors between the United States and Korea is benchmarked to 2005 flows. Lastly, total sectoral imports and exports for the United States are targeted to observed 2005 trade data.

The trade protection data were also adjusted to reflect policy measures implemented under the Uruguay Round and the Agreement on Textiles and Clothing (ATC), full implementation of NAFTA, and the 2005 level of applied tariffs between the United States and Korea. Other recent bilateral FTAs between the United States and partner countries are reflected in the updated U.S. import and export flows. Trade with these countries is aggregated into larger groups (the rest of the Americas and the rest of the world), in which their contribution to average tariff rates is small. Since the simulations conducted here do not involve changing these other tariff rates, any influence on the results is quite small.

To take into account the evolving oil and gas market, regional production levels of oil and gas were adjusted to reflect the state of the world in 2005. Changes in production were benchmarked to international production data maintained by the Energy Information

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<sup>2</sup> Compiled from official statistics of the U.S. Department of Commerce. The years over which the model was updated span a period of tremendous growth in certain commodity prices, particularly oil and gas. Special attention was paid to updating the oil and gas sector within the model; see below for a more detailed discussion. Note that a relatively small amount of oil is traded between Korea and the United States, mitigating the influence of any misspecification on simulation results in this report.

<sup>3</sup> USDA, ERS, "Real Projected Gross Domestic Product," August 1, 2007.

Agency.<sup>4</sup> The price changes generated in the model in response to these production levels are in broad agreement with observed price changes. The nominal price of oil increased by 120 percent over the period in question, while the price in the simulation rose from 2001–05 by 118 percent.

Gross output for select sectors is also targeted for the textiles and wearing apparel sectors in the United States. This adjustment is necessary because the two sectors experienced substantial contraction over the period, while in the absence of targeting the model anticipates only stagnation of growth.

Once the database is updated to align with key observable 2005 data, the 2005 database is then projected forward to 2008. This is accomplished by incorporating real GDP and population growth projections from the sources listed above. Anticipated continued contraction in the textiles and wearing apparel sectors are also incorporated into the projection, as is removal of the remaining TRQs on wearing apparel imports from China, which are scheduled to expire in 2008. Certain key trade flows are also benchmarked to expected growth rates, including exports of vegetables, fruits, and nuts; and dairy products.

## **Key Assumptions**

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The Commission's simulation liberalizes trade completely in all goods subject to liberalization under the U.S.-Korea FTA, except for the vegetables, fruits, and nuts sector, which is subject to partial liberalization as a result of permanent, though increasing, TRQs. An additional policy change that is modeled is the reduction in the excise tax on the sale in Korea of all passenger vehicles with an engine displacement in excess of 2 liters. In order to reflect the effects of tariff elimination on U.S. beef exports, the 2008 U.S. export benchmark value assumes full resumption of U.S. beef exports to Korea, based on 2003 (pre-BSE) values, which are then projected forward to establish the 2008 baseline. To reflect the unchanging treatment for rice and rice products under the FTA and the limited trade expansion potential for products in the raw milk and sugar sectors, bilateral traded quantities are held level for products in the following model sectors: paddy and processed rice, raw milk, sugarcane and sugar beet, and manufactured sugar. In order to take into account the differential treatment of food-grade soybeans under the agreement, several changes to the standard liberalization scenario have been made. First, Korean consumer demand is held constant in quantity terms to reflect the limits placed on U.S. exports of food-grade soybeans. Second, demand for oilseeds by food manufacturers in Korea (specifically, the sugar manufacturing, food products n.e.c., beverages and tobacco, and wholesale trade) are also held constant. There is no implicit or explicit time elapsing in the model, and no adjustment costs are considered. This assumption means, first, that all provisions of the FTA are assumed to be fully phased in immediately on January 1, 2008, rather than staged in over many years per the FTA. The assumption also means that the modeled results are long-run effects of a fully implemented FTA in an economy otherwise identical to the benchmark 2008 economy—i.e., an economy with the same resources, population, and other characteristics as the 2008 economy.

A full list of the initial measured trade barriers in the model is shown in table F.2. These barriers essentially constitute price gaps, or wedges, between world prices and domestic prices in the importing country. The differences are accounted for principally by tariffs and

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<sup>4</sup> USDOE, EIA, "World Crude Oil Production," May 25, 2007.

other barriers.<sup>5</sup> As tabulated, they consist of tariffs and price premiums due to TRQs, measured in the GTAP database as AVEs.<sup>6</sup> The sectors listed in table F.2, and their corresponding import tariff equivalent measures, are highly aggregated. For example, the “other crops” category includes commodities such as coffee, tea, cut flowers, cotton, spices, and tobacco. As a result, the listed import tariff equivalent measures are trade-weighted averages of the measures faced by the individual commodities composing the aggregates. The tariff equivalents listed here include the effects of TRQs imposed on certain agricultural products. As shown in table F.2, the tariffs on Korea’s imports from the United States (i.e., U.S. exports) are higher than the tariffs on U.S. imports from Korea. Services are restricted by nontariff barriers but these barriers are not measured in the GTAP data, precluding a quantitative assessment of the services sector liberalization under the FTA on these sectors.

In addition, the Commission did not explicitly model the impact of rules of origin, but the simulation performed is consistent with the existence of such rules. In the simulation, it is assumed that traded commodities are differentiated by country of origin, which implies a limit to the substitutability of imports sourced from a third country.

## **Solution Technique**

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### ***Full FTA Implementation***

The analysis employs a comparative static framework in which a benchmark equilibrium depiction of the U.S. economy, as of January 1, 2008, is derived through a set of balanced accounts of trade, production, consumption, and taxes. Once this benchmark has been created, policy shocks are imposed on the balanced model. A policy shock simply means a change in policy imposed on the model to measure its effect. In this analysis, the policy shocks consist of the reduction or elimination of tariffs and measurable TRQs agreed to in the FTA shown in table F.2.

To estimate the marginal effect of the FTA, the trade policies (tariffs and TRQs) shown in table F.2 are replaced with new levels (generally zero) to represent the new, post-FTA economic state. The model is rebalanced, and new values for trade flows, outputs, employment, welfare, and GDP are generated. The difference between the benchmark values of these variables and their new values is the estimated marginal effect of the removal of tariffs and measurable TRQs under the FTA. It is expected that sectors facing relatively high trade barriers will show relatively larger effects as a result of the implementation of the FTA.

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<sup>5</sup> A price gap summarizes the price impact of several border measures: ad valorem duties and specific duties that insulate domestic prices from short-term fluctuations in world markets. These price gaps are modeled as constant ad valorem gaps between domestic and world prices.

<sup>6</sup> *Global Trade, Assistance, and Production: The GTAP 6 Data Base.*

**Table F.2 U.S.-Korea FTA benchmark tariffs and elasticities of substitution, estimates for 2008**

Sector	Tariffs on Korea's imports from the United States	Tariffs on U.S. imports from Korea	Elasticity of substitution between foreign and domestic varieties ( $\sigma_n$ )	
	Percent		$\sigma_n$	Standard deviation
Paddy and processed rice	N/A <sup>a</sup>	7.5	5.05	2.00
Wheat	1.0	0.0	4.45	2.10
Cereal grains n.e.c.	2.2	1.1	1.30	0.55
Vegetables, fruit, nuts	<sup>b</sup> 38.5	0.7	1.85	0.20
Oilseeds	2.5	0.0	2.45	0.40
Sugarcane, sugar beet	3.0	0.0	N/A	N/A
Plant-based fibers	1.0	0.5	2.50	1.20
Crops n.e.c.	5.6	1.1	3.25	0.20
Bovine cattle, sheep and goats, horses	5.9	0.0	2.00	0.35
Animal products n.e.c.	3.3	0.5	1.30	0.15
Raw milk	0.0	0.0	N/A	N/A
Wool, silkworm cocoons	1.0	0.0	6.45	1.35
Forestry	2.0	0.2	2.50	0.35
Fishing	19.6	0.0	1.25	0.30
Coal	0.0	0.0	3.05	1.20
Oil and gas	0.0	0.0	5.20	1.90
Minerals n.e.c.	1.9	0.0	0.90	0.15
Bovine meat products	38.0	0.4	3.85	0.95
Meat products n.e.c.	24.8	2.4	4.40	0.45
Vegetable oils and fats	5.4	4.1	3.30	0.35
Dairy products	39.6	16.8	3.65	0.40
Sugar	43.5	8.8	2.70	1.00
Food products n.e.c.	10.0	4.6	2.00	0.05
Beverages and tobacco products	35.1	3.3	1.15	0.15
Textiles	8.3	11.0	3.75	0.05
Wearing apparel	12.4	16.5	3.70	0.10
Leather products	6.2	8.8	4.05	0.15
Wood products	4.8	0.5	3.40	0.10
Paper products, publishing	2.4	0.3	2.95	0.10
Petroleum and coal products	5.6	2.1	2.10	0.55
Chemical, rubber, plastic products	6.7	3.0	3.30	0.05
Mineral products n.e.c.	7.8	2.1	2.90	0.10
Ferrous metals	1.2	0.2	2.95	0.15
Metals n.e.c.	3.7	2.4	4.20	0.20
Metal products	6.8	2.4	3.75	0.10
Motor vehicles and parts	<sup>c</sup> 7.9	2.4	2.80	0.15
Transport equipment n.e.c.	0.9	0.1	4.30	0.20
Electronic equipment	0.6	0.2	4.40	0.10
Machinery and equipment n.e.c.	5.2	1.3	4.05	0.05
Manufactures n.e.c.	5.3	3.4	3.75	0.10
Services	0.0	0.0	N/A	N/A
<b>Average</b>	<b>4.4</b>	<b>1.6</b>	<b>N/A</b>	<b>N/A</b>

Source: Commission calculations and GTAP version 6.1.

<sup>a</sup>There is "no change in treatment" for rice and rice products under the FTA.

<sup>b</sup>Vegetables, fruit, and nuts are subject to partial liberalization. The simulated tariff after liberalization is 6.7 percent.

<sup>c</sup>The motor vehicles and parts sector is also subject to reduction of the 10 percent excise tax on all passenger vehicles with a displacement in excess of 2 liters to 5 percent. For the United States, this is the equivalent of an additional tariff reduction of 0.14 percent.

The simulation results presented in the report are given as ranges. These ranges are calculated by performing a systematic sensitivity analysis of the model with respect to two of its key parameters, the elasticities of substitution between domestic and imported varieties of goods (the GTAP parameter ESUBD) and between different foreign suppliers of goods (the GTAP parameter ESUBM).<sup>7</sup> The parameter ESUBM used in the model is drawn from an econometric study of the elasticity of substitution.<sup>8</sup> Commission staff varied these parameters to provide a range for the estimated impact of the tariff and TRQ liberalizations.<sup>9</sup> It should be noted that this exercise in systematic sensitivity analysis pertains to only one pair of parameters—the elasticities of substitution—employed within the model. There are a number of other behavioral parameters that have a substantial bearing on the outcome of the model.<sup>10</sup> Conducting a similar analysis on these parameters would likely lead to wider reported ranges throughout the report.

As is typical of experiments conducted in the standard GTAP framework, this analysis measures the long-term effects of a one-time, full implementation of an agreement.<sup>11</sup> The model assumes that sufficient time is allowed to let the full effect of the agreement work its way through the economy. Reported figures show the marginal effects of a trade policy shock as it would have appeared in the base year of the data. Said differently, effects are expressed in terms of proportional effects relative to the projected 2008 economy, although those effects would take several years to be actually felt.

### ***Implementation of Immediately Duty-Free Tariff Lines***

In order to assess the liberalization effect of tariff lines subject to immediate duty-free treatment (see chapter 2 of this report), it is necessary to establish a trade-weighted measure for each of the GTAP sectors reflecting the degree to which each of these aggregates is immediately liberalized. This task is accomplished by developing a trade-weighted aggregation of all the lines in the agreement to the concordance level for the GTAP data set (HS 6-digit) for all lines and separately using a tariff of 0 for those with an “A” code.<sup>12</sup> The resulting data are then concorded to GTAP sectors to establish a measure of the baseline tariff and the level of protection once those lines slated for immediate duty-free treatment are implemented. The proportion of liberalization thus obtained is then applied to the baseline tariffs and simulation process identified above.

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<sup>7</sup> These parameters determine the degree to which purchasers substitute between different foreign sources, and between domestic and foreign sources.

<sup>8</sup> Hertel, et al., “How Confident Can We Be in CGE-Based Assessments of Free Trade Agreements?,” 2004.

<sup>9</sup> This study provides the mean values used in the simulation for ESUBM, and the associated standard deviations for ESUBM those values, which are employed by the sensitivity analysis. ESUBD and ESUBM are held in a fixed relationship, the so-called “rule of two.” In the sensitivity analysis, these two parameters are set to covary, with each sector’s elasticity pair drawn from a uniform distribution constructed to have the same standard deviation as that estimated by Hertel et al. The entire process is conducted using Stroud’s method of Gaussian quadrature, a computation technique that is far more computationally parsimonious than the Monte Carlo method. The ranges for reported model results are  $\pm 2$  standard deviations from the mean result of the systematic sensitivity analysis. See also Jomini, et al., *SALTER*, vol. 1, 1991.

<sup>10</sup> Dimaranan, et al., “Behavioral Parameters.”

<sup>11</sup> See, for example, USITC, *The Impact on the U.S. Economy*; or USITC, *Overview and Analysis of the Economic Impact of U.S. Sanctions*.

<sup>12</sup> The code “A” in the U.S. and Korea tariff liberalization schedules indicates a tariff line that is subject to immediate duty-free treatment upon implementation of the FTA.

## **Measuring the Impacts of the FTA and Model Limitations**

The probable effects of the U.S.-Korea FTA reported are simply the deviations of the relevant variables from their levels in the projected baseline at any given solution point. Reported deviations in economic variables, such as production, trade, and income, indicate the likely degree to which the policy causes the modeled economies to deviate from the baseline levels. As stated, changes in the variables of interest are calculated as percentage deviations from the baseline, and are quite stable with respect to changes in the baseline. That is to say, if the actual levels of trade in 2008 differ from the values projected in this analysis (as they are likely to do), the marginal percent-change effects of the FTA on trade flows estimated by the model will still likely be similar to those presented here, relative to the new baseline.

Economic models capture the most important factors for the question under consideration. They are limited in their ability to reflect the degree of complexity evident in the real world, however;<sup>13</sup> thus, a number of caveats are in order regarding this modeling framework. One source of bias, found in virtually any quantitative analysis of economic data, arises from the process of data aggregation. In particular, international trade occurs in thousands of different products and services. The United States collects trade data under about 17,000 statistical categories and some 10,000-plus tariff rate lines. For most general equilibrium analyses, these groupings represent far too much detail to be tractable computationally. Furthermore, analysis and comparison of data collected from different economies require that data be aggregated into categories that are generally comparable from one economy to another. This aggregation process introduces two general types of bias into a modeling exercise.

One type involves the calculation of tariffs for aggregated product categories. In this study, trade-weighted average tariffs were calculated. The value of trade in a tariff line provides the weight for the tariff in that line. This procedure tends to mask the importance of those products within the aggregate that have particularly high tariffs, and that therefore present a greater barrier to imports than would be the case if all goods within the aggregation had the same average tariff. As a result, the analysis may understate the effect of reducing the tariff of a high-tariff component of the aggregate.

Another type of aggregation bias is the likelihood that goods within an aggregate may not be close substitutes for one another. Imported goods of a particular category may be quite dissimilar to an economy's domestic product in that category. When, however, the price of an import falls, for example, the model may indicate a certain amount of substitution of that import for the domestic product when, in fact, they are not close substitutes. In this case, the model would overstate the effect of a given average tariff reduction.<sup>14</sup>

Despite these limitations, the simulations performed here can be quite useful in providing insights on the effects of an FTA, stemming solely from the implementation of the FTA's tariff and TRQ liberalization, on a number of economic measures. The model presents a unified framework in which to assess the likely effects of the policy.

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<sup>13</sup> Examples of real-world complexities that are difficult to reflect in the model include the changing relative growth of different economies; politically motivated, export-oriented investment; relationships between multinational subsidiaries that influence trade patterns; and such things as catastrophic weather or violence that are inherently unpredictable (at least in their details).

<sup>14</sup> This type of bias is reduced in empirical trade models, like the GTAP model, that apply the Armington assumption, which treats products produced in different economies as imperfect substitutes.



**APPENDIX G**  
**General Effects of Trade Agreements**

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# General Effects of Trade Agreements

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Studying the economic impact of an FTA entails investigating static effects such as trade creation and trade diversion, as well as terms of trade (i.e., the price of exports relative to the price of imports). In addition, issues related to scale effects and less tangible effects have to be considered. These issues are discussed below.

## Static Effects: Trade Creation and Trade Diversion

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Trade liberalization can in general be undertaken in two different manners. First, trade liberalization can be based on the MFN principle, where better market access is granted to all or nearly all trading partners equally. The classical “gains from trade” argument asserts that such trade liberalization will offer consumers access to more goods at lower prices, and producers more sources for their inputs and more markets for their products (for which they may receive higher prices). Second, trade liberalization can be done in a preferential way, with better market access granted to one or several partners but not to others. It should be noted that better market access can result not only from bilateral tariff removal but also from other negotiated provisions in the areas of cross-border trade in services, telecommunications, electronic commerce, and government procurement, all of which are not readily quantifiable. An FTA such as the one between the United States and Korea is an agreement in which preferential liberalization is negotiated and undertaken reciprocally between participating countries.<sup>1</sup>

To the extent that FTAs are designed to liberalize trade, they are likely to engender economic gains similar to those of an MFN liberalization. Given their discriminatory nature, however, studying the economic impact of FTAs involves additional issues that are not present in an MFN liberalization. The traditional way to study an FTA is to categorize the FTA-induced trade expansion into trade creation or trade diversion.<sup>2</sup> Trade creation improves net welfare and occurs when partner-country production displaces higher-cost domestic production.

Trade diversion reduces net welfare and occurs when partner-country production displaces lower-cost imports from the rest of the world.<sup>3</sup> The combined effect of an FTA on intrabloc trade will then reflect trade creation as well as trade diversion. Whether the trade creation (welfare-enhancing) or the trade diversion (welfare-reducing) effects dominate depends on a variety of factors, including external trade barriers, cost differences, relative supply and demand responses, and other domestic policies. Thus, the overall welfare impact of an FTA can be empirically determined.

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<sup>1</sup> It should be noted that, although negotiated bilaterally, some FTA provisions, such as those related to customs administration, labor, or environment, tend to be applied in a nondiscriminatory manner and are closer to the MFN principle.

<sup>2</sup> The seminal works on this issue are Viner, *The Customs Union Issue*; and Meade, *The Theory of Customs Union*.

<sup>3</sup> Losses from trade diversion occur when lost tariff revenue associated with changes in the pattern of trade exceeds efficiency gains from the decline of the prices paid by consumers. These losses will be larger the higher the FTA’s margin of preferences (i.e., the trade barriers facing nonmembers relative to intra-FTA barriers).

## Static Effects: Terms of Trade

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The impact of an FTA also can be studied from a “terms-of-trade” (i.e., the price of exports relative to the price of imports) viewpoint. If the participating countries are large enough to be able to affect world import and export prices by their actions, the establishment of an FTA is likely to affect the terms of trade of a given FTA member principally in three ways. First, by increasing the demand for its partner’s products, the country’s own preferential trade liberalization may increase the (pretariff) price of its imports from the partner country, leading to a deterioration in its terms of trade. Second, tariff reductions by the partner country can increase the demand (and the price) for the FTA member’s exports and improve its terms of trade. Third, the decreased demand for imports originating from nonmember countries tends to decrease their price and improve the FTA members’ terms of trade. Therefore, the impact on economic welfare will depend on whether the terms of trade have improved or deteriorated for a given partner country.

## Nonquantifiable Effects

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In addition to the generally more easily quantifiable effects discussed so far, regional integration can provide other potential benefits that are more difficult to evaluate because of data limitations. A World Bank publication discusses a variety of additional effects (or classes of effects) that may result from regional integration agreements.<sup>4</sup> One such effect is enhanced security (either in relation to nonmembers or between members).<sup>5</sup> Another potential benefit is that by forming a unit and pooling their bargaining power, FTA members can negotiate more efficiently in international forums. Regional integration can also be useful in “locking in” domestic (trade or other policy) reforms by raising the cost of policy reversal.

Another potential gain is the increased possibility for cooperation in environmental or technological assistance projects. Effects stemming from these nontariff-related FTA aspects assessed in the Commission’s report pertaining to the U.S.-Korea FTA are associated with market-access provisions related to cross-border trade in services, telecommunications, and government procurement; trade-facilitation provisions related to customs administration and technical barriers; and regulatory-environment provisions related to investment, intellectual property rights, trade remedies, and labor and environment.<sup>6</sup>

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<sup>4</sup> The World Bank, *Trade Blocs*, 66.

<sup>5</sup> For additional information, see Schiff and Winters, “Regional Integration as Diplomacy,” 271–96. As has been mentioned above, the data estimating potential impact of negotiated commitments of an FTA related to, for example, intellectual property rights and customs administration and services, are not readily available.

<sup>6</sup> Qualitative assessments of the impact of the U.S.-Korea FTA on these negotiated objectives are provided in chaps. 4–6 of this report.

**APPENDIX H**  
**Tariff Equivalents in Korean Banking**  
**Services**

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# Tariff Equivalents in Korean Banking Services<sup>1</sup>

## Introduction

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The Commission estimates the price effects of trade barriers on net interest margins (NIMs), which are the spread between lending and deposit interest rates, by using a two-stage econometric method. In the first stage, bank-level data are used to estimate country-level pure spreads, which are net interest margins corrected for the effect of prudential regulations. Prudential regulations are governmental measures intended to ensure the integrity and stability of the financial system, but they increase NIMs due to the costs of compliance. In the second stage, data from 57 countries are used to estimate the effects of macroeconomic variables, including one trade policy index measuring nontariff trade impediments found in the General Agreement in Trade in Services (GATS) and another reflecting the latest available GATS offers tabled in the Doha Round. From these results, the Commission estimates multilateral “tariff equivalents” (TEs), which measure the percentage increase in NIMs due to trade impediments. The Commission then creates a trade policy score from the U.S.-Korea FTA and, drawing on the findings of the second-stage regression, constructs a TE consistent with that agreement. The Commission finds a 76 percent TE for Korea under Uruguay Round GATS commitments, a 59 percent TE under the Doha Round GATS offers, and a 29 percent TE under the FTA.

It is acknowledged that the TEs developed in this appendix, which are not directly comparable to an import tariff, are not used here in the strictly conventional sense in that these restrictions are not applied at the border and therefore are not applied in the GTAP model in chapter 2.<sup>2</sup> In using the term, the Commission follows work performed by Deardorff and Stern, who use “tariff equivalent” to describe the price and quantity effects of services trade restrictions.<sup>3</sup>

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<sup>1</sup> The methodology used in developing tariff equivalents (TEs) used in this analysis differs from the methodology used to develop TEs in the USITC’s 2006 publication entitled *Recent Trends in U.S. Services Trade* in that, based on input received from industry and academic sources, more variables and banking sectors are now analyzed. Therefore, TEs developed in this analysis are not directly comparable with TEs found in *Recent Trends 2006*. The TEs are, however, comparable with those developed in the USITC’s report entitled *U.S.-Colombia Trade Promotion Agreement: Potential Economy-wide and Selected Sectoral Effects*, where a similar methodology was employed. See also the Financial Services section of chapter 4 of this report for a discussion on the interpretation of tariff equivalents in Korean banking services.

<sup>2</sup> Commercial presence is not captured in the GTAP model, whereas commercial presence restrictions are a crucial component of the TEs developed in this section.

<sup>3</sup> Deardorff and Stern, “Empirical Analysis of Barriers to International Services Transactions and the Consequences of Liberalization,” 2005, 550-5.

## Previous Literature

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The method for constructing TEs in banking services was originally developed by Saunders and Schumacher<sup>4</sup> and further refined by Kalirajan et al.<sup>5</sup> Saunders and Schumacher regressed net noninterest operating expenses and capital and liquidity measures on net interest margins using bank-level data in seven OECD countries. The intercept terms for each country estimated the country-level pure spread, which is the interest rate spread after controlling for firm-level and prudential measures. In the second stage, Saunders and Schumacher used these estimated pure spreads as the dependent variable, with market structure and interest rate volatility as the independent variables. Kalirajan et al. employed the same basic model using bank data from 27 countries. The key addition they made to the model was the introduction of a trade policy variable in the second stage, which allowed for the subsequent calculation of TEs. The trade policy measure employed was developed by McGuire and Schuele<sup>6</sup> using countries' GATS schedules and various other sources. Restrictions are scored on a scale from 0 to 1 based on their severity, and restrictions are also weighted on their relative importance. Verikios and Zhang<sup>7</sup> inserted TEs developed by Kalirajan et al. into the FTAP2<sup>8</sup> model, a CGE model which includes commercial presence. They then computed welfare effects for a number of regions and countries, including the United States and Korea, of several multilateral banking liberalization scenarios. They estimate a global GNP increase of 0.1 percent based on complete global banking liberalization.<sup>9</sup>

## Conceptual Framework

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Restrictions on banking have the effect of shifting up the foreign supply curve in the domestic banking market.<sup>10</sup> The domestic supply curve is unaffected because the concerned restrictions are discriminatory in that they are imposed on foreign, but not domestic, banks. This shift up in the foreign supply curve causes the price of intermediation services,<sup>11</sup> as measured by NIMs, to increase.<sup>12</sup> The total quantity of banking services supplied decreases, while the share provided by domestic banks increases and the share provided by foreign banks decreases. The econometric analysis below estimates the wedge between observed prices and prices that would exist in the absence of any discriminatory restrictions on foreign banks. Assuming the domestic banks are able to capture the rents generated from these restrictions, this wedge may be considered a TE.

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<sup>4</sup> Saunders and Schumacher, "The Determinants of Bank Interest Margins: An International Study," 2000, 813–32.

<sup>5</sup> Kalirajan et al., "The Price Impact of Restrictions on Banking Services," 2000, 215–20.

<sup>6</sup> McGuire and Schuele, "Restrictiveness of International Trade in Banking Services," 2000, 201–13.

<sup>7</sup> Verikios, and Zhang, *Global Gains from Liberalising Trade in Telecommunications and Financial Services*, October 2001, 36.

<sup>8</sup> Foreign direct investment and Trade Analysis Project model version 2.

<sup>9</sup> The multilateral welfare effects estimated by Verikios and Zhang would not be comparable to expected welfare effects of banking the banking liberalization resulting from a bilateral treaty, such as the U.S.-Korea FTA.

<sup>10</sup> Deardorff and Stern "Empirical Analysis of Barriers to International Services Transactions and the Consequences of Liberalization," 2005, 550–55.

<sup>11</sup> Kalirajan et al., "The Price Impact of Restrictions on Banking Services," 2000, 215.

<sup>12</sup> The effect of TEs on NIMs will vary based on the size of a country's banking sector relative to the total world banking market. For a small country, the expected price effect should be equal to the TE. For medium or large countries such as Korea and the United States, the expected price effect may be smaller than the TE. In addition, markets are assumed to be competitive and foreign and domestic services highly substitutable.



## *Econometric Analysis*

Following the previous empirical work, the first stage used a log-log specification to determine the effect of three firm-level measures plus country dummy variables on NIMs. Country-level pure spreads were then calculated by adding the coefficients of the country dummy variables to the intercept term. In the second stage these pure spreads were used as the dependent variable, with country-level independent variables including a trade policy measure. The Commission developed this trade policy measure by using a technique suggested by the OECD.<sup>13</sup> The OECD identified restrictions and their relative impact on trade for each of the four modes of services trade.<sup>14</sup> Commission staff assigned scores to market access and national treatment commitments on the seven activities defined as banking services in the GATS. The services included deposit taking and lending services as well as fee-based services.<sup>15</sup>

Where countries scheduled a given subsector as completely open, a score of 0 was assigned, whereas the absence of a commitment was assigned a score of 1. It is recognized that countries' actual practices may be more liberal than their GATS commitments or offers indicate; therefore the GATS scores, and consequently the TEs developed from the GATS scores, should be considered an upper bound. A score of 0.25 was assigned if the measure was deemed to have little effect on trade by the OECD; a score of 0.5, if the measure has a restrictive effect; and a score of 0.75 if the measure was deemed to have a highly restrictive effect. Horizontal restrictions were assumed to have an equal effect across all subsectors unless otherwise noted, and therefore horizontal scores were assigned to each service scheduled by a given country. The total scores were aggregated across services, modes, and market access and national treatment categories. This score was then divided by 56, the score which would be observed if all services in all modes for both market access and national treatment were unbound. The resulting GATS scores were between 0 and 1. No attempt was made to weight various restrictions based on their relative importance.

From the coefficient of the GATS score estimated in the second-stage equation and the trade policy score for each individual country, the TEs were estimated using the equation:<sup>16</sup>

$$(1) TE = 100 * (e^{\text{GATS coefficient} * \text{GATS score}} - 1)$$

Owing to the logarithmic form of the first-stage equation, it is necessary to incorporate  $e$ , the base of the natural logarithm, to the equation calculating TE. Conceptually, the TE measures the percentage difference between the observed NIM and the NIM that would be observed in the absence of any trade restrictions.

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<sup>13</sup> OECD, "Assessing Barriers to Trade in Services: Revised Consolidated List of Cross-Sectoral Barriers," 2001, 5–9.

<sup>14</sup> Cross-border supply (Mode 1) entails the provision of services from a provider in one country to a consumer in another; consumption abroad (Mode 2), the provision of a service in the country of the supplier to a consumer from another country; commercial presence (Mode 3), the provision of a service through an affiliate established in a foreign market; and the presence of natural persons (Mode 4), the provision of a service by a natural person in a foreign market.

<sup>15</sup> Commitments were scored for (1) acceptances of deposits, (2) lending of all types, (3) financial leasing, (4) all payment and money transmission services, (5) guarantees and commitments, (6) provision and transfer of financial information, and (7) advisory, intermediation, and other auxiliary financial services.

<sup>16</sup> For the derivation of this formula, see Kalirajan et al., 226–7.

For the purposes of this report, a similar scoring method was used to score the text and nonconforming measures on banking contained in the U.S.-Korea FTA. In order to generate trade policy scores directly comparable to the GATS score developed for Korea, it was necessary to account for the negative listing approach used in the FTA. In order to account for the negative listing approach, a score of 0 (completely open) was assigned to any banking service or mode that was not specifically mentioned in the FTA, whereas a score of 1 (completely closed) was assigned to any banking service or mode not addressed in the GATS. Additionally, since Mode 4, the provision of a service by a natural person in a foreign market, is not covered by the FTA, the Commission assumed that the Mode 4 commitments made under the GATS would continue to be binding, thus leaving the Mode 4 scores unchanged from the GATS to the FTA. Commitments that referred to banking services in general were treated as horizontal commitments.

Firm-level data for over 1,400 commercial banks from more than 50 countries were retrieved from Bankscope, a large international database that compiles financial information on public and private firms. These data were used in the estimation of the first stage using the equation:

$$(2) \quad \ln \text{NIM} = \beta_1 + \beta_2 \ln(\text{net noninterest operating expenses}) + \beta_3 \ln(\text{capital adequacy ratio}) + \frac{\text{Total assets}}{\beta_4 \ln(\text{liquidity ratio}) + \sum_i \text{country dummies} + \varepsilon}$$

The dependent variable for the first stage was the NIM, which is the interest rate spread between lending and deposit rates. Firms with NIMs in the top 5 percent for each country were excluded.<sup>17</sup> The independent variables were net noninterest operating expenses, the capital adequacy ratio, and the liquidity ratio. Net noninterest operating expenses were calculated by subtracting pretax profits from net interest income and dividing this by total assets. The capital adequacy ratio, which is defined as total share capital and reserves divided by total assets, is a prudential measure with minimum levels set by regulatory agencies to ensure the solvency of banks.<sup>18</sup> The liquidity ratio, which is defined as total loans divided by total deposits, measures a bank's ability to meet depositors' claims. An increase in any of these factors should raise the NIM.

The second stage, which accounts for country-level variation in pure spreads, was estimated using the following equation:

$$(3) \quad \text{pure spreads} = \beta_1 + \beta_2 \text{market share} + \beta_3 \text{interest variability} + \beta_4 \text{GATS score} + \beta_5 \text{credit rating} + \beta_6 \text{tax rate} + \beta_7 \text{GDP/capita} + \varepsilon$$

The dependent variable was the country-level pure spread variable discussed above. Independent variables included market share, interest rate volatility, the GATS score, credit rating, the tax rate, and GDP per capita. Market share is defined as the share of total banking assets controlled by the five largest banks in each country. Its expected relationship with NIMs is ambiguous. On the one hand, more assets in the hands of a few firms may imply these firms exercise market power, thereby increasing NIMs. On the other hand, the relationship may be negative if economies of scale exist, in which firms could reduce marginal costs by expansion, thereby lowering their NIMs through consolidation. Interest

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<sup>17</sup> A high percentage of these firms were in fact credit card companies, which are not directly comparable with traditional commercial banks.

<sup>18</sup> Although minimum capital adequacy ratios are typically set by regulatory agencies, the actual capital adequacy ratio maintained by individual banks, which is what is used by this analysis, varies.

variability, which is the variance of the quarterly interest rate over the preceding three years, should also increase NIMs because banks must compensate for increased uncertainty. Countries that had interest rate volatility of more than two standard deviations above the mean were excluded. Cases of extreme interest rate volatility occurred in countries experiencing hyperinflation over the period. The GATS score variable is described above. Credit rating, which measures perceived credit worthiness, is a score assigned to a country by the trade publication *Institutional Investor* and reported in the *Global Competitiveness Report*.<sup>19</sup> It should have a negative relationship with NIMs because a higher score indicates a less risky country. The tax rate is defined as the average taxes paid by banks divided by pretax profits, and is expected to have a positive sign. As corporate tax rates rise, banks have to adjust by increasing their NIMs. GDP per capita should have a negative effect on NIMs, because as personal incomes rise, the supply of banking services provided should increase, thereby reducing NIMs. In addition to Bankscope, data for these variables were obtained from the *Global Competitiveness Report*, the IMF, and the World Bank.

## Results

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In order to test for stability of the model across time, results for 2 years were estimated. For the first stage reported in table H-1, all the prudential and firm-level measures were of the expected sign and statistically significant with similar coefficients reported in both years. The adjusted R<sup>2</sup>s for the first stage were 0.74 and 0.76 for 1999 and 2005, respectively, meaning approximately three-quarters of the variation in NIMs between firms were accounted for by prudential regulations and noninterest operating expenses. For the second stage reported in table H-2, interest rate variability and tax rate were positive and statistically significant, consistent with previous studies. Market share was found to have a negative relationship with pure spreads, indicating the presence of economies of scale. This effect was only significant in 2005, however. A number of other variables were also found to be significant in one year and not the other. The GATS scores were positive and statistically significant, signifying an increase in the GATS score will increase pure spreads. Critically, however, the GATS scores between the two years were statistically close,<sup>20</sup> and the estimated results of the model as a whole were quite similar.<sup>21</sup> From these results, TEs were generated using equation (1).<sup>22</sup> As noted above, these TEs represent how much higher a given country's average NIM is versus what the NIM would be if no trade restrictions existed.

The TEs for Korea were estimated, first using the GATS scores for 1999 and 2005 respectively, and then by substituting the U.S.-Korea FTA score for the GATS score in the TE equation. The estimated TE for Korea under the GATS was 76 percent for 1999 and 59 percent for 2005, whereas the TE estimated from the FTA was 29 percent, a decline of

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<sup>19</sup> World Economic Forum, "The Global Competitiveness Report," 2000, 296; and World Economic Forum, "The Global Competitiveness Report," 2005, 498.

<sup>20</sup> To test this, the data for the 2 years were pooled and the same model was run with the inclusion of a year dummy variable and an interaction term between the year dummy variable and the GATS score. The coefficient on this interaction term was not statistically significant, indicating that the GATS score was relatively stable over time.

<sup>21</sup> Pure spreads were estimated using 2005 data and the coefficients estimated from the second stage of the 1999 and 2005 models respectively. These pure spreads were found to have a correlation coefficient of 0.80, indicating that the predictive power of the model is relatively strong.

<sup>22</sup> In order to hold all other factors constant aside from changes in trade policy, the calculation of all the TEs was performed using the 2005 GATS coefficient.

**Table H.1** Tariff equivalents in Korean banking services: Stage 1 results<sup>a</sup>

Variable	1999 results		2005 results	
	Coefficients	T-statistics	Coefficients	T-statistics
Intercept	2.26	13.55 <sup>b</sup>	2.07	11.59 <sup>b</sup>
Ln (Noninterest operating expenses)	0.39	13.60 <sup>b</sup>	0.39	16.12 <sup>b</sup>
Ln (Capital adequacy ratio)	2.02	4.94 <sup>b</sup>	1.48	3.86 <sup>b</sup>
Ln (Liquidity ratio)	0.07	3.55 <sup>b</sup>	0.06	3.27 <sup>b</sup>
R-Squared	0.75		0.77	
Adjusted R-squared	0.74		0.76	
Number of observations	1,055		1,441	

Source: Compiled by Commission staff.

<sup>a</sup>Estimates corrected for heteroskedasticity. Results for country dummy variables not reported.

<sup>b</sup>Significant at the 1 percent level.

**Table H.2** Tariff equivalents in Korean banking services: Stage 2 results<sup>a</sup>

Variable	1999 results <sup>b</sup>		2005 results <sup>b</sup>	
	Coefficients	T-statistics	Coefficients	T-statistics
Intercept	2.433	12.39 <sup>c</sup>	3.041	11.77 <sup>c</sup>
Market share	-0.075	-0.65	-0.231	-2.23 <sup>d</sup>
Interest variability	0.454 <sup>f</sup>	2.66 <sup>d</sup>	0.003	3.40 <sup>c</sup>
GATS score	0.803	3.20 <sup>c</sup>	0.665	3.19 <sup>c</sup>
Credit rating	-0.008 <sup>f</sup>	-0.08	-0.009	-2.85 <sup>c</sup>
Tax rate	0.141	3.15 <sup>c</sup>	0.425	1.72 <sup>e</sup>
GDP/Cap	-0.012 <sup>f</sup>	-2.57 <sup>d</sup>	-0.001 <sup>f</sup>	-0.24
R-squared	0.56		0.65	
Adjusted R-squared	0.49		0.61	
Number of observations	42		57	

Source: Compiled by Commission staff.

Note: Data not available for all countries in 1999.

<sup>a</sup>Results corrected for heteroskedasticity.

<sup>b</sup>Coefficients for 1999 and 2005 not directly comparable because of differing countries in sample.

<sup>c</sup>Significant at the 1 percent level.

<sup>d</sup>Significant at the 5 percent level.

<sup>e</sup>Significant at the 10 percent level.

<sup>f</sup>Results multiplied by 1,000.

roughly one-half from the Uruguay Round to the FTA. This decline in the TE represents both the lowering of barriers to entry and operation for U.S. firms in Korea as well as the lowering of the price of intermediation services (NIMs) facing Koreans.<sup>23</sup> The drop in the TE from the GATS Uruguay Round commitments reflect decreased barriers to the acquisition of existing Korean firms, reduced residency requirements for senior executives, and the elimination of minimum investment restrictions for FDI. Further reductions in the TE from the GATS Doha Round offers compared to the FTA reflect the reduction of restrictions in the cross-border supply of certain financial information services, the elimination of Mode 2 restrictions on the provision of a service in the country of the supplier to a consumer from another country, and the increased ability of foreign banks to offer a full range of financial products. The reduction of these barriers would decrease the costs of entry for U.S. banks wishing to establish a presence in Korea and enhance the operating environment for U.S. banks already located in the country. The lower NIMs that result from the increased level of liberalization under the FTA should promote more lending and economic growth in Korea, both of which should benefit U.S. banks in the country. Since the FTA is a bilateral as opposed to a multilateral agreement, the lower TE calculated for the FTA reflects a lower entry barrier for U.S.-based firms, but not necessarily for firms from other foreign countries. Banks from other countries would still face the higher TE when attempting to do business in Korea, unless they receive the same treatment as U.S. banks by making investments in Korea via U.S. affiliates.<sup>24</sup>

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<sup>23</sup> NIMs will vary across countries even for countries with identical TEs due to nontrade policy factors such as macroeconomic climate and country-level risk.

<sup>24</sup> If non-U.S. foreign banks are unable to enter the Korean market via U.S. affiliates, the decline in NIMs may be smaller than otherwise.



# **APPENDIX I**

## **Services Nonconforming Measures Tables**





**Table I.1 U.S.-Korea FTA: Korean services sectors subject to nonconforming measures related to cross-border trade**

Current measures	Potential measures
Construction Services	Disadvantaged Groups
Leasing or Rental, Maintenance, Repair, Sales and Disposal Services of Construction Machinery and Equipment	Firearms, Swords, Explosives, Etc.
Transportation Services - Automobile Maintenance, Repair, Sales, Disposal, and Inspection Services; Automobile License Plate Issuing Services	State-Owned National Electronic / Information System
Distribution Services—Wholesale and Retail Distribution of Tobacco and Liquor	Social Services
Business Services—An-gyung-sa (Optician and Optometry) Services	Transportation Services—Railroad Transportation
Wholesale and Retail Distribution Services	Environmental Services—Treatment and Supply Services for Potable Water; Collection and Treatment Services for Municipal Sewage; Collection, Transportation, and Disposal Services for Municipal Refuse; Sanitation and Similar Services; Nature and Landscape Protection Services (except for Environmental Impact Assessment Services)
Retail Distribution of Pharmaceuticals	Atomic Energy—Nuclear Power Generation; Manufacturing and Supply of Nuclear Fuel; Nuclear Materials; Radioactive Waste Treatment and Disposal (including treatment and disposal of spent [irradiated] nuclear fuel); Radioisotope and Radiation Generation Facilities; Monitoring Services for Radiation; Services relating to Nuclear Energy; Planning, Maintenance, and Repair Services
Transportation Services—Rail Transportation and Incidental Services	Energy Services—Electric Power Generation other than Nuclear Power Generation; Electric Power Transmission, Distribution and Sales; Electricity Business
Transportation Services—Passenger Road Transportation Services excluding Taxis and Scheduled Passenger Transportation	Energy Services—Gas Industry
Transportation Services—International Maritime Cargo Transportation and Maritime Auxiliary Services	Distribution Services—Commission agents' Services, Wholesaling, and Retailing of Agricultural Raw Materials and Live Animals (nong chuk-san mul)
Transportation Services—Specialty Air Services	Transportation Services (Taxi and Scheduled Passenger Transportation)
Transportation Services—Road Transportation Support Services	Transportation Services—Road Transportation Services (Freight Transportation Services except Road Transportation Services Related to Courier Services)
Courier Services	Transportation Services—Internal Waterway Transport Services and Space Transport Services
Telecommunications Services	Transportation Services—Storage and Warehousing Services
Real Estate Brokerage and Appraisal Services	Communication Services - Nonmonopoly Postal Services
Retail, Rental, or Repair Services—Medical Devices	Communication Services - Broadcastin Services
Rental Services—Automobiles	
Scientific Research Services and Sea Map Making Services	
Professional Services—Labor Affairs Consulting Services	
Professional Services—Labor Affairs Consulting Services	
Professional Services—Patent Attorney (byeon-ri-sa)	
Professional Services—Accounting and Auditing Services	
Professional Services—Tax Accountant (se-mu-sa)	
Professional Services—Customs Clearance Services	
Engineering and Other Technical Services - Industrial Safety, Health Institution, and Consulting Services	

**Table I.1** U.S.-Korea FTA: Korean services sectors subject to nonconforming measures related to cross-border trade—*Continued*

Current measures	Potential measures
Engineering and Other Technical Services - Architectural Services, Engineering Services, Integrated Engineering Services, Urban Planning and Landscape Architectural Services	Communication Services—Broadcasting and Telecommunications Services
Business Services—Electric Billboard Operator Services and Outdoor Advertisement Services	Business Services—Real Estate Services (excluding Real Estate Brokerage and Appraisal Services)
Business Services—Job Placement Services, Labor Supply and Worker Dispatch Services, and Education Services for Seafarers	Business Services—Insolvency and Receivership Services
Investigation and Security Services	Digital Audio and/or Video Services
Distribution of Publications	Business Services—Surface Surveying Services and Cadastral Map Making Services
Transportation Services—Aircraft Maintenance and Repair Services	Business and Environmental Services—Examination, Certification, and Classification of Agricultural Raw Materials and Live Animal (nong chuk-san mul) Business Services - Services incidental to Agriculture, Hunting, Forestry and Fishing
Education Services—Higher Education	Publishing of Newspapers
Education Services—Adult Education	Education Services—Preprimary, Primary, Secondary, Higher and Other Education
Education Services—Vocational Competency Development Training Services	Social Services—Human Health Services
Veterinary Services	Recreational, Cultural and Sporting Services—Motion Picture Services
Environmental Services—Waste Water Treatment Services, Waste Management Services, Air Pollution Treatment Services, Environmental Preventive Facilities Business, Environmental Impact Assessment, Soil Remediation and Groundwater Purification Services, and Toxic Chemical Control Services	Recreational, Cultural and Sporting Services—Museum and other Cultural Services
Performance Services	Legal Service—Foreign Legal Consultants
News Agency (News-tong-sin-sa) Services	Professional Services—Foreign Certified Public Accountants
Publishing of Periodicals (excluding Newspapers)	Business Services
Distribution Services—Agriculture and Livestock	Transportation Services—Maritime Passenger Transportation and Maritime Cabotage
Communication Services—Broadcasting Services	Insurance
Recreational, Cultural, and Sporting Services—Motion Picture Services	Banking and Other Financial Services (excluding Insurance)
Insurance	
Banking and Other Financial services	

Source: USTR, "Final - United States - Korea FTA Texts," 2007, Annexes I, II, and III.

**Table I.2** U.S.-Korea FTA: U.S. services sectors subject to nonconforming measures related to cross-border trade

United States	
Current measures	Potential measures
Business Services	Insurance
Specialty Air Services	Communications
Transportation Services—Customs Brokers	Social Services
Professional Services—Patent Attorneys, Patent Agents, and Other Practice before the Patent and Trademark Office	Minority Affairs
Banking and Other Financial Services (excluding Insurance)	Maritime Transportation Services and Operation of U.S.-flagged Vessels
Insurance	

Source: USTR, "Final - United States - Korea FTA Texts," 2007, Annexes I, II, and III.



**APPENDIX J**  
**Description of Possible Nontariff Measures**  
**Analysis**

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# Use of Indicative Quantitative Information to Assess Possible Nontariff Measures Affecting Korean Imports

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The analysis of nontariff measures (NTMs) affecting trade begins with the understanding that their effects are analogous to tariffs—i.e., NTMs restrict the quantity of imported goods and raise their prices. An import tariff raises the price of an internationally traded product to consumers and creates a “wedge” or “gap” between the price paid by consumers/importers and that received by sellers/exporters of the product. In similar ways, importing country policies that add to the cost of selling the good in their countries also create such a price gap. Policies that restrict quantities also raise prices, since the scarcity induced by the quantity restriction causes consumers to pay more.

In the absence of trade barriers one would expect the import prices for a good of uniform specifications and quality to be identical in all countries, varying only by differences in transportation costs. If the only trade policy affecting import prices was tariffs, we would expect price differences across countries inclusive of tariffs (known as the landed-duty-paid price) to be roughly equivalent to differences in tariff rates. The more widely available internationally comparable measure of import prices is the cost-insurance-freight (c.i.f.) price, which does not include tariffs. In an ideal case, in which one country exports an identical good to many different countries, differences in c.i.f. import prices should only reflect differences in transport costs. If the product in question comes in a wide range of varieties, then it may be the case that different countries import a different mix of varieties, which could also lead to a difference in c.i.f. import prices.<sup>1</sup>

When NTMs are present in a country, they either restrict the supply of foreign goods entering the country or raise the cost of selling into the country. For example, nonautomatic licensing requirements could restrict the quantity of goods imported. Cumbersome customs procedures or regulatory measures, such as certification of technical standards or measures for food inspection,<sup>2</sup> may raise the cost of imported goods. Higher prices in turn lead to lower quantities imported, since the final consumer is less willing to pay the higher price.

Since the prices charged for goods subject to an NTM are likely higher than those that would be generated from production and transport costs, they may generate benefits or “rents” for somebody in the supply chain. Depending on where in the supply chain these measures are implemented, and on the bargaining power of different agents in the supply chain, the higher prices arising from NTMs may be observed at points other than at the point of unloading (the c.i.f. price). For example, “behind-the-border” restrictions, such as excise taxes, may lead to higher wholesale or retail prices. Comparisons here are made in terms of c.i.f. prices not only because of the availability of internationally comparable data, but because c.i.f. prices

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<sup>1</sup> Partner-specific export taxes and subsidies could also induce variation in the c.i.f. price.

<sup>2</sup> NTMs related to regulatory or technical standards are generally referred to as technical barriers to trade (TBTs). These include agriculture-related TBTs such as labeling requirements. Regulatory or technical standards regarding human, animal, and plant health are generally known as sanitary and phytosanitary (SPS) measures. The analysis presented here is intended to address only the market effects of such measures, not the extent to which such measures may or may not promote domestic policy objectives related to health or safety.

are in effect import prices, and the measures in question are usually understood to affect the act of importing in some manner.

This report makes use of various comparisons of international trade data in its assessment of potential NTMs in the Korean market. While an effort is made elsewhere in the report to represent NTMs in the modeling of effects of the trade agreement, the direct comparisons of import unit values and import quantities for a small number of products of importance to U.S. exporters may be illustrative of the impacts of these measures. In the presence of NTMs, one would expect either Korean import unit values to be noticeably higher than one might expect, or quantities imported by Korea to be noticeably lower than one would expect, or both. In previous work, analysts at USITC and elsewhere have used a variety of methods to assess the effects of NTMs.<sup>3</sup> Commission staff examined price and quantity data for nearly 40 product categories at the HS-6 level, corresponding to products in the sector-specific analysis (chapter 3 of this report). Staff focused on goods with significant U.S. exports and goods for which common units of measure made international comparisons feasible. In many cases, the analysis of price and quantity data reflect the presence of NTMs. The selected cases for which price and quantity comparisons are reported (certain processed foods, small passenger vehicles, and ultrasonic scanning apparatus) represent cases in which high import prices and/or low quantities, by international standards, coincided with reports of significant NTMs in the Korean market.

The indicative quantitative information (IQI) presented in this report is meant to be suggestive rather than dispositive, and does not include a number of factors, such as transportation costs, that would be relevant in a full-blown analysis of individual products. More elaborate methods would produce more focused estimates. IQI is presented only in cases for which the price and/or quantity of information is suggestive of the presence of NTMs, and for which available qualitative information also indicates the potential importance of nontariff policies in limiting Korean import demand.

If products were homogeneous (i.e., all countries imported exactly the same type and quality of products within a trade classification), calculating price effects of trade policy measures would be straightforward; comparing a particular country's import price with that of countries known not to have trade barriers (and adjusting for transportation cost differences) would provide a reasonable estimate of a price differential. Products within a trade category (e.g., the 6-digit HS code), however, are generally more heterogeneous than this; countries do not import the same mix of products, and in addition to differing composition of imports within the category is the possibility of differing quality of products of the same type.

In developing IQI for this report we assume initially that the composition of Korean imports within an HS-6 (subheading) category, the finest level at which international comparisons can be made in the Harmonized System of the World Customs Organization, does not vary systematically from that of the average world importer. Averaging unit values over the

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<sup>3</sup> See Linkins, L.A. and H. M. Arce, (2002) revised, "Estimating Tariff Equivalents of Non-Tariff Barriers," U.S. International Trade Commission Office of Economics Working Paper 94-06-Ar, Washington, DC: USITC, for a foundational discussion of estimating price gaps of NTMs; Dean, J., R. Feinberg and M. Ferrantino (2005), "Estimating the Tariff-Equivalent of NTMs," in P. Dee and M. Ferrantino, (eds.), *Quantitative Measures for Assessing the Effect of Non-Tariff Measures and Trade Facilitation*, Singapore: World Scientific Ltd. for APEC, 289–310, for econometric methods using price data; and M. Ferrantino (2006), "Quantifying the Trade and Economic Effects of Non-Tariff Measures," OECD Trade Policy Working Paper No. 28, TD/TC/WP2005(26)/FINAL, Paris: OECD, for a broader review including both price and quantity methods by a variety of researchers.



2004–2006 calendar years, we report the percentage by which the Korean import unit value exceeds the trade-weighted import unit value by all countries that report quantities of the product in the same units as does Korea; the latter is a proxy for a world price.<sup>4</sup> Korean import unit values significantly above this are consistent with the view that NTMs may be affecting trade and leading to a price distortion. As a check on this, however we also try to control for the mix of products Korea imports within that trade category, which we do by noting the percentage by which Korea’s unit value of imports *from the United States* exceeds the U.S. export unit value *to the world* (this comparison assumes that what U.S. exporters sell to Korea is comparable to what they sell to the world). Some of this discrepancy may be attributable to shipping costs but where the import unit value differences are relatively large, one may infer that some is due to the capture of rents by various parties involved in the international transaction.

We also perform quantity comparisons in which average Korean import quantities from the world, at the HS-6 level, are compared with import quantities of other countries. Since one would expect that larger economies import more, the comparisons are made in terms of import quantity per million dollars of GDP.<sup>5</sup> In general, whenever quantity information is included in the analysis, or either the import quantity relative to GDP is less than 25 percent that of the median country, Korean import quantity relative to GDP ranks in the bottom 25 percent of countries with available data, or both.

In making quantity comparisons, one should recognize that cross-cultural differences in consumer tastes and preferences may play a role in differences in the quantity imported. This is, however, less likely as the deviation of import quantity relative to GDP from the global average increases.

Price and quantity data were taken from Global Trade Analyzer, a product of GTIS, which reports primary-country trade data for a sample of over 60 countries, which include most important traders. Prices are calculated as unit values and averaged over 2004–06. Quantity comparisons are averaged over 2003–05 due to the lag in availability of comparable GDP data. Unit values are in standardized units of measure wherever possible; e.g., metric tons have been converted to kilograms. For some manufactured goods, such as medical devices, units of measure are not standardized internationally and comparisons have been made for the subset of countries with units of measure comparable to those used in Korean trade data. This may affect the quality of the comparisons, and has been noted when applicable.

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<sup>4</sup> While they used this for a different purpose, the average world import unit value was also taken to be a world price proxy by Gibson, Wainio, Whitley, and Bohman, *Profiles of Tariffs in Global Agricultural Markets*, Agricultural Economic Report No. AER796, USDA, January 2001. The comparison of the Korean import unit value to this world price proxy would be a conservative estimate of the extent to which Korean trade distortions raise their import price if Korea’s imports within the product category were of the same composition and quality as are those of the rest of the world, as the world average import-unit-value is itself likely raised by other countries’ trade distortions.

<sup>5</sup> This is equivalent to maintaining the hypothesis that import demand of the representative international consumer is unit-elastic with respect to income; i.e., that a 1 percent increase in income leads to a 1-percent increase in import demand. Exploratory econometrics showed that this is a reasonable assumption for the products under consideration in this study, and in most cases is a conservative assumption. That is, most of the true income elasticities are likely to be somewhat higher than 1. If these were used in the analysis, we would be more likely to find that Korean import quantities appeared unusually low.



**APPENDIX K**  
**Overview of Agricultural-Sector-Related**  
**Regulatory Environment in Korea**

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Below are examples of regulations and requirements that Korea applies in the case of agricultural goods.

**Sanitary and Phytosanitary Standards (SPS):** For live animals, plants, and meat products, SPS certificates from the exporting country's inspection authority are required. For example:

- Preapproval of meat facilities is also mandatory. The Korean government banned imports of beef from the United States in 2003 following an outbreak of BSE. The market opened partially in 2006 to allow unprocessed boneless beef from cattle 30 months old or younger.
- Processed foods containing corn must include a letter, statement, or certificate from the manufacturer or exporter stating the raw corn was free of StarLink protein. A U.S. producer's first shipment of unprocessed corn also must be certified as Bt 10 free by GeneScan; subsequent shipments are tested only when subject to random inspection. White corn, sweet corn, waxy corn, and popcorn are exempt from Bt 10 requirements.

**Labeling Requirements:** Korea has issued regulations that govern food labeling requirements related to language, country of origin, nutrition, high caffeine content, liquor content, organic content, and genetically modified content. In addition, producers exporting to Korea must monitor frequent changes to labeling requirements. Examples of such regulations include

- General labeling rules: All products under purview of the Korean Food and Drug Administration (KFDA) must use Korean language labels. Among the 102 meat, eggs, and dairy products that the Ministry of Agriculture and Forestry (MAF) oversees, dairy and sausage products are required to have Korean-language labels. In general, sticker Korean-language labels suffice, which require manufacturer labels printed in Korean. Ingredient disclosure requirements were added in 2006 for livestock, dairy, and egg products.
- Country of origin labeling: Korea requires that all agricultural products be labeled for country of origin. Specific rules vary by product, but generally require a label on the smallest packing unit. As of January 2007, both inner and outer packages of meat and fishery products require country of origin labels; stickers are not allowed on frozen meat products.
- Korean-language nutrition labels, though optional for most products, must be based on Korean nutrient reference values. Labels using terms such as "low" and "non" must conform to nutrient content restrictions.
- Genetically modified food: Korea requires that all genetically modified food for human consumption be labeled according to the following criteria: (1) processed foods must be labeled as recombinant if GM maize, potatoes, soybeans, or bean sprouts are the primary ingredient; if one of five major raw materials is a GM ingredient; or if recombinant DNA or foreign proteins are present in the final product; and (2) unprocessed maize, potatoes, soybeans, or bean sprouts must be labeled as recombinant if they contain biotech-enhanced content of at least 3 percent. Legislation announced in March 2007, however, would expand GMO labeling requirements to all items approved for human consumption.

Additionally, although current regulations do not include feedstuffs under GM labeling requirements, Living Modified Organisms (LMO) legislation is expected to require environmental risk assessments for LMOs for food, feed, and processing and for seed sometime in 2007. The KFDA prohibits “non-GMO” and “GMO-free” labeling on products under its purview, and the MAF allows such labels on its products only if the food is 100 percent GMO-free.

**TRQ Administration:** Agricultural imports typically enter the Korean market via one of three distribution systems: consignments to state trading entities (STEs), import quota auctions, or case-by-case distribution of import rights to final users. When STEs or producer associations are responsible for TRQ administration, a potential conflict of interest arises.

- In 2004, the average fill ratio for agricultural TRQs was 70 percent. Reasons cited for unutilized quota included low domestic demand, quarantine measures, and breach of agreement by the exporter.
- Korea’s flexible tariff rate system includes adjustment, emergency, special emergency, and seasonal tariffs. Where a gap exists between Korea’s applied tariff rate and maximum bound tariff rate, the government may legally impose temporary additional tariffs up to the bound rate. The uncertainty that results from flexible tariffs may complicate planning for producers and exporters.

**Customs Administration:** The WTO reported in 2004 that Korean customs practices seem to differ significantly from international norms in conformity testing, inspection, and acceptance of overseas results. Examples of regulations include

- Strict quarantine assignments and sanitary and phytosanitary standards: In 2005, revisions were announced to eliminate mandatory laboratory inspections and require only document inspections. These revisions would apply to agricultural products that have a five-year clean record and that the KFDA commissioner recognizes as safe.
- Customs classification standards are reported to change arbitrarily, and misclassification of blended products into base-product categories has resulted in higher tariff charges. Increases in sample sizes for import price checks have also reportedly been utilized to protect Korean farmers.
- To enter Korea, agricultural products generally must clear several different customs agencies. This increases the chance of port delays, which can be costly due to the perishable nature of many agricultural products.

**Other Regulations:** The Korean government also maintains regulations related to food additives, biotech environmental assessments, biotech advertising, pesticide residue levels, disease and pest control, genetically modified agricultural products, and packaging materials. Examples of other regulations include

- Korea maintains a positive list of approved food additives; in July 2006, it contained 627 items. If an additive is not registered in the Korean Food Additive Code, or usage in a certain food is not specified, the additive is prohibited, regardless of CODEX standards. Thus, certain ingredients, food colors, dyes, and manufacturing processes considered safe by CODEX are prohibited in Korea.

Additionally, foods and food additives developed through recombinant DNA techniques may not be distributed commercially until the KFDA commissioner confirms that they pose no health risk to humans. The process of adding a new additive or usage to the list can be a time-consuming and burdensome.

- Environmental risk assessments for biotech crops used for food, feed, and seed were scheduled to become mandatory when the Living Modified Organism Act was to take effect in 2007. Safety assessments for biotech feed are also in development.
- The Korean food code defines maximum residue levels (MRLs) for 370 pesticides. As with additives, Food Code standards supersede CODEX standards. If the Korean Food Code does not define a pesticide MRL, CODEX standards then apply. As of July 2006, the KFDA English Web site of MRLs was discontinued for Web site changes.
- For disease and pest control reasons, Korea prohibits entry of most fresh fruit from most countries. Korea permits import of oranges, lemons, limes, and persimmons from all U.S. states except Florida, Hawaii, and Texas.
- As of 2004, neither importation nor domestic production of genetically modified agricultural products (GMAPs) was permitted in Korea. Funding for detection of GMAPs increased substantially in 2004.
- Polyvinyl chloride (PVC) shrink wrap packaging is subject to regulations as of 2001. Recyclable packages must include “separation and discharge” labels.

*Sources:* USDA, FAS, Global Agriculture Information Network. Republic of Korea: Food and Agricultural Import Regulations and Standards, 2006; USDA, FAS, GAIN report, Republic of Korea: Food and Agricultural Import Regulations and Standards, 2005, 32; USDA, ERS, “Genetically Engineered Crop Varieties,” *Amber Waves*, September 2004, 1; Sally Schuff, “Syngenta reports mix-up with biotech corn,” *Feedstuffs*, March 28, 2005; USDA, FAS, Global Agriculture Information Network. Republic of Korea: Food and Agricultural Import Regulations and Standards, New Country of Origin Labeling Requirements, 2006; World Trade Organization Committee on Technical Barriers to Trade. Notification G/TBT/N/KOR/135, 2007; The Economist Intelligence Unit. South Korea Country Commerce. New York, NY: The Economist Intelligence Unit Limited, 2006; World Trade Organization, Trade Policy Review: Republic of Korea. WTO Secretariat Trade Policy Review Body, 2004; Office of the U.S. Trade Representative. National Trade Estimate Report on Foreign Trade Barriers, 2007; and “Codex Alimentarius.” [http://www.codexalimentarius.net/web/index\\_en.jsp](http://www.codexalimentarius.net/web/index_en.jsp) (accessed July 11, 2007).

# About This Report

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The United States and the Republic of Korea (Korea) concluded negotiations for a free trade agreement on April 1, 2007. On April 1, 2007, President Bush notified Congress of his intent to enter into the U.S.-Korea Free Trade Agreement (FTA), and the United States Trade Representative requested this investigation under section 2104(f) of the Trade Act of 2002 (Trade Act), which requires that the U.S. International Trade Commission (the Commission) submit a report to the President and the Congress not later than 90 calendar days after the president enters into a trade agreement.

Section 2104(f)(2) of the Trade Act requires that the Commission prepare a report assessing the likely impact of the U.S.-Korea FTA on the U.S. economy as a whole and on specific industry sectors, and section 2104(f)(3) requires that the Commission, in preparing its assessment, review available economic assessments regarding the agreement.

A copy of the request letter for this investigation is in appendix A. The Commission's notice of institution and notice of rescheduling of public hearing, published in the *Federal Register* of May 7, 2007 and May 23, 2007, respectively, are in appendix B. The Commission held a public hearing for this investigation on June 20, 2007. A calendar of the hearing is included in appendix C of this report, and a summary of hearing testimony and written submissions is provided in chapter 7.



