REPUBLIC OF KOREA

TRADE SUMMARY

In 2002, the U.S. trade deficit with Korea totaled $13.0 billion, a slight decrease of $22 million from 2001. In 2002, Korea was the United States' 6th largest export market. During 2002, two-way goods trade between the United States and Korea increased to $58.2 billion, a slight increase over 2001. U.S. exports to Korea totaled $22.6 billion, a 1.9 percent increase over 2001. U.S. imports from Korea also increased in 2002 to $35.6 billion, up 1.1 percent from 2001.

U.S. exports of private commercial services (i.e., excluding military and government) to Korea were $7.1 billion in 2001 (latest data available), and U.S. imports from Korea were $3.8 billion. Sales of services in Korea by majority U.S.-owned affiliates were $1.7 billion in 2000 (latest data available), while sales of services in the United States by majority Korea-owned firms were $385 million.

The stock of U.S. foreign direct investment in Korea in 2001 was $9.9 billion, an increase of 10.7 percent from 2000. U.S. foreign direct investment is concentrated largely in manufacturing, banking, and wholesale sectors.

IMPORT POLICIES

Tariffs and Taxes

Korea bound 91.7 percent of its tariff line items in the Uruguay Round negotiations, and in 2001, Korea's average tariff rate was 8.9 percent. However, Korea's 50 percent average out-of-quota tariff rate for agricultural products in 2002 poses a significant barrier to trade and contrasts sharply with the relatively low average tariff for industrial products of 7.5 percent. Korea's tariffs on all agricultural products, except rice, are bound at an average of 62 percent. In the case of rice, Korea committed under Annex 5 of the WTO Agriculture Agreement to provide increasing market access for rice at a tariff rate of 5 percent. Tariffs on forestry and fishery products remain unbound. Between 1995 and 2004, Korea agreed to lower duties on more than 30 agricultural products of primary interest to U.S. exporters. These products include bulk, intermediate- and high-value items, such as mixed feeds, feed corn, wheat, vegetable oils and meals, fruits, nuts,

Under its Uruguay Round commitments, Korea also established tariff-rate quotas (TRQs) intended to either provide minimum access to a previously closed market or maintain pre-Uruguay Round access. (See also "Quantitative Restrictions, TRQs and Import Licensing.") In-quota tariff rates are zero or very low, but over-quota tariff rates on some products are prohibitive. Specifically, natural and artificial honey are assigned an over-quota tariff rate of 251.1 percent; skim and whole milk powder, 189.2 percent; barley, 334.8 percent; barley malt, 278 percent; potatoes and potato preparations, more than 314.2 percent; and popcorn, 651 percent.

Duties are still very high on many high-value agricultural and fishery products. Korea imposes tariff rates above 40 percent on many products of interest to U.S. suppliers, including shelled walnuts, table grapes, beef, canned peaches and fruit cocktail, distilled spirits, apples, pears and a variety of citrus fruits. Products subject to 30 percent or higher tariff rates include certain meats, most fruits and nuts, many fresh vegetables, starches, peanuts and peanut butter, soups, various vegetable oils, juices, jams, beer and some dairy products.

By 2004, Korea will reduce bound tariffs to zero on most or all products in the following sectors: paper, toys, steel, furniture, semiconductors and farm equipment. Korea is harmonizing its chemical tariffs to final rates of 0 percent, 5.5 percent or 6.5 percent, depending on the product. In addition, tariffs on scientific equipment are being reduced 65 percent from pre-Uruguay Round levels. On textile and apparel products, Korea has harmonized and bound most of its tariffs to the following levels: 13 to16 percent for man-made fibers and yarns, 30 percent for fabrics and made-up goods and 35 percent for apparel.

Korea uses "adjustment tariffs" and compounding of taxes to boost the applied tariff rate in order to protect domestic producers, practices about which the U.S. Government has expressed concern to the Government of Korea. In 1997, Korea agreed as a condition of its IMF stabilization package to reduce the number of products subject to tariff adjustments. In 2002, Korea renewed adjustment tariffs on 22 of 26 items that received adjustment tariffs in 2001 (reducing the tariff rates for 9 of these 22 items) and implemented a new adjustment tariff for one

product, live croaker. Most of the 23 adjustment tariffs are imposed on agricultural products and seafood, including frozen croaker and skate.

The combination of relatively high tariffs and value-added taxes continues to render a variety of products uncompetitive in Korea. One such product is motor vehicles, which are subject to a tariff rate of 8 percent – more than three times the U.S. tariff – as well as multiple taxes compounded on the tariff. Three of these taxes are based on engine size and have a disproportionate impact on imported vehicles. Although Korea eliminated or reduced some motor vehicle taxes based on commitments it made under the 1998 Memorandum of Understanding Regarding Foreign Motor Vehicles in the Republic of Korea, the combination of the tariff and remaining taxes levied on imported cars continues to severely impede their price competitiveness. In November 2001, Korea temporarily reduced the special consumption tax on autos through June 2002. The United States continues to urge Korea to undertake reforms of its overall auto tax system in an open and transparent manner that fully involves all stakeholders throughout the process.

Non-Tariff Measures

Internal Supports

Korea agreed as part of the Uruguay Round Agreement on Agriculture to reduce its domestic support (Aggregate Measurement of Support, or AMS) for agricultural products by 13 percent by 2004. The Government of Korea substantially increased the level of domestic support it provided to its cattle industry during 1997 and 1998, thereby raising the overall level of support for agriculture as well. The issue of whether Korea had adequately confined domestic support within the constraints of its WTO reduction commitments on domestic subsidies was raised, along with other related issues, by the United States and Australia in WTO dispute settlement proceedings in 1999. While the panel ruled against Korea on this issue, the outcome of the dispute was inconclusive as the WTO Appellate Body was unable to make a specific finding on the consistency of Korea's subsidy level with the applicable obligations under the WTO Agreement on Agriculture. Nonetheless, the Appellate Body did conclude that Korea had not been computing the current level of domestic support in a manner compatible with the requirements of the Agreement. The United States will continue to monitor Korea's notification of its AMS to the Committee on Agriculture to ensure that the calculation is now in conformity with Korea's commitments.

Quantitative Restrictions, TRQs and Import Licensing

Quantitative Restrictions

Pursuant to a 1993 U.S.-Korea agreement and Korea's Uruguay Round commitments, effective January 1, 2001, the Government of Korea removed its eight remaining quantitative restrictions on items subject to balance-of-payments protection. These items consisted mainly of live cattle (dairy and beef) and beef products (HS 0201 and 0202). However, as a result of limits on the number and size of official port quarantine inspection facilities, Korea effectively placed quantitative restrictions on all live animals eligible to be imported under Korea's commitment to the WTO.

The U.S. Government, joined by the Government of Australia, initiated WTO dispute settlement proceedings in 1999 (*see above section*) to ensure that Korea would fulfill its obligation to remove these balance-of-payment restrictions and, more broadly, that Korea would adhere to WTO rules in the conduct of its beef import and distribution system. The WTO Panel found in favor of the United States and Australia on this issue, and after considering an appeal by Korea, the Appellate Body report affirmed the key findings of the WTO Panel. (*See also "Beef" under the TRQ section.*)

Tariff-Rate Quotas (TRQs)

Most imported non-food goods no longer require government approval, but some products, mostly agricultural/fishery items, face import restrictions such as quotas or TRQs with prohibitive over-quota tariffs. Korea implements quantitative restrictions through its import licensing system which domestic producer groups or government buying agencies – the Agricultural Fishery Marketing Corporation (AFMC) and Public Procurement Services (PPS) – administer. A government export-import notice lists products that are restricted.

The U.S. Government has raised concerns about Korea's administration of quotas, specifically regarding rice, citrus, and unprocessed food grade and value-added soybean and corn products. In some cases, including for onions, potatoes, shelled nuts and garlic, the Ministry of Agriculture and Forestry (MAF) authorizes AFMC to auction in-quota quantity allocations. Such an allocation system adds costs to the permissible charges foreign firms face in entering the Korean market, raising questions about the WTO-consistency of the system. The U.S. Government also has raised concerns about MAF's delegation of authority to the Cheju Citrus Cooperative (CCC) to administer its citrus quota. The CCC attempts both to auction in-quota quantity allocations and to impose trade terms on the award winner. It also retains the revenue generated by the auctions. Proceeds from quota auctions used to support producers do not appear to have been notified as domestic support to the WTO. Moreover, the CCC restricts market access by delaying tender announcements and limiting import dates. The Government of Korea condones the CCC's anti-import practices, which ultimately burden Korean consumers by limiting product availability and raising prices.

Korea also continues to restrict imports of value-added soybean and corn products. By aggregating raw and value-added products under the same quota, Korea restricts market access for value-added products, such as corn grits and soy flakes. Domestic producer groups, which administer the quotas, invariably allocate the more favorable in-quota rate to their major members, who use it to import raw ingredients.

Beef

On September 10, 2001, Korea brought its retail beef distribution system into compliance with its WTO obligations. The U.S. Government has sought changes to Korean regulations prohibiting the freezing of meat sold as "fresh" or "chilled" and the re-freezing of meats sold as "frozen." After much encouragement by the U.S. Government, the Government of Korea responded by changing Korean regulations to permit greater flexibility to importers in the freezing of chilled beef in early July 2002, creating more U.S. beef export opportunities.

According to Korean statistics released in November 2002, Korean imports of chilled U.S. beef have risen to $30.7 million (Jan to Oct 2002 basis), up 253 percent or $18.5 million above 2001. Korean imports of chilled U.S. beef since the change in regulations in July increased by $8.9 million over the same July – October period in 2001. Prorated on an annual fiscal year basis, imports of chilled U.S. beef are projected to increase $26.8 million over the previous year. The United States will continue monitoring the situation to ensure these measures are fully implemented.

Rice

The Government of Korea continues to exercise full control over the purchase, distribution and end-use of imported rice. Korean law allows imported rice to be used only for industrial or processing purposes. The state trading enterprises that administer the WTO-mandated minimum access program typically purchase only low-quality rice on instruction from the buying ministry – MAF. In 2001, Korea imported for the first time high-quality U.S. rice under its minimum market access (MMA) quota, after adjusting its tender specifications to target higher quality rice. The United States sold 30,000 MT out of the 142,520 MT tariff rate quota (TRQ) available in CY2001 and 40,000 MT out of the 171,023 MT TRQ available in CY 2002. (Korea's quantitative restrictions on rice expire in 2004.)

The U.S. Government welcomed this development while raising concerns that the imported U.S. rice remains relegated to storage facilities as does most other rice imported under the MMA quota programs. Specifically, the access afforded to U.S. rice is not on par with domestic rice due to marketing restrictions placed on rice imported under the TRQ. Korea repeatedly has stated that it will not allow imported table rice to be marketed directly to Korean consumers, raising questions about the consistency of Korea's actions with its WTO obligations.

The U.S. Government also remains concerned with continued Korean statements that its rice policies are non-negotiable in the current WTO agriculture negotiations. Such statements serve to undermine Korea's broader goals and initiatives within the WTO's Doha Development Agenda negotiations. The United States will continue to actively engage Korea to ensure its full compliance with its WTO obligations on

rice and to press for further liberalization.

Oranges

Quotas on fresh oranges were liberalized in July 1997 to permit out-of-quota imports. The in-quota tariff rate is currently 50 percent, and the out-of-quota rate is 59.8 percent and will be lowered to 50 percent in 2004. The in-quota quantity for 2002 was 45,052 metric tons and will be expanded at an annual growth rate of 12.5 percent through 2004.

The Ministry of Agriculture and Forestry (MAF) delegated administration of Korea's citrus tariff-rate quota (TRQ) regime to the Cheju Citrus Cooperative (CCC), a Korean producer group. Allowing the CCC to administer the TRQ raises questions about whether it is being administered in a non-discriminatory manner. While the CCC has purchased the majority of its imports from the United States, it failed to exercise the full amount of the TRQ in 1999, 2000, and 2001. Moreover, in 1999 and 2001, Korea auctioned a portion of the quota, despite U.S. protests that such an allocation system adds costs to the permissible border charges facing foreign firms entering the Korean market. Korea likewise ignored U.S. Government and industry requests for the issuance of a viable, market-based tender schedule for the unfilled quota amount. In 2002, the CCC auctioned the full quota allocation which quota buyers used to import the full amount of the 2002 TRQ. The United States will continue to actively engage Korea to ensure its full compliance with its WTO obligations.

Import Clearance Procedures

U.S. suppliers of food and agricultural products, including products for which market access was liberalized under bilateral or multilateral trade agreements, continue to encounter market access barriers in Korean ports despite the steps the Government of Korea has taken in this area over the past few years. After WTO dispute settlement consultations with the United States between 1995 and 1999, the Government of Korea revised its import clearance procedures by: (1) expediting clearance for fresh fruits and vegetables; (2) instituting a new sampling, testing and inspection regime; (3) eliminating some non-science-based phytosanitary requirements; (4) revising the Korean Food and Food Additives Codes, for example, to bring Korean pesticide residue level standards for citrus into conformity with CODEX Alimentarius standards; and (5) requiring food ingredient listings by percentage for major, rather than for all, ingredients.

Import clearance of agricultural products at Korean ports remains generally slow and procedures continue to be somewhat arbitrary, despite the steps the Government of Korea has taken in this area over the past couple of years. Surveys of U.S. trading partners in Asia indicate that import clearance for most agricultural products requires less than three to four days. In Korea, import clearance for new products still typically takes 10 to 18 days, and four to six months if a food additive is not specifically recognized in Korea's Food Additive Code for use in that product. (Any unauthorized additive must go through a formal approval process before it can be approved for use in a particular food).

Ministry of Agriculture and Forestry (MAF) and its agencies responsible for administering plant, animal and animal product inspection, including the National Plant Quarantine Service and National Veterinary Research and Quarantine Service, account for the greatest delays in import clearance. MAF imposes numerous requirements that restrict access or delay import clearance, such as incubation testing for non-quarantine pests and product detention based on administrative errors on export certificates, which add costs for importers and, ultimately, for consumers. Improvements in expedited clearance of fruits and vegetables are slowly being eroded through various new testing and documentation requirements, extension of detention periods for pest identification, and registration of every conceivable insect as a potential pest subject to quarantine measures.

In 2001, the Korea Food and Drug Administration (KFDA) revised the Food Code and the Food Additives Codes, addressing many of U.S. industry's concerns, such as establishing allowances for subsidiary colors in select food coloring and the easing of overly-burdensome restrictions on food. However, other changes in 2001 raise concerns about whether KFDA procedures are overly burdensome. KFDA's requirements for extensive documentation for mandatory pre-market approval of each new-to-market product, its determination that a product is new if formula ratios are changed or if substitute ingredients are used, and its non-

recognition of "good manufacturing practices" in the production process of imported food products set its procedures apart from those of other OECD food safety agencies. More work is needed to bring Korea's food code standards up to international standards, specifically those standards related to food additives *(e.g.*, Korea has not effectively adopted the "generally recognized as safe" standard).

Starlink: Beginning in the fall of 2000, the U.S. Government has worked closely with the KFDA and MAF to provide assurances that the U.S. Government is helping to minimize the risk of importing U.S.-origin food-grade corn and corn-based food products that tested positive for the "Starlink" protein. KFDA guidance to field inspectors in late December 2000 helped ease, although not eliminate, port clearance delays caused by confusion over Korea's import requirements regarding Starlink. Since the first quarter 2001, Starlink corn has not been detected in any U.S. food-grade corn exported to Korea. Nonetheless, KFDA continues to require a separate import certification with food-grade corn, in addition to the U.S. grain export certificate, that the product does not include Starlink corn.

Poultry: In late 2002, the MAF imposed a temporary ban on U.S. poultry products as a result of an outbreak of low pathogenic Avian Influenza (AI). However, according to World Organization for Animal Health (OIE) guidelines, regulatory action is mandated only for outbreaks of highly pathogenic avian influenza. MAF's restrictive action on U.S. poultry in response to the outbreaks of low pathogenic avian influenza deviated from the OIE standards. The World Organization for Animal Health is the standard-setting organization for international animal health standards. International standards should guide country standards to avoid unnecessary constraints on legitimate trade.

Chemical Tests: In early 2002, U.S. fruit and grain exporters experienced delays in quarantine inspection with extra testing costs due to a policy change in the "same company, same product treatment." Same company, same product treatment allows exemptions from certain agricultural chemical tests if the same company had previously passed tests for the same product in an earlier shipment. In January 2002, the KFDA added 12 new chemicals to their list of chemicals subject to simultaneous residue testing and required all products to be tested (including products with same company, same product status from earlier tests). Those companies/products which passed the new test regained same company, same product status. However, re-testing would be required again if KFDA adds additional chemicals to their list of chemicals subject to simultaneous residue testing.

The U.S. Government expressed concern about the extended clearance time resulting from the new chemical tests and the cost associated with the tests (over 1,000 US dollars for each simultaneous multi-residue test). KFDA Headquarters maintained that same company, same product status will have to be renewed whenever there is a change in the chemical test requirements or standards. Since KFDA makes such changes at least once or twice each year, the new policy will burden traders with additional testing costs and extended clearance times.

Clearance time could be shortened by simultaneously conducting tests and document verification procedures. In many instances, these products are not new to the Korean market and pose no safety risk. In addition, excessive documentation and repeated inspections are still required to clear goods, and variability of enforcement makes adherence to regulations difficult. For example, customs clearance procedures and locations vary depending on commodity. This prohibits efficient mixed commodity shipments, and also results in inconsistent customs classification of processed (blended) products.

The United States will continue its dialogue with the Government of Korea on import clearance procedures until clearance times in Korean ports are comparable to those in other Asian ports and Korean procedures are based on science and consistent with international trade rules and norms. (See also "Standards and Conformity Assessment Procedures.")

Customs Procedures

The Korea Customs Service (KCS) frequently classifies "blended products" under the Harmonized System (HS) heading for the major ingredient of that product rather than the HS heading for the blended product, which usually

has a lower tariff rate. Changes in classification often are based on arbitrary standards (*e.g.*, for dehydrated potato flakes to be classified as blended products, they must include at least 10 percent non-potato ingredients) and are at odds with practices observed by other OECD members. "Blended products" disadvantaged by this practice include potato flakes, soybean flakes, flavored popcorn and peanut butter chips.

KCS's misclassification of potato preparations under the HS heading 1105 has restricted U.S. exports of these products to Korea. Korea should import dehydrated potato products under the unrestricted HS 2005 heading, with an applied tariff rate of 20 percent and a bound rate of no more than 31.5 percent in 2004. Instead, KCS has classified preparations of potato flour, flakes, granules or pellets under HS 1105, which is subject to a tariff-rate quota (TRQ) with an in-quota quantity of 60 metric tons and an over-quota tariff of 304 percent. Although the situation has improved somewhat in the past year, the U.S. Government will continue to seek to address this issue.

U.S. exporters have faced classification issues on other products as well. Since 2000, KCS has automatically classified all imported skate and ray as skate, unless the import is accompanied by a government-issued inspection certificate that identifies the ray by its scientific name. Skate is subject to a 50 percent adjustment tariff; ray is subject to a 10 percent general tariff. Purportedly, this action was taken to help prevent fraudulent mislabeling of ray, but similar actions have not been pursued with other fish or food products subject to fraudulent labeling. U.S. exports of soda ash also have been misclassified, resulting in a higher tariff.

The Korean Customs Service (KCS) has issued tariff code classifications of commodities that diverge from classifications observed by other countries (e.g. United States and EU). For example, Citrus Pulp Pellets are classified in under HS 2308 by the United States and the EU. However, Korea has classified them under HS 2309, subject to a quota. U.S. representatives have asked KCS to revisit its classification, given how other nations are classifying this product.

In addition, KCS routinely rejects customs clearance applications on administrative grounds (wrong print, font size, erasure marks on application, etc.), thereby delaying the official start of the customs clearance process. Finally, Korean regulations often require local trade associations to certify or approve import documentation. In addition to requiring the importer to pay a processing fee, which is used to help fund the association, this rule requires importers to submit proprietary business information, to which their local competitors often appear to have access.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Standards and Conformity Assessment Procedures (Sampling, Inspection, Testing and Certification)

Korea maintains standards and conformity assessment procedures, such as sampling, inspection, testing and certification, that appear to be overly burdensome and appear to have a disproportionate impact on imports.

Korea plans to require mandatory environmental risk assessments (ERA) of biotechnology crops. On March 28, 2001, the Ministry of Commerce, Industry, and Energy (MOCIE) issued legislation (the so-called "LMO Act") to implement Korea's interpretation of the Cartagena Bio-safety protocol. On June 25, 2002, MOCIE announced a proposed Presidential Decree and Ministerial Ordinance to the LMO Act in the government gazette for public comments. To date, no notification regarding mandatory ERA's has been submitted to the WTO. The U.S. Government has expressed concern that Korea's plans related to implementation of the Biosafety Protocol could disrupt an estimated $520 million amount of U.S. exports to Korea, and could also harm Korea's plans to develop its own biotechnology industry. U.S. representatives have encouraged Korea to make every effort to implement a regulatory approach to biotechnology that is rigorously based on science, transparent and predictable. Moreover, as Korea develops and implements new regulations, the United States has urged Korea to fully involve all stakeholders, avoid duplication and respect international commitments.

Under the Food Safety Act, issued by Korea's Ministry of Health and Welfare (MHW), KFDA was given the authority to conduct mandatory safety assessments to evaluate biotechnology

applications for products intended for human consumption to ensure their safety. The Act passed in August 2002 and provides for an 18 month (grace) period during which technology firms must file and have completed applications for safety assessment. The U.S. Government has expressed concern that the draft implementing regulations for mandatory food safety assessments have not been notified to the WTO for international comments. U.S. officials have urged their Korean counterparts to consult with both local and foreign industry (importers, traders, exporters, and processors) prior to finalizing the implementing regulations to address concerns so as to avoid trade disruptions once the safety assessments become mandatory.

In May 2002, a shipment of U.S. organic food was detained by regional Korea Food & Drug Administration (KFDA) inspectors. The reason for the detention was that the shipment was accompanied only by an organic certificate issued for the farm or plant and not for the specific lot that was exported to Korea. Means for being approved as a government-recognized certification agency have also caused delays in import clearance of U.S. organic exports. To overcome these problems, KFDA headquarters agreed to accept the following documents: 1) Copy of the certificate issued by a U.S. government accredited lab for the plant or farm; 2) Copy of the opening page of the Agricultural Marketing Service website and subsequent pages leading to (and including) the list of all private certifiers recognized by USDA; and 3) an original transaction certificate issued by a U.S. government accredited lab that certifies that the specific shipment lot is organic, with information on the lot number, volume, etc. Despite the verbal agreement from KFDA, additional shipments of U.S. organic exports have faced detention for the same reasons. To eliminate port detentions of U.S. organic products, U.S. officials have urged KFDA to provide clear guidelines on how to recognize shipments of imported organic products to inspectors in branch offices so that each shipment does not have to be detained until KFDA headquarters intervenes.

In 2000 and 2001, the KFDA revised the Food Code, Food Additive Code, and Labeling Standards to make them more consistent with international standards. However, KFDA requires that products be classified according to a narrowly defined product category, which is then further restricted by limits on ingredients or additives not approved for that product category. Manufacturers using products with ingredients or additives not already approved for that product category must seek KFDA approval, which can take six months to one year. KFDA will not initiate the review process until all data/documentation is submitted, further extending the process and cost. In addition, KFDA approves each product on a company basis, institutionalizing redundancy in examination and increasing costs, while providing no additional benefit or level of product safety to the consumer. The United States has continually expressed concerns about these practices and prohibitions under the Food Code and Food Additive Code, particularly those relating to the many ingredients, classes of ingredients, food colors and dyes, and food and food manufacturing processes that are generally recognized as safe by international standards (i.e., CODEX, JEFCA, etc.). (See also "Import Clearance Procedures").

The U.S. Government has expressed concern over Korea's phytosanitary and sanitary certification requirements that continue to limit market access for a variety of products. In January 2002, MAF issued a proposal that should address the key concerns of U.S. industry regarding the extensive pre-clearance inspection requirements for imported in-shell walnuts, and the U.S. Government is hopeful that this issue will be resolved shortly. However, delays in Korea's review of documentation on pest mitigation provided by the United States continue to effectively preclude market access for cherries and apples.

In an effort to prevent imports of products including BSE-tainted ingredients, in spring 2001 Korea enacted requirements that the U.S. Government certify ruminant and ruminant product exports as BSE-free. These requirements proved overly restrictive. However, the issue was resolved when the Government of Korea, after extensive legal review, decided to accept BSE-free certifications by governments, relevant legal entities (associations, etc.), or manufacturers (if notarized).

Korean government agencies also require pre-approval for pharmaceuticals, chemicals, computers, telecommunications equipment, other products and all food additives. While

many other countries require pre-approval for some products, the range of affected products is exceptionally broad in Korea, and companies must submit documentation that is extraordinarily detailed. In the past, information provided by importers as part of the pre-approval/certification process often was not adequately protected. Regarding pharmaceuticals, in June 2002, the KFDA implemented Drug Master File (DMF) requirements that oblige manufacturers to submit significant quantities of proprietary manufacturing data to the KFDA as part of the drug approval process. The Government of Korea says the requirements are designed to assure product quality. U.S. industry, however, has expressed concern that because the requirements apply only to new drugs they apply almost exclusively to foreign manufacturers of innovative pharmaceuticals and not local generic companies. Industry has raised additional concerns that the requirements may delay market access and could jeopardize intellectual property protection. A KFDA task force is studying the concerns expressed by industry and other stakeholders.

KFDA approval for local sale of drugs developed outside Korea remains slow. The frequent need for companies to duplicate in Korea clinical trials already completed elsewhere is of particular concern because such trials are costly and delay market access for U.S. products. Duplicate trials were expected to decrease following Korea's 1999 announcement that it would implement International Conference on Harmonization (ICH) guidelines. While the KFDA has made progress in accepting the concepts in the ICH E5 guidelines, the KFDA typically fails to include Koreans as members of the general Asian population for drug testing and presumes that drugs are more narrowly sensitive unless proven otherwise. In November 2002, Korea published revised guidelines that could improve market access for U.S. companies. The U.S. Government will monitor the implementation of these guidelines. In addition, the KFDA needs to streamline its clinical trial application process, which delays market access for U.S. products.

Finally, Korea has impeded market access for foreign pharmaceuticals by requiring redundant local test data for three lots of imported pharmaceuticals, vaccines and biologics for purposes of product registration. Moreover, once registered, each shipment of a drug imported into Korea for commercial purposes must be tested. This is expensive, inefficient and scientifically unsound. The United States will continue to emphasize the need for the Government of Korea to implement appropriate international guidelines on the acceptance of foreign clinical test data, to make the drug approval process for new drugs more science-based, and to shorten the overall drug approval process in Korea (see also "Intellectual Property Rights Protection" and "Pharmaceuticals").

The United States and Korea have worked together cooperatively over the past few years to resolve a range of motor vehicle standards issues. Consistent with the 1998 U.S.-Korea Memorandum of Understanding (MOU) Regarding Motor Vehicles, Korea has taken steps to simplify and streamline its safety and environmental standards and certification procedures. In October 2000, Korea joined the Global Agreement, an agreement intended to encourage the international harmonization of motor vehicle standards. In 2001, the United States and Korea established a new working group to improve the dialogue between the two sides on complex standards and certification issues. The meetings of this group to date have proved highly productive, and the U.S. Government believes that this forum offers the potential to build a stronger cooperative relationship on standards and certification issues as the work of this group continues. The U.S. Government has closely consulted with the Government of Korea on the development of a self-certification system, which Korea implemented in January 2003. The establishment of this system will be a key agenda item of the working group over the next year. Finally, with member governments working to develop a new global standard on side impact crash tests under the Global Agreement, the Government of Korea committed to the U.S. Government, in January 2002, that it would continue to accept both the U.S. and European side impact standard. Nonetheless, the U.S. Government continues to be concerned about a variety of other auto standards issues, which serve as serious market access barriers to U.S. automakers, and will continue to work with Korea to expeditiously address these matters.

REPUBLIC OF KOREA

Labeling Requirements

U.S. exporters cite Korea's non-transparent and burdensome labeling requirements as barriers to entry, despite various recent changes by the Korea Government to these requirements. The U.S. Government will continue to address these issues with the Government of Korea.

In July 2000, KFDA revised its food labeling standards to bring Korea's labeling standards more in line with international standards. For example, mandatory Korean-language labeling of product type for most products was eliminated and foreign languages may be used on the label. The new labeling standards were implemented in January 2002 after an 18-month grace period. On January 1, 2001, the Ministry of Environment's (MOE) new packaging and labeling standards for food went into effect. Aimed at protecting the environment by minimizing land-fill material, the standards prohibited the use of PVC-shrink-wraps and promotional packaging that included more than 20 percent "dead space" in the container. MOE addressed U.S. Government concerns about the restricted use of PVC-shrink-wrap on some products, including frozen products, on food safety grounds. However, the U.S. Government continues to question Korea's rationale for restricting package size based on gross dead space to minimize landfill material. Net space displaced by such containers, once collapsed and measured (MOE does not allow this), is minimal and well within the objective of the standard. The U.S. Government will monitor implementation of these standards.

Korea implemented mandatory biotechnology labeling requirements for corn and soybean commodities in March 2001 and in July 2001 for processed foods containing biotech-enhanced corn, soybeans or soybean sprouts. In March 2002, MAF extended biotechnology labeling requirements for fresh potatoes. The Korea Food & Drug Administration (KFDA) initially intended to follow MAF's lead by requiring biotechnology labeling for processed potato based-products in 2003 (consistent with Japan's plan to start biotechnology labeling for potato-based products). MAF officials have indicated that U.S. fresh potatoes will be exempt from biotechnology labeling requirements with no requirement for extra documentation as long as biotechnology potatoes are not produced in the United States. The U.S. Government will continue to work with Korean officials to clarify and confirm Korean requirements for non-biotech fresh potatoes. In addition, the U.S. Government has urged Korea to consult with its seed industry to avoid disruptive requirements.

Korea provided only vague and limited information on the mandatory biotechnology labeling requirements prior to September 2002, however, which hampered companies' ability to properly comply with the requirements. Moreover, the new requirements appear far more burdensome than necessary to achieve their stated goal of providing Korean consumers clear information and appear to raise national treatment concerns as well. Korea's labeling requirements and, in particular, rules for exemption from the requirements generated confusion and delays in custom clearance. Ultimately, the rules led to a significant reduction in Korean imports of U.S. products having a soy or corn base. The U.S. Government expressed concern over Korea labeling requirements in late 2001 and suggested Korea adopt more flexible requirements. In September 2002, Korea permitted acceptance of a notarized self-declaration in-lieu-of full identity preserved documentation as certification that product meets requirements to be exempt from biotechnology. The United States will continue to work with the Government of Korea to resolve this issue in a manner that ensures consumer information requirements are satisfied and is no more burdensome than necessary to achieve these goals.

GOVERNMENT PROCUREMENT

Korea joined the WTO Agreement on Government Procurement (GPA) on January 1, 1997, and agreed to cover procurement of goods and services over specific thresholds by numerous Korean central government agencies, provincial and municipal governments and some two dozen government-invested companies. In accordance with its commitments under the GPA, procurement of satellites is included in Korea's coverage as of January 1, 2002.

EXPORT SUBSIDIES

Korea has aggressively promoted exports through a variety of policy tools, including export subsidies. However, it committed several years ago to phase out export subsidy programs that are not permitted under the WTO

Agreement on Subsidies and Countervailing Measures. Under its IMF economic stabilization package, Korea eliminated four WTO-prohibited export subsidies earlier than originally planned. Korea is rationalizing its overall subsidy regime, including through the notification of 19 programs to the WTO, as required by reporting obligations, and the elimination or reduction of the benefits available in 68 others. The U.S. Government has strongly urged Korea to ensure that its government support programs comply with its WTO obligations.

In February 2002, the Government of Korea revised the "Act for the Export-Import Bank of Korea" (KEXIM) to enable KEXIM to become more active in undertaking risks and extending credit lines to exporters. Under the new regulations, KEXIM is able to undertake risks that commercial banks are reluctant to assume. In addition, KEXIM's financing sources were expanded to include non-bank guarantee fees, thereby boosting exports from Korean companies. The U.S. Government will continue to monitor modifications made to the Act to ensure that they are consistent with Korea's WTO obligations, including that financing provided under this Act does not take the form of a prohibited subsidy. In addition, the United States will also work to ensure that Korea is respecting its obligations as a participant in the OECD Export Credit Arrangement.

Government Support for Certain Industrial Sectors

The U.S. Government continued to express strong concerns about instances of possible Korean government subsidization of semiconductor production and export that could adversely affect U.S. trade interests. In particular, the U.S. Government raised concerns about continued support extended to Hynix Semiconductor, Inc. (Hynix) by Korean government-owned financial institutions. Hynix is Korea's second largest and the world's third largest semiconductor manufacturer.

Aid to Hynix was provided and/or arranged by its state-owned or state-controlled creditors on several occasions throughout 2001 and 2002 in complex refinancing agreements involving debt rollovers, partial debt forgiveness, interest rate reductions, new lending and other forms of assistance. The interventions were ostensibly designed to provide Hynix an opportunity to restructure and wait out the worldwide semiconductor market downturn. However, repeated bailouts of highly indebted Hynix perpetuated the chronic problems of the global semiconductor market by helping to maintain uneconomic capacity and excess supply, thereby keeping prices depressed.

Following an unsuccessful attempt to buy Hynix in the spring of 2002, Micron Corporation of the United States filed a petition with the Department of Commerce on behalf of the U.S. Dynamic Random Access Memory (DRAM) chip industry for a countervailing duty (CVD) investigation of allegedly subsidized DRAMS from Korea, including those produced by Hynix. The International Trade Commission has issued an affirmative preliminary injury determination, and the Commerce Department is expected to announce its preliminary subsidy determination in March 2003. The EU launched its own CVD case against Korean semiconductor manufacturers last summer, and its preliminary decision is due in April 2003.

The U.S. Government has repeatedly raised concerns with Korea in bilateral and multilateral fora regarding the Hynix bailouts, as these call into question Korea's commitment to genuine structural market reform and to its obligations under the WTO. The U.S. Government, together with U.S. industry, continues to monitor developments carefully and has relayed the United States' strong expectation that the Government of Korea will not provide any inappropriate support for Hynix or exert undue influence on the credit restructuring process in the future.

The U.S. Government also began looking into concerns raised by members of the U.S. paper industry about alleged targeted Korean government aid to its coated paper sector, including low-cost facility investment loans and loan guarantees, tax benefits for facility expansion, government-sponsored creation of a paper manufacturing complex and government sale of debt obligations. Since a significant percentage of Korean coated paper output is exported to the United States and other markets, U.S. industry is concerned that this support may be distorting international markets for paper goods. The U.S. Government raised the issue both formally and informally several times with Korean government officials and will continue

to closely monitor the situation to ensure that Korea fully abides by its WTO obligations.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Korea was downgraded from the Special 301 "Priority Watch List" to the "Watch List" in 2002 due to the Government of Korea's agreement to take significant steps to strengthen its IPR legislation and enforcement. The two Governments held several consultations on IPR issues during 2002, as part of the bilateral quarterly trade consultations, and the United States continues to monitor the implementation of commitments Korea made in 2002. These include giving police authority to a new special enforcement unit within the Ministry of Information and Communications (MOIC) to conduct raids for software piracy, providing the United States with detailed data on its software piracy enforcement efforts and establishing exclusive transmission rights for sound recordings and performances. The United States also remains concerned with respect to the transparency of Korea's enforcement efforts, the protection of temporary copies, technical protection measures, Internet service provider (ISP) liability and *ex parte* relief, the lack of full retroactive protection for pre-existing copyrighted works, continued counterfeiting of consumer products, pharmaceutical patents, and lack of coordination between Korean health and IPR authorities on drug product approvals for marketing. Finally, in 2002 a new loophole emerged in the Korean film and video rating system that allows foreign movies to be fraudulently registered in Korea. An interim solution has been agreed to in concert with a commitment by the Government of Korea to introduce into the National Assembly in the first half of 2003, legislation to permanently solve this problem. The U.S. Government continues to monitor both the interim measures and progress on the legislation.

IPR Enforcement

Despite the actions taken by the Government of Korea over the past year, IPR enforcement continues to be an issue of serious concern. The United States welcomed the establishment in January 2002 of a Special Investigation Team (SIT) in MOIC. The SIT is charged with conducting raids of commercial firms thought to be utilizing pirated software. Korea pledged to grant the SIT full police powers to allow the team to conduct effective enforcement raids on its own. The legislation to grant the SIT this authority reached the committee of the National Assembly by November 2002, but unfortunately did not pass in 2002. The U.S. Government expects that this will occur in early 2003. The United States remains concerned about the transparency of the SIT enforcement process, including whether the right holders will be notified about all raids initiated by SIT. The United States requested that the Government of Korea to provide detailed information on the result of court decisions (i.e., acquittals, convictions, punishments) to both the rights holders and the U.S. Government. The Korean side has responded that in some instances this information is burdensome to collect, while in others, divulging details of cases violates the privacy of the individuals involved. While the Government of Korea passed amendments to the patent, trademark and utility model laws in January 2001 that increased fines and terms of imprisonment for infringers, the U. S. has urged Korea to further review the penalties for IPR violations in order to increase their effectiveness as a deterrent to piracy.

Copyright Act (CA) and Computer Program Protection Act (CPPA)

In December 2002 the National Assembly took an important step forward by passing revisions to the Computer Programs Protection Act (CPPA) which added transmission rights, a critical element of an effective copyright regime in the digital age. The Government of Korea also accepted the U.S. suggestion that online service providers should immediately stop the infringing activity upon request of the copyright owner. The United States believes that the CPPA needs to be strengthened further and has urged Korea to make additional amendments to this law, as well as to the Copyright Act, to clarify that the copyright owner has the exclusive right to make copies, temporary or permanent, of a work or phonogram.

In July 2000 and again in December 2001, the Government of Korea drafted revisions to the Copyright Act, and this legislation went to committee of the National Assembly in April 2002. It is expected to be passed in early 2003. Although the draft revisions addressed U.S. concerns about exceptions relating to reproduction in libraries, the United States

remains concerned about several provisions. For example, the provisions on technical protection measures (TPMs) in both the CA and the CPPA includes exceptions that effectively undermine their purpose. Specifically, the Government of Korea needs to clarify that although the CA states trafficking in circumvention devices and services is "considered to be infringement," the various exceptions and defenses to infringement do not apply in this context. Furthermore, the U.S. Government has urged Korea to amend the language to prohibit technologies, services, products, or devices that have a limited commercially significant purpose or use other than to circumvent TPMs. Korea has responded that it is studying the issue to identify logical exceptions and limitations. Also, the article providing limitations on the copyright liability of On-line Service Providers is vague as to the underlying liability of service providers. Without clarity, the need for limitations on such liability is suspect, as is the ability of the law to promote cooperation between service providers and right holders.

The United States has also recommended that the Government of Korea clarify the availability of injunctive and *ex parte* relief in civil enforcement actions, as required under the TRIPS Agreement. In addition, the United States has urged Korea to delete the reciprocity provision relating to database protection in the Copyright Act, as it discourages the introduction of databases from other countries without such legislation. Finally, the United States has expressed concerns about the failure of the Government of Korea to address other key issues in its most recent amendments to the Copyright Act, including provision for exclusive transmission rights for sounding recordings (which Korea has pledged to do by the end of 2003) and a provision of the full 50-year protection for pre-existing sound recordings.

Patent and Trademark Acts

Over the past year, changes to the Patent Act both strengthened and streamlined the patent application process. The revisions also gave the Korean Industrial Property Office (KIPO) more power to protect technologies exchanged through the Internet. In 2002, the Government of Korea proposed legislation to streamline the procedures for foreign PCT (Patent Cooperation Treaty) members. Overall, while the patent law is fairly comprehensive and offers protection to most products and technologies, U.S. industry still believes that deficiencies remain in the interpretation of claims and in the treatment of dominant and subservient patents.

Trademark Act changes were made by Korea to bring the country into compliance with the Madrid Protocol on International Registration of Marks as it prepares for membership in 2002 and to the Trademark Law Treaty. The revisions simplified application procedures for international applications and introduced a retroactive damage compensation system for registrants. However, the successful pursuit of claims under this system has continued to be difficult, particularly in cases involving agricultural entities.

The Trademark Act also contains provisions prohibiting the registration of trademarks filed without the authorization of the foreign trademark holder by allowing examiners to refuse registration of applications made in "bad faith." Despite this change, the legal procedures that U.S. companies must pursue in order to seek cancellation proceedings reportedly discourage U.S. companies from pursuing legal remedies to address infringement in Korea, thereby acting as a barrier to effective enforcement. As such, problems still arise with respect to "sleeper" trademark registrations (i.e., registrations that infringe the rights of legitimate mark owners but are not challenged and removed). In January 2002, MOIC established a Domain Name Dispute Resolution Committee to accelerate the resolution of disputes over this issue. The U.S. Government has recommended that Korea include foreign participants on this committee. Also in 2002, MOIC prepared draft legislation for the Internet Address Space Management Act that gives more legal ground to a domain name dispute resolution committee and prohibits cyber-squatting.

Korea has long been a source of exports of infringing goods. Textile designs were afforded copyright protection (in addition to protection under Korean design law) through a July 1, 2000, revision to the Copyright Act. However, protection remains problematic largely because of the lack of enforcement, and some Korean companies allegedly pirate U.S.-copyrighted textile designs and export them to third countries where they compete with genuine U.S.-produced goods.

Although Korean laws on unfair competition and trade secrets provide some trade secret protection, these statutes remain deficient. For example, U.S. firms, particularly some manufacturers of chemicals, candy and chocolate, face continuing problems with government regulations requiring submission of very detailed product information, specifically formulae or blueprints, as part of registration or certification procedures. U.S. firms report that although Korean law forbids the release of business confidential information, they have experienced instances where information submitted has not been given sufficient protection by government officials and, in some cases, has been made available to Korean competitors or to their trade associations.

The Government of Korea has taken steps over the years to remedy data or patent protection problems that affect pharmaceuticals, but problems remain, including the lack of coordination between Korean health and safety and intellectual property officials. This lack of coordination results in the granting of marketing approval for products that may infringe existing patents. However, in March 2002, the United States and Korea resolved questions related to Korea's commitment to provide full protection against unfair commercial use of test data submitted for marketing approval, as required by Article 39.3 of the TRIPS Agreement.

SERVICES BARRIERS

Korea continues to maintain restrictions on some service sectors through a "negative list." In these sectors, foreign investment is prohibited or severely circumscribed through equity or other restrictions. (See also "Investment Barriers")
.

Construction

The construction and engineering markets in Korea were first opened to foreign competition in 1996. Foreign companies may bid on public projects, including the massive capital projects designed to improve basic infrastructure in Korea. Foreign firms still report problems with attempts to renegotiate accepted bid prices, as well as with registration and bonding procedures, which are excessively burdensome.

Advertising

Korea is among the world's top twelve largest advertising markets; however, it remains a highly restricted market. Since broadcast advertising time is still sold exclusively through the state-sponsored Korea Broadcast Advertising Corporation (KOBACO), advertisers and their agencies must work through KOBACO to advertise on broadcast television. Legislation was passed in 1999 to end KOBACO's monopoly, but implementation of these laws has been delayed. As a result, advertisers and their agencies must still work through KOBACO to advertise on broadcast television.

Some progress has been shown by KOBACO in recent years in offering more flexible packages and a wider range of commercial time lengths to better meet advertisers' needs. However there are still further changes in airtime sales that should be urgently considered. Firstly, in-program advertising has been proposed several times to KOBACO. The government is reconsidering the issue. Secondly, most TV airtime packages are still offered on a monthly basis, limiting the opportunity for advertisers to engage in spot buying of advertising time. This impedes advertisers' ability to run short-term campaigns and tailor their media delivery. Thirdly, the practice of conditional selling - packaging radio (primarily religious radio spots) with TV airtime - is still evident. Finally, the current pricing structure for TV spot time lengths outside of the 15-second standard offers insufficient incentive to advertisers.

Broadcast advertising censorship presents a continuing source of difficulty for all advertisers and agencies doing business in Korea. KARB's censorship committee is comprised of representatives of various organizations who change regularly. This handicaps television and radio advertisers since their advertising has to be submitted in its final, fully produced film format for approval by KARB. This approval process contributes significantly to the risk and costs involved for developing new advertising campaigns and introducing new brands. Often the committee requires that substantiating testing be repeated in Korea, disregarding advertising claim substantiation accepted in other countries. In some product categories, such as cosmetics, the Ministry of Health and Welfare requires that advertising copy be additionally approved by the local manufacturers' association in advance of airing or publication. Efficacy claims for pharmaceuticals, over-the-counter medicines and cosmeceuticals are also not permitted. This

makes advertising of technologically superior products less effective and ultimately contributes to the discouragement of innovation.

Direct Selling

Until recently, the U.S. direct selling industry faced a variety of barriers in Korea, one of its largest markets in the world. However, some improvements in this trade situation have resulted following the Government of Korea's recent passage of a new Door-to-Door Sales Act (DDSA), which governs direct selling. Of particular concern to industry were changes being considered that would have made direct selling companies jointly and severally liable for actions taken by direct sellers' independent contractors that are outside the contractors' scope of duties and responsibilities and beyond the control of the direct selling company. The U.S. side repeatedly raised concerns over this issue with the Government of Korea in 2001 and 2002, and these concerns appear to have been addressed. The new DDSA cleared the Korean National Assembly on February 28, 2002 (and was signed by Korean President Kim, Dae-Jung in the summer) and meets the key multi-level marketing (MLM) industry request that the "joint and several liability" (which had assigned liability to the MLM companies for the actions of the independent distributors of their products) be stricken from the new legislation. Also, although the price limitation has been raised to 1.3 million won ($1,093 at 1,200 won/dollar), the distributors' sales commission limit remains unchanged at 35 percent.

Screen Quotas

Korea maintains screen quotas on imported motion pictures, requiring that domestic films be shown in each cinema a minimum number of days per year (currently, 146 days with reductions to 106 days possible if certain criteria are met). The quota discourages trade, cinema construction, the expansion of theatrical distribution in Korea, and the competitiveness of the Korean film industry. In January 1999, the National Assembly passed a resolution introduced by the Culture and Tourism Standing Committee that a relaxation of the screen quota should only be considered if and when Korean films achieve a 40 percent market share, which was exceeded beginning in 2001. In December 2000, a similar resolution was introduced by the Unification and Foreign Affairs and Trade Standing Committee and was passed by the entire National Assembly. Korea's resistance to reducing its screen quotas has held up negotiation of the U.S.-Korea Bilateral Investment Treaty.

Foreign Content Quota for Free Terrestrial TV

Korea restricts foreign activities in the free TV sector by limiting the percentage of monthly broadcasting time (not to exceed 20 percent) that may be devoted to imported programs. Annual quotas also limit broadcasts of foreign programming to a maximum of 75 percent for motion pictures, 55 percent for animation, and 40 percent for popular music. Foreign investment is not permitted for terrestrial television operations.

Foreign Content Quota for Cable and TV

Korea restricts foreign participation in the cable TV sector by limiting per channel airtime for most foreign programming to 50 percent. Annual quotas for broadcast motion pictures are set at 70 percent and for animation at 60 percent. These restrictions limit foreign access and the development of Korea's film and animation industries. The Government of Korea also restricts foreign ownership of cable television-related system operators and program providers to 33 percent, although pending legislation would raise the ceiling to 49 percent. Network operators are limited to 49 percent. For satellite broadcasts, foreign participation is limited to 33 percent.

Satellite Re-Transmission

The Integrated Broadcast Law mandates that Korean firms that wish to re-broadcast satellite transmissions of foreign programmers must have a contract with the foreign program provider in order to obtain approval from the Korean Broadcasting Commission (KBC). Foreign re-transmission channels are limited to10 percent of the total number of operating channels. This artificial restriction limits the amount of international broadcasting which could otherwise be made available to Korean consumers and limits foreign investment in Korea in the broadcasting sector.

Restrictions on Voice-overs and Local Advertisements

Presently, there are restrictions on voice-overs (dubbing) and local advertising for foreign re-transmission channels. These restrictions are written into the Korean Broadcasting Commission's guidelines for implementation of the Broadcasting Act, and as such, could easily be revised. Allowing voice-overs in the Korean language would not only make the broadcasts truly accessible to Korean consumers, but also would benefit the Korean economy by creating more studio/production jobs and foreign investment. The prohibition on local advertising for foreign retransmission channels restricts the long-term viability of foreign re-transmission channels in the Korean market. Foreign re-transmission channels should be allowed to broadcast their content and add/insert local advertising in order to ensure their financial stability as well as to show relevant advertising to their Korean viewers.

Accounting

Korea restricts the establishment of foreign accounting firms by requiring that companies must employee at least 10 Korean-certified accountants/partners, including at least three of whom must be partners and seven of whom must be employed accountants. Foreign Certified Public Accountants (CPAs) are required to fulfill the same requirements as Korean CPAs, including: (1) obtaining Korean certification; (2) completing a two-year internship; and (3) registering with the public accountants association. Accounting firms in Korea are prohibited from making an investment in or providing a debt guarantee to any other firm in excess of 10 percent of the accounting firm's paid-in-capital.

Engineering

Although there are no restrictions on foreign engineering services specified in Korean law or regulation, procuring agencies (national, local and private) can specify particular conditions and/or requirements for engineers and engineering services depending on the nature of the project. Such specifications can be written to favor domestic engineering services firms. The Ministry of Construction and Transportation (MOCT) imposes no requirements that engineering services be provided on a joint venture basis.

Legal

At the time of Korea's accession to the OECD in 1996, the Government of Korea amended the "Lawyers Act" to permit non-Koreans to be licensed to practice law in Korea, provided that they meet the same criteria that are applied to Korean nationals. The Government of Korea also amended the "Regulation on Foreign Investment" in 1997 to allow for foreign investment in the legal sector. Any individual not qualified as a lawyer under Korean law is prohibited from providing legal services to Korean and foreign clients in Korea and from establishing a law firm or office in Korea. There is no provision for "foreign legal consultants" in Korean law, although in practice many foreign attorneys in Korea perform legal advisory functions. The U.S. Government continues to have concerns that no foreign law firms may practice law in Korea and that delineation of permitted practices for foreign lawyers is non-transparent, creating serious difficulties for foreign lawyers employed by local firms.

Financial

As a condition of its IMF economic stabilization package, Korea agreed to bind its OECD commitments on financial services market access in the WTO. Korea's revised schedule of WTO financial services commitments entered into force in September 1999. The U.S. Government will continue to work with Korea to ensure that it meets its WTO and OECD financial services commitments and to bring about more liberal treatment of foreign financial services providers.

Foreign-based, non-financial businesses in Korea face burdensome and costly procedural requirements for financial transactions that are inappropriate to Korea's level of development and financial sophistication. For instance, virtually all inter-company transfers are subject to certification. This is a cumbersome, costly, and unnecessary requirement, particularly for transactions between subsidiaries. Even after most foreign exchange transactions were liberalized in 2001, foreign bank and financial subsidiaries must receive Bank of Korea (BOK) permission on their capital account transactions.

Insurance

Korea is the second largest insurance market in Asia after Japan, with $47 billion in premiums paid in the fiscal year ending March 31, 2002. The environment for foreign insurance companies has improved considerably since Korea implemented a series of regulatory changes following its 1996 OECD accession. Korea incorporated many of these changes, including expanded market access and national treatment commitments, into the 1997 WTO Financial Services Agreement.

The 1997-98 financial crisis led to an ambitious restructuring of the Korean insurance industry. In 1998, the newly established Financial Supervisory Commission (FSC), the Government of Korea's financial watchdog and center for financial reform, revoked the licenses of some insurance companies and forced the merger of others on the grounds of insolvency. In addition, 16 life and non-life insurance companies entered FSC-supervised workout programs. (A workout program is a voluntary, out-of-court debt-restructuring framework, which may or may not involve government oversight.)

After failing several times to sell Korea Life Insurance (KLI) to foreign buyers since 1999, the Government of Korea sold the company to the Hanhwa group in December 2002. KLI has roughly a 16 percent share of the Korean insurance market. The Government of Korea is gradually liberalizing foreign entry into the life and non-life insurance markets and has lifted some restrictions on partnering with Korean financial companies and on hiring Korean insurance professionals. In April 1998, Korea liberalized insurance appraisals and activities ancillary to the management of insurance and pension funds. Korea's brokerage market was opened to foreign firms in April 1998. Several foreign reinsurance firms like Reliance and ARIGA have since entered the market. In 2002, the government submitted to the National Assembly a new insurance act bill removing most limitations on business area and working capital, and the Assembly is still considering this bill.

Banking

The most significant banking events in Korea in 2002 were two big merger deals, creating new mega banks. With $105 billion in assets, Shinhan and Chohung Bank will be the second largest bank in Korea while Hana and Seoul Bank will be the fourth largest with $67 billion in assets. Kookmin is the only Korean bank listed on the New York Stock Exchange.

In the aftermath of the economic crisis, the Government of Korea injected over KRW 34 trillion in public funds into the commercial banking system, effectively nationalizing it. Currently, four commercial banks are government-owned and managed (Hanvit, Kyongnam, Kwangju, and Cheju). The Government of Korea also retains majority ownership in Chohung Bank and significant minority stakes in Korea First, Korea Exchange, and Kookmin Banks. (In January 2000, the Government of Korea sold 51 percent of Korea First Bank to a U.S. firm, Newbridge Capital.)

In September 2000, the Government of Korea commenced a "second round" of bank restructuring. The National Assembly authorized the formation of financial holding companies and granted authority for the government to spend a further 50 trillion won in public funds to recapitalize ailing financial institutions. In April 2001, the Government of Korea combined four state-owned banks (Hanvit, Kyongnam, Kwangju, and Peace banks) into Woori Financial Holding Company, after injecting 6 trillion won as bank recapitalization. Unlimited deposit insurance, which had been introduced to shore up confidence in banks during the 1997-98 financial crisis, was revoked on January 1, 2001, and replaced by a per-account limit of 50 million won.

The IMF and the U.S. Government have repeatedly urged Korea to privatize state-owned banks to allow market forces to more efficiently allocate financial resources and increase investor confidence in the Korean economy. On January 25, 2002, the Government of Korea announced a comprehensive plan to sell off its stake in Woori Financial Holding Company, Chohung Bank, Seoul Bank, and Cheju Bank and to liquidate its minority stakes in Korea First Bank, Korea Exchange Bank, and Kookmin Bank. The Government of Korea already has sold Seoul Bank and is close to selling Chohung Bank. It has announced its intention to sell its 9 percent share of Kookmin bank during the winter of 2003. In June 2002, KDIC listed Woori Financial Holding Company on the Korea Stock

Exchange, selling an 11.8 percent stake of the company. One month later, the Government of Korea sold off a 51 percent stake of Cheju Bank to the Shinhan Financial Group.

At the beginning of 2002, Korea modified its regulations to allow foreign bank branches to borrow from their head offices and to include the net borrowing as Class B capital. However, the Government of Korea did not allow the foreign branches to use head office capital to meet regulatory lending limit requirements and continues to restrict the operations of foreign bank branches based on branch capital requirements. These restrictions limit: (1) loans to individual customers; (2) foreign exchange trading; and (3) foreign-bank capital adequacy and liquidity requirements. Foreign banks are subject to the same lending ratios as Korean banks, which require them to allocate a certain share of their loan portfolios to Korean companies other than to the top four *chaebol* conglomerates and to small and medium enterprises. Foreign banks can establish subsidiaries or direct branches. Although foreign investors may legally become majority owners of Korean banks, this has proven to be difficult in practice. In 1998 and 1999, the Government of Korea opened the capital markets to foreigners, permitting foreign financial institutions to engage in non-hostile mergers and acquisitions of domestic financial institutions.

All banks in Korea continue to suffer from a non-transparent regulatory system and must seek approval before introducing new products and services - an area where foreign banks are most competitive.

The April 1999 Foreign Exchange law introduced the first phase of foreign exchange and import-export transaction liberalization. The second phase of foreign exchange liberalization on January 1, 2001, deregulated foreign exchange and capital account transactions for individuals, but the restrictions on corporations and financial institutions regarding their foreign exchange transactions still remain.

Securities

On June 24, 2000, the Government of Korea removed limits on local currency issues of stocks and bonds by foreign firms. The Government of Korea places no limits on foreign ownership of listed bonds or commercial paper, no longer restricts foreign ownership of securities traded in local markets and has removed almost entirely foreign investment ceilings on Korean stocks. Despite this liberalization, foreign securities firms in Korea continue to face some non-prudential barriers to their operations.

INVESTMENT BARRIERS

The Kim Dae-jung Government made a strong commitment to create a more favorable investment climate and to facilitate foreign investment, and the U.S. Government is hopeful that his successor Roh Moo-hyun will do the same. Progress has been made in recent years, but additional steps are needed to fully achieve this goal.

The 1998 Foreign Investment Promotion Act: (1) increased the number of business sectors open to foreign investment (currently, two remain fully closed to foreign direct investment (FDI) including television and radio stations, and 27 remain partially closed); (2) provided more tax incentives; (3) simplified investment procedures; and (4) established Foreign Investment Zones. The Government of Korea must automatically approve a foreign investor's notification unless the activity appears on an explicit "negative list" or is related to national security, the maintenance of public order or the protection of public health, morality or safety. Since May 1998, foreigners have been permitted to engage in hostile takeovers and may purchase 100 percent of a target company's outstanding stock without consent of its board of directors.

Capital market reforms have eliminated or raised ceilings on aggregate foreign equity ownership, on individual foreign ownership and on foreign investment in the government, corporate and special bond markets, and have liberalized foreign purchases of short-term financial instruments issued by corporate and financial institutions. However, the Government of Korea still maintains foreign equity restrictions with respect to investments in various state-owned firms and many types of media, including cable and satellite television services and channel operators, as well as schools and beef wholesalers.

The Government of Korea has taken several important steps to privatize state-owned corporations. In 2002, foreign investment limits for Korea Telecom (KT) were increased from 37.2 percent to 49 percent. The government abolished the foreign investment limits for Korea Tobacco & Ginseng in December 2002 and plans to increase the foreign investment limit for Korea Gas Corporation up to 49 percent in 2003. The National Assembly passed legislation in December 2000 that sets the stage for the privatization of KEPCO, the state-owned electric power utility. KEPCO subsequently divided its power generation division into six subsidiaries to lay the foundation for a market-driven electric power industry. In June 2001, KT sold Depository Receipts amounting to $2.24 billion, while in October 2001, Korea Tobacco & Ginseng Corp. sold Global Depository Receipts and Exchangeable Bonds totaling $550 million.

The Government of Korea removed restrictions on the direct purchase of land by foreigners through the 1998 revision of the Alien Land Registration Acquisition Act. Non-Koreans, however, still cannot produce certain agricultural products for commercial purposes, nor can agriculturally-zoned land be taken out of agricultural production.

General Motors (GM) finally took over Daewoo Motor, the ailing Korean automaker in April 2002 and launched a new company, GM-Daewoo Motor in October. Throughout 2001 and into 2002, the local creditor banks, in cooperation with the Government of Korea, have engaged in negotiations to sell key Korean firms such as Hyundai Investment and Trust Securities to U.S. companies. To date, none of the deals have been concluded.

While the more liberalized Korean investment regime has increased U.S. investor interest in Korea, additional changes, including a more transparent and predictable regulatory environment, more sustained intellectual property protection, significant progress on structural reform and market opening, and enhanced labor-market flexibility would greatly improve Korea's attractiveness as a destination for foreign investment, a stated goal of the Government of Korea. Conclusion of the U.S.-Korea Bilateral Investment Treaty also could further this goal.

ANTICOMPETITIVE PRACTICES

Competition Policy

The Government of Korea's enforcement of its competition policy, although historically weak, has been improving. The Korea Fair Trade Commission (KFTC) has been playing an increasingly active role both in enforcement of Korea's competition law and in advocating for regulatory reform and corporate restructuring. KFTC's powers to conduct investigations and to impose tougher penalties were enhanced in January 1999 with the revision of the Monopoly Regulation and Fair Trade Act. The Act was subsequently revised in December 2000 to broaden KFTC's authority in corporate and financial restructuring and to raise substantially the administrative fines for violations and/or for failure to cooperate with KFTC investigations. In December 2001, the KFTC fined seven mid-ranking *chaebol* $5.5 million for illegally subsidizing affiliates. The KFTC did not inspect the "Big Four" *chaebol* (Samsung, LG, SK and Hyundai Motor Company) in 2001, however Korean press reports in early 2003 indicate the KFTC plans to initiate such an investigation this year. Despite the KFTC's increased enforcement activity, it remains somewhat weak in comparison with the other economic ministries.

ELECTRONIC COMMERCE

Korea continues to be a world leader in Internet penetration and usage. In 2002, the total number of Internet users in Korea was 26.7 million, over one-half of the country's total population and over twice the 11 million Internet users counted in 1999. Households with high-speed Internet access numbered 10.4 million in 2002, an increase of 2.6 million from the 7.8 million users counted in 2001. Competition in DSL-based services appears robust, and may be further boosted by the Government of Korea's decision to require Korea Telecom to unbundle local loops. Korea Telecom, which provides half of Korea's high-speed Internet service, is the world's fastest-growing ADSL provider. Despite the rapid growth of the Internet in Korea, the global recession caused a downturn in electronic transactions in 2001. Moreover, Korean banking practices and requirements for documentation restrict the growth of electronic commerce trade of intangibles, particularly for software products.

In December 2001, the National Assembly passed a revision to the Basic Electronic Commerce Act, which went into effect on July 1, 2002. The revised act more clearly lays out the rights and obligations of the sender and receiver of a commerce-related electronic message, gives the government more authority to settle electronic commerce disputes, and brings security and consumer protection rules more in line with OECD standards. The original law, passed in July 1999, encourages private sector development of electronic commerce and codifies authorization of electronic signatures as legally binding on consumers and businesses.

In December 2001, the National Assembly also passed the Digital Content Promotion Act, which has helped industry construct the infrastructure it needs and, more importantly, imposes stiff penalties for the copying or retransmission of online content. However, the Government of Korea should eliminate inconsistencies between this law and the Copyright Act, which would take precedence in any areas where the laws diverge. In addition, the Digital Signature Act was amended in 2002. While Korea previously has used only digital signature keys, this new law brings Korea in line with international signature recognition policies by allowing the use of various types of authentication technologies. The impact of these changes remains to be seen, especially given that the Government of Korea will maintain final approval of the use of these technologies by requiring their review by licensed authorities, and the Ministry of Information and Communications will write the guidelines and standards for authentication methods used in Korea.

OTHER BARRIERS

Lack of Transparency

The lack of transparency in rule making and in Korea's regulatory system continues to be the principal problem cited by investors or exporters seeking to compete in the Korean market. While the Government of Korea has made some progress in certain areas, many Korean trade-related laws and regulations lack specificity and the implementing regulations often diverge from the objectives of the laws. Korean officials exercise a great deal of discretion in applying broadly drafted laws and regulations, resulting in inconsistency in their application and uncertainty among businesses. Compounding this problem is the Government of Korea's frequent failure to provide specific and timely notification of planned or actual changes to laws and regulations to stakeholders. Moreover, vague laws or regulations may be reinterpreted and then applied retroactively, even in cases where companies have sought to fully follow Korean government guidance on implementing domestic regulations. These transparency-related problems continue to be serious problems for market entry in a wide variety of sectors, including agriculture, pharmaceuticals, telecommunications, and automotives. Food producers are particularly negatively affected by the ability of individual Korean government officials to apply their own interpretations of vague or ambiguously worded labeling and product categorization standards. The U.S. Government places a very high priority on addressing these problems.

Frugality Campaigns and Anti-Import Bias

While the Government of Korea is no longer directly involved in frugality or anti-import campaigns and has taken some steps to discourage overt anti-import activity, concerns about anti-import biases remain. The legacy from past anti-import campaigns has proven difficult to overcome, especially in the auto sector. A February 2001 survey revealed that the main factor restraining imported car sales in Korea is social pressure and the negative public image of foreign cars in Korea. Another Korean study completed in January 2002 confirmed these findings and found that such attitudes weaken the competitiveness of the Korean auto sector.

In 2002, the Government of Korea continued to take steps to improve attitudes toward foreign cars and there was gradual, but steady improvement in Koreans' perception of imported vehicles. Much of the improvement can be attributed to President Kim's occasional public statements encouraging Koreans to purchase imported cars, along with tax authorities' public statements that audits will not be conducted on the basis of foreign car ownership. In an important symbolic step, the Government of Korea purchased 50 U.S.-made cars in 2002 and will purchase another 50 imported cars in 2003 for use as highway patrol cars for Korea's National Police Agency. This figure will equal more than one-third of the

Agency's fleet. The Government of Korea also lent its support to the establishment of an "imported car" taxi fleet with 100 imported mini-vans prior to the opening of the 2002 World Cup games. Finally, the Government of Korea has expressed a willingness to disseminate the results of twin studies by U.S. and Korean economic research institutes on the contribution of foreign automakers and foreign autos to the development of the Korean auto industry and the overall Korean economy. These are useful steps. However, it is essential that the Government of Korea continue to make sustained and vigorous efforts to help eliminate the negative attitudes of Koreans toward foreign cars.

In April 2001, the National Agricultural Cooperative Federation (NACF), a quasi-government producer group that allocates Ministry of Agriculture (MAF) policy-directed loans, showed solidarity with several Korean livestock-related farmer associations that demonstrated against Korea's liberalization of its live cattle market per its Uruguay Round commitment. The demonstrators killed and injured imported cattle they offloaded from detained transport trucks while riot police, sent to protect such animals, stood by watching. The U.S. Government expressed concern about NACF's role in the boycott, especially given its links to the Government of Korea. Farmer associations also approached the Cheju Citrus Cooperative, the administrator of Korea's citrus import quota, regarding importing citrus that the farmers claimed undermined prices of various domestic fruits and vegetables. The Cheju Citrus Cooperative subsequently chose not to tender for the remaining quota, the third year Korea failed to do so.

Effective July 1, 2002, the Korean Fair Trade Commission (KFTC) began requiring indication of the presence of biotech-enhanced components in advertisements. KFTC defines the "presence" of a biotechnology component as principal information to be provided in an advertisement for any food product required to be labeled by MAF or KFDA in the revision of the guideline entitled, "Notification of Principle Information on Labeling & Advertisement." According to KFTC's advertisement notification, the requirement applies to anyone who manufactures or sells biotech-enhanced food and advertises such products in printed materials such as newspaper or magazine or through broadcast media such as television. U.S. officials have encouraged Korea to eliminate this non-science-based requirement on the grounds that it duplicates existing labeling requirements and creates an unfounded negative perception of biotechnology products among consumers.

Motor Vehicles

In 1998, the United States and Korea concluded a Memorandum of Understanding (MOU) to improve market access for foreign motor vehicles. Although the Government of Korea has implemented most of its commitments under the 1998 MOU, the United States has serious concerns about the lack of progress toward the key goals of the agreement, which include: (1) substantially increasing market access for foreign motor vehicles; and (2) establishing conditions so that the Korean motor vehicle sector operates according to market principles. While Korean auto exports to the U.S. market again hit record levels in 2002, sales of foreign autos in Korea totaled 16,119 vehicles, representing just over one percent of the market.

The United States has held frequent consultations with Korea to address market access concerns in the automotive sector (See also "Frugality Campaigns and Anti-Import Bias") and to resolve numerous standards and certification issues (See also Standards and Conformity Assessment Procedures"). In 2002, the Gover temporarily reduced the Special Consumption Tax (SCT), a three-tiered tax system based on engine displacement size. The reduction included cars with engines greater than 2,000 cc – which includes most imports. Market demand for imported vehicles and total market demand increased in direct response to this temporary reduction. In September 2002, the Government of Korea ended this temporary reduction. However, it has announced plans to simplify and reduce this tax. Preliminary reports from Korea indicate that it plans to replace the three-tiered tax with a two-tiered system, which will still be based on engine displacement size. The new tax will become effective in 2004. The U.S. Government continues to urge the Government of Korea to undertake such changes in a transparent manner which fully involves all stakeholders, including foreign industry, throughout the process.

The United States has welcomed these steps but has strongly urged Korea to take additional meaningful actions to open this sector, including: (1) elimination or reduction of Korea's 8 percent tariff on autos, which would signal to Korean consumers that the Government of Korea is serious about opening the auto market to foreign competition; (2) development and implementation of a plan to simplify the auto tax regime in a manner that enhances market access for foreign motor vehicles, as Korea committed to do under the MOU; (3) positive resolution of remaining standards and certification issues, including the successful implementation of Korea's self-certification system; and (4) continued active efforts to address anti-import sentiments and negative perceptions that serve as significant barriers to the purchase of a foreign automobile. While steps in each of these areas is critical, reduction of the tariff – which a Korean study showed would increase foreign auto imports to 12 percent in 5 years with a tariff reduction to 2.5 percent – and simplification of the auto tax system would have the most immediate and significant impact.

The United States and Korea also have reviewed corporate restructuring in the Korean motor vehicle sector. The Daewoo Motor Company went bankrupt in July 1999, and a U.S. company concluded a non-binding MOU for its sale in September 2001. After several months of due diligence and negotiations, the sale was completed in October 2002 and GM Daewoo began production of a new model the same month. The U.S. Government will continue to urge Korea to rely on market-based solutions to the restructuring of this and other sectors and will closely monitor Korean actions as they have a direct impact on the ability of U.S. firms to compete in the Korean market.

Motorcycles

Although progress was made to resolve U.S. concerns over Korea's pass-by noise standard in 2002, several market access issues remain including a highway ban, tariff and tax levels, and standards and certification procedures. Korea's highway ban is the most serious of these barriers because it prohibits the use of motorcycles on expressways and on designated bridges and severely restricts the market penetration potential for heavyweight motorcycles, safely designed for highway use. Korea is the only major world market in which heavy motorcycles are denied access to major highways and designated overpasses in cities. Traffic safety statistics from other developed countries and research organizations demonstrate that highways are actually safer for motorcycles than are other types of roads with numerous intersections and hazards. The U.S. and Korean Governments have consulted on lifting the ban, and these discussions are on-going.

Pharmaceuticals

Korea is seeking to cut health-care costs and has adopted a variety of new measures to achieve this goal, many of which would adversely affect Korean patients and U.S. and other foreign pharmaceutical companies. The Government of Korea often has developed such proposals in a seemingly piecemeal manner without adequate input from domestic or foreign stakeholders. Moreover, the Government of Korea has largely failed to consult in advance with the U.S. Government on these proposed measures, despite the 1999 U.S.-Korea agreements on pharmaceutical pricing. To address U.S. concerns about transparency and pre-notification, the Government of Korea agreed in January 2002 to establish a bilateral health-care reform working group. The group is intended to provide a forum for foreign pharmaceutical companies to discuss their view of changes the Government of Korea is contemplating and to establish a dialogue on health-care reform. The U.S. Government serves as an observer on the working group. The United States welcomed the formation of the working group, which it hopes will address transparency concerns and serve to improve Korea's plans to develop comprehensive health-care reforms. The United States urges the Government of Korea to fully use the working group as a forum to share information with industry and other key stakeholders in a timely manner, and recommends that the working group continue to serve as a forum for discussing these issues through 2003 and beyond.

In 2002, as part of efforts to cut health-care costs, Korea adopted new Triennial Repricing and Lowest Transaction Pricing measures and issued new proposals on Reference Pricing. The Government of Korea did not consult with the United States on these measures, which threaten

to have a disproportionately negative impact on U.S. research-based pharmaceutical manufacturers. The U.S. Government has expressed concern to the Government of Korea about its lack of transparency of this process, including Korea's failure to provide the United States with adequate time for meaningful comment prior to finalization of these measures. U.S. industry has discussed these concerns in the working group without success.

Triennial Repricing: The Triennial Repricing system was adopted in August 2002 for all drugs registered on the national reimbursement list as of the end of 1999. All registered drugs will be subject to repricing every three years under this system, which took effect on January 1, 2003. The system is expected to reduce prices for 2,732 products by an average of 7.2 percent in its first year. The U.S. Government and industry have expressed concern that the repricing system may unfairly discriminate against U.S. producers of innovative drugs because the repricing formula disproportionately reduces the price of innovative drugs compared to the price of generics. In addition, the repricing system was implemented without meaningful consultation with industry.

Actual Transaction Price: The United States and Korea reached agreement to price new, innovative drugs at the average ex-factory price of A-7 countries (United States, United Kingdom, Germany, France, Italy, Switzerland, and Japan). In addition, in 1999, the two countries agreed to the Actual Transaction Price (ATP) system, which was intended to end typical hospital practice of demanding a discount from pharmaceutical manufacturers when purchasing drugs and then receiving a full reimbursement from the government-operated national health insurance system.

Lowest Transaction Pricing: However, due to inadequate enforcement, ATP failed to achieve the goal of aligning the prices hospitals pay for drugs with the reimbursement they receive from the Government of Korea. In August 2002, Korea adopted a new Lowest Transaction Pricing (LTP) system on a one-year trial basis. The change from ATP to LTP means Korea will reduce the reimbursement price of a pharmaceutical from the weighted average price of the previous quarter's sales to the lowest transaction price of the previous quarter's sales. The U.S. Government and industry are concerned that LTP will severely impede the ability of U.S. products to receive reimbursement at levels reflecting the cost of intensive research and development. LTP is more likely than ATP to result in discrimination against the products of U.S.-based pharmaceutical manufacturers. The United States has expressed opposition to the Government of Korea's elimination of ATP, a system that had been viewed as fair and as a way to resolve previous bilateral trade disagreements. The U.S. Government has also expressed concern about the lack of a clear process for handling companies' appeals of LTP decisions, and has urged Korea to seek meaningful input on LTP from industry and other stakeholders.

Reference Pricing: The Government of Korea has been considering implementation of a reference pricing system since 2001. Facing considerable opposition from doctors, hospitals, patients associations and other domestic stakeholders, as well as foreign pharmaceutical companies, the Government of Korea has temporarily shelved the proposal while attempting to reverse the broad national consensus opposing reference pricing. The U.S. Government continues to have serious concerns about the proposed reference pricing program, as it would introduce inequalities in access to innovative medicines in Korea and discriminate against foreign manufacturers of these products.

Reimbursement Guidelines: As part of its efforts to trim health-care costs, the Health Insurance Reimbursement Agency (HIRA) has imposed unduly restrictive reimbursement guidelines on the innovative drugs of several foreign pharmaceutical companies. Under these guidelines, a product can be reimbursed only for the indications listed on the product label. These guidelines are initially set by the Korea Food and Drug Administration, but can later be modified by guidelines established by HIRA. The process for establishing these modified guidelines is non-transparent and there is no appeals process. The U.S. Government raised its concerns over the guidelines with the Ministry of Health and Welfare (MHW) and HIRA throughout 2002, and continues to urge the Government of Korea to develop a transparent process for revising reimbursement guidelines.

Certain key regulatory issues under the oversight of MHW remain unresolved, and new issues
have arisen as a result of the Government of Korea's introduction of health-care reforms and cost-containment measures. These issues include Drug Master File requirements, redundant local testing of biologics, vaccines, and drugs, and requirements that clinical trials completed elsewhere be unnecessarily duplicated in Korea (on the ostensible grounds of ethnic sensitivity) (See also "Standards and Conformity Assessment Procedures").

Medical Devices

The United States continues to have serious concerns in this area, including reductions in reimbursement pricing (particularly related to orthopedic devices), hospitals' buying practices, proposed provisions of the Medical Devices Act, and a proposal for third party review of product approvals. There is a need for more transparency in and streamlining of the regulatory approval process.

In 2002, the Government of Korea continued to face increasing pressure to reduce expenditures in its national health insurance system in order to address a mounting deficit. One of the major factors leading to this financial crisis was the implementation of a new policy in 2000 to separate the prescribing and dispensing of pharmaceuticals. Doctors, who have maintained the right to dispense pharmaceuticals with profits for many decades, were against the policy and many participated in a five-month strike, which ended in December 2000 after the Government of Korea agreed to series of increases in service fees for doctors. However, the anticipated savings to the health-care system did not happen and, as a result, the Health Insurance Reimbursement Agency (HIRA) spearheaded cost-savings initiatives to reduce spending in all areas, including reimbursement for medical devices. In late 2002, MHW approved proposed HIRA price reductions on medical products from 2 percent to 75 percent, depending on the product and category. These reductions, effective January 1, 2003, are especially burdensome for all categories of orthopedic devices, for which reimbursement prices have been reduced between14 percent to 60 percent.

These reductions place a tremendous burden on patient co-payments, threaten to limit the availability of products in the market, and have the potential of leading to a two-tiered health-care system. By approving these cuts, Korea appears to have disregarded the Medical Device Pricing Task Force's April 2001 recommendations to MHW on price regulations. The Task Force, which was comprised of eight members of the HIRA Medical Device Specialists Committee and three members from the Korean and U.S./EU industries, jointly developed proposed guidelines that provide an incentive for U.S. medical device manufacturers to introduce advanced and competitive products to the Korean market. In contrast to the present reimbursement guidelines which limit pricing for new products to 90 percent or less of pricing for similar products on the market, the proposed guidelines allow for pricing up to 130 percent provided the new product has improved features and benefits. The United States will continue to urge the Government of Korea to increase transparency through close and timely consultation with the U.S. Government and industry on all issues pertaining to market access for medical devices. One important measure in this regard is the inclusion of U.S. industry representatives on key committees that formulate policy proposals and decisions.

It should be noted that in compliance with WTO obligations to eliminate tariffs on medical products, in 2000 the Government of Korea eliminated tariffs on orthopedic devices and, in 2004 plans to eliminate tariffs on other medical products.

Cosmetics and Cosmeceuticals

The United States welcomes the Government of Korea's stated goal of moving toward self-regulation in the cosmetics sector; however, there is a significant amount of work left to be done for Korea to achieve this goal, and obstacles remain against the entry and distribution of foreign cosmeceutical products in Korea. Korea has testing and import authorization requirements for cosmeceuticals that appear excessive. Furthermore, Korea has implemented new packaging requirements that appear to limit the use of outer containers considered vital to the protection and presentation of cosmetics.

When the Korean Cosmetic Products Act (KCPA) became effective July 1, 2000, a new product category "cosmeceuticals" was created. Accordingly, cosmeceuticals must be reviewed for safety and efficacy by the Korean Food and Drug Administration (KFDA) and must not be "falsely advertised" to have functions beyond proven efficacy. The KCPA regulations relating to cosmeceuticals go far beyond requirements in this area set by Europe, the United States, or Japan, and the approval process is lengthy. Compliance with Korean regulations remains difficult, particularly for foreign manufacturers who must incur additional expenses for onerous and duplicative testing and labeling requirements. Because imported products are produced overseas, foreign companies must submit more data to prove their efficacy, which often is business proprietary.

Moreover, the process of introducing new products in Korea is difficult because of a tendency on the part of the Korean bureaucracy to resist products and procedures that are different from those used by domestic companies. Foreign cosmetics often contain different ingredients or different concentrations of common ingredients and often use differing testing procedures in their home country, and the KFDA has tended to be conservative when foreign product applications come before it. This problem has been exacerbated since the product approval process has been taken over by the KFDA, as that agency is still refining its approval procedures.

The United States continues to work with the Government of Korea to further simplify and increase the transparency of the cosmetics testing procedures and product approvals process and to ensure that all cosmetics companies fully understand the scope and requirements of the KFDA regulations.

Telecommunications

As one of the world's leading nations in telecommunications, Korea currently is developing its projects for IMT-2000 wireless services and introducing satellite TV broadcasting. As a result, rapid growth is forecast for this sector. Despite such growth opportunities, some leading U.S. suppliers have been hurt by excessive governmental influence over private operators' selection of technologies and interference in issues involving, for example, foreign licensing and technology transfers. This governmental influence on the choice of sources of equipment and technologies is often implied in the licensing process for operators and also is clearly evident in localization policies for procurement. The U.S. Government will continue to urge Korea to avoid mandating specific technologies and standards or intervening in private sector negotiations related to this sector.

The Government of Korea also appears to be leading efforts to discourage use of foreign-sourced software for certain telecommunications applications, while simultaneously supporting development of a Korean national standard for competing products. For example, the Ministry of Information and Communications funds development of competing telecommunications standards through its research and development arm, the Electronics and Telecommunications Research Institute (ETRI). The Government of Korea's control over tariff rate approvals, certification of equipment and other regulatory authority provides it the means to exert strong influence over industries' selection of specific standards or technologies. Such practices deny Korean consumers access to innovative products and potentially discriminate against U.S. software suppliers. The U.S. Government will continue to urge Korea to live up to its bilateral and multilateral commitments not to hinder the import of such products.

A key concern for U.S. industry and the U.S. Government that has been the focus of a number of bilateral meetings in 2002 and early 2003 relates to the "wireless Internet platform for interoperability ("WIPI") standard for mobile phone applications. The Government of Korea, in its notification to the WTO under the Technical Barriers to Trade (TBT) Agreement, stated it intends to make WIPI mandatory. The U.S. Government continues to have a number of concerns related to the Government of Korea's stated plans related to WIPI, including: inappropriate government involvement in the creation, standardization and deployment of WIPI, recent actions taken by the Government of Korea to discourage Korean telecommunications service providers from subscribing to competing foreign standards; overly-restrictive WIPI specifications which appear to be designed to keep competing foreign systems out of the market; and possible infringement on U.S. companies' intellectual

property in the creation/promulgation of the WIPI standard. The Government of Korea has stated that it will not make any decisions on whether to make WIPI mandatory until it has fully consulted bilaterally and within the WTO. Consultations are ongoing.

The Government of Korea has also announced plans to reallocate the 2.3 gigahertz spectrum to a new wireless Internet system and appears to be planning to mandate a new standard in this area as well. The U.S. Government has repeatedly expressed its expectation that Korea, in launching any new telecommunications standards, will fulfill its bilateral and multilateral obligations and that all efforts will be made to avoid creating unnecessary obstacles to international trade in the telecommunications sector.

In the services sector, foreign ownership restrictions, including a ceiling of 49 percent foreign ownership for facilities-based (Type 1) carriers also impede the access of foreign firms in the Korean market. The Government of Korea divested the government's final holdings in Korea Telecom in May 2002. The United States believes that full privatization should inject much-needed competition into the market and allow more U.S. suppliers to qualify for KT procurement through locally qualified agents and distributors. However, the true measure of effectiveness of privatization will be demonstrated through KT's commitment to make needed changes to ensure a fair and transparent and non-discriminatory procurement process. In broadcasting, foreign re-transmission channels are restricted to 10 percent of the total of all cable and satellite broadcasting channels and foreign investment in local system operators and program providers is limited to 33 percent. These restrictions also severely limit market access for U.S. broadcast channels and considerably raise the cost of market entry. The United States will continue to recommend that Korea fully liberalize investment in the telecommunications sector as soon as possible in order to enhance the competitive environment in this key sector.