



Business Roundtable

**Real Liberalization
in the U.S.-Korea FTA:
Moving Beyond the Traditional FTA**

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Business Roundtable

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Table of Contents

EXECUTIVE SUMMARY _____	1
U.S.-KOREA: A MUTUALLY BENEFICIAL TRADING RELATIONSHIP _____	3
BEYOND THE TRADITIONAL FTA: Addressing Real Barriers to U.S. Exports and Investment _____	6
A. Identifying and Removing Non-Traditional Barriers to the Korean Market _____	6
B. Durable Market Access: Building Regulatory Transparency into the U.S.-Korea FTA _____	11
CONCLUSION _____	14



Executive Summary

Business Roundtable applauds the President's decision to initiate negotiation of a free trade agreement with the Republic of Korea. The time is right for a comprehensive United States-Korea Free Trade Agreement (FTA). Korea is a strong ally and important trading partner to the U.S. Its rapidly growing economy is the tenth largest in the world, and it is our seventh largest trading partner. A successful U.S.-Korea FTA will strengthen our political and economic ties to Korea and create the largest U.S. trade agreement since the North American Free Trade Agreement. A U.S.-Korea FTA also will provide the United States with an important foothold in Asia's dynamic economy.

- ▶ A U.S.-Korea FTA offers significant economic growth opportunities for the U.S. and will help ensure that America's economic position in Asia remains strong and continues to grow.
- ▶ To be commercially meaningful, the FTA must address several unique market access issues – including regulatory and tax regimes that serve as barriers to trade with Korea.
- ▶ A comprehensive U.S.-Korea FTA will provide for long-term, durable market access that will benefit U.S. business, agriculture and workers for years to come.

For the U.S.-Korea FTA to produce meaningful results for American businesses and their workers, the negotiations must produce real, durable market access and investment liberalization. To produce such durable results, the U.S. Trade Representative (USTR) must not limit the U.S.-Korea FTA negotiations to the template followed in recently completed FTAs. Although that template has produced meaningful and important market access in past negotiations, the unique issues presented in the Korea negotiations require a more comprehensive approach. A negotiation focused on tariffs and other traditional barriers to trade will not yield real market access in Korea.

Barriers to U.S. exports and investments in Korea's economy come not only from tariffs and other traditional barriers. Indeed, the most significant barriers to Korea's market are regulatory and tax regimes that block entry and discriminate against non-Korean enterprises. A meaningful U.S.-Korea FTA must ensure that regulatory barriers do not undermine liberalization achieved in the FTA. Effective removal of the real barriers to the Korean market requires negotiators to develop a comprehensive negotiation strategy that identifies those Korean laws, regulations, and policies that produce barriers to U.S. exports and U.S. investments. The negotiations must result in significant reductions, and eventual elimination, of these barriers.

FTA negotiations must also ensure that Korea's regulatory process becomes fair, open and transparent to prevent future barriers to American exports. Experience in the Korean market demonstrates that removal of barriers is not enough to ensure market access; the U.S.-Korea FTA must also lock in negotiated access by requiring meaningful reforms to the Korean regulatory regime. Successful negotiation of such an agreement requires negotiators to work closely with American business to develop an FTA that will produce the long-term, durable market access that U.S. business requires to successfully expand in the Korean market.

Because the President's Trade Promotion Authority expires in July 2007, the time is short for negotiations of the U.S.-Korea FTA. The time pressure must not lead to weakened provisions or a less-than-comprehensive U.S.-Korea FTA. USTR must dedicate the resources necessary to the FTA negotiations to achieve timely completion and to ensure that the unique features required in the U.S.-Korea FTA are meaningfully addressed. To aid this process, Business Roundtable has prepared this paper to illustrate the types of barriers to the Korean market that require this negotiation to move beyond the traditional FTA model.

U.S.-Korea: A Mutually Beneficial Trading Relationship

The United States and the Republic of Korea have enjoyed more than 50 years of strong economic and political ties that have produced a mutually beneficial trading relationship. Today, Korea is a major world economy, an important American trading partner, and a significant political ally to the U.S. Our trading relationship has helped Korea grow its economy and lift its population out of poverty; it also has allowed U.S. exporters and investors access to a significant, and growing, Asian economy. The time is right to take this mutually beneficial relationship to the next level by negotiating a comprehensive U.S.-Korea FTA. An FTA will help Korea continue to grow its economy, while also ensuring that U.S. exporters of goods and services have the same access to Korea's market that Korean exporters have to the U.S. market.

Korea is an important and growing market for U.S. goods and services. Today, Korea is the tenth largest economy in the world and the third largest in Asia, behind China and Japan. Its per capita income in 2005 was \$20,300 and its economy is growing at a rapid rate. Between 1994 and 2004, the Korean economy grew an average of 4.9 percent annually; its growth in trade was even more rapid, averaging 12.5 percent annually between 1994 and 2004. U.S. goods exports to Korea have increased by 53 percent and services exports have grown 98 percent since 1994. Total U.S. exports of goods and services to Korea were approximately \$37 billion in 2005, making Korea the seventh largest market in the world for U.S. exports.

Korea is the 7th largest market for U.S. goods. But, the U.S. share of the Korean market has fallen recently; an FTA will help reverse that trend.

Although U.S. exports to Korea are growing, the U.S. share of the Korean market for imported goods has been falling recently. In 2002, the U.S. supplied 15 percent of Korea's goods imports; by 2004 that percentage had slipped to 13 percent, while the share held by other Asian exporters rose. A successful U.S.-

Korea FTA will help reverse this trend by ensuring that U.S. exporters have meaningful access to Korea's robust market.

Today, Korea's tariffs are 3-4 times higher than U.S. tariffs. An FTA will help level the playing field for U.S. exporters.

A U.S.-Korea FTA also will be beneficial to Korea's economy. Today, the U.S. accounts for 17 percent of Korea's worldwide goods exports, making the U.S. the second largest world market for Korean goods. An FTA will help Korean producers remain competitive in the U.S. market as they face growing competition from China and other exporters. By opening the Korean market, an FTA will help Korean business and consumers by giving them better access to competitive U.S. goods and services, including agricultural products, automobiles, and financial and telecommunication services. In addition, an FTA would help Korea continue its rapid economic growth by helping it attract greater amounts of U.S. and other foreign investment in key sectors.

The U.S.-Korea FTA also will level the playing field between the U.S. and Korea. Although the trade between the two countries has been mutually beneficial, it has not occurred on a level playing field. Korea's applied tariffs on imports are more than three times greater than the average U.S. tariffs. There is even greater disparity in the bound rates (the rates that Korea is permitted to apply under World Trade Organization "WTO" rules). In addition, Korea maintains significant non-tariff barriers to imports and barriers to investment that further limit U.S. access to its market. As Korea becomes an ever more important player on the world economic stage, it is important that the disparities in market access between the countries be reduced, and eventually eliminated.

A U.S.-Korea FTA will offer significant benefits to both countries.

According to a 2001 study by the U.S. International Trade Commission (ITC), a free trade agreement with Korea would increase U.S. annual income by \$20 billion and Korean annual income by \$3.9 billion. The ITC further estimated that an FTA with Korea would grow yearly U.S. exports to Korea by \$19 billion and increase Korean exports to the U.S. by \$10 billion. Increased exports and growth will produce additional jobs and wealth in both of our economies. However, to maximize the mutual benefit, the U.S.-Korea FTA must be carefully crafted to remove real barriers that prevent U.S. exporters and investors from accessing the Korean market.

Beyond the Traditional FTA: Addressing Real Barriers To U.S. Exports and Investment

All trade negotiations must address traditional barriers to market access such as tariffs and quotas, limitations on provision of services, and restrictions on foreign investment. The U.S.-Korea FTA, however, must go beyond these traditional FTA topics

to ensure that the agreement yields real and enduring liberalization for U.S. exports and investment.

To be sure, the U.S.-Korea FTA must address tariffs and other traditional barriers – although Korea’s tariffs on most non-agricultural goods are not prohibitively high, they remain three to four times higher than U.S. tariffs and thus add significant cost to U.S. goods and services competing in the Korean market. However, the real barriers to U.S. exports and investment lie not in the Korean tariff code or other traditional barriers, but in Korea’s domestic laws, regulations and policies. An effective FTA must move beyond the traditional model and address the real barriers to the Korean market.

“Exporters view the Korean regulatory regime as the most significant barrier to trade with Korea for nearly every product sector. Both USTR’s Foreign Barriers to Trade Report and the EU’s Market Access Database identify this regime as imposing vague, arbitrary, or unnecessarily burdensome standards, testing, and certification regulations... Exporters state that their principal problem with the Korean regulatory process is lack of transparency.”

–U.S.-Korea FTA: The Economic Impact of Establishing a Free Trade Agreement (FTA) between the United States and the Republic of Korea (2001)

A. Identifying and Removing Non-Traditional Barriers to the Korean Market

Across the spectrum of U.S. business, Korea’s regulatory regime is identified as the most significant barrier to trade with Korea. The hidden barriers imposed by Korea’s regulatory system come in many forms, and stem mainly from a complex and opaque regulatory regime

that presents formidable challenges to U.S. companies and investors doing business in Korea. Obstacles to trade include discriminatory regulations, inconsistent regulatory enforcement, and a lack of transparency in the regulatory process. Regulatory issues often undermine liberalization achieved in traditional trade negotiations. Thus, the U.S.-Korea FTA must not only achieve traditional liberalization commitments in goods, services, and investment, but must also establish a framework for addressing the more systemic, but less obvious, barriers to trade that U.S. exporters and investors face in Korea.

Regulatory barriers to Korea's market come in many forms, including technical barriers, discriminatory treatment by regulators, and overly burdensome regulatory approval procedures for imported products and services. We highlight below a few examples. We urge the U.S. trade negotiators to work closely with U.S. business to construct meaningful FTA provisions that eliminate regulatory barriers to U.S. exports and investment.

***Technical Barriers.* In many sectors, U.S. products are excluded or made less competitive by laws or regulations that appear neutral on their face.** For example, in the banking industry, Korea requires branches of foreign banks to meet the same capital requirements imposed on Korean banks; however, the foreign branches may not use their foreign parent's capital to meet those requirements. Korea's automobile regulations impose safety and emissions regulations that are inconsistent with global standards, placing foreign producers at a disadvantage. In the telecommunications industry, Korea has begun setting standards for next generation communications equipment and mandating a single standard for telecom technology in a manner that favors Korean technology. These are only a few examples – similar cases of technical barriers to imports of U.S. goods and services abound in the USTR's National Trade Estimate, comments to the Trade Policy Staff Committee, and in the ITC's report on the economic impact of a U.S.-Korea FTA. U.S. trade negotiators should take steps to identify technical barriers across sectors and develop meaningful FTA provisions that eliminate such barriers.

Overly-burdensome Regulatory Approval Procedures. Product approval, registration, and safety standards constitute one of the greatest barriers to U.S. goods exports to Korea. In many sectors, Korea does not follow international norms for product standards and in many cases it does not accept information or documentation from foreign sources, requiring costly re-testing and certification of products in Korea before they can be marketed. For example, the Korean food and drug administration does not accept international manufacturing norms for pharmaceutical products and requires local (i.e. Korean) testing for each batch of imported drugs, placing U.S., and other foreign producers, at a distinct disadvantage to Korea's domestic pharmaceutical companies. Korea has not adopted the "Generally Recognized as Safe" standard for food products; consequently food products are often detained upon import. Similarly, label requirements for food products exceed international norms.

Korea is one of only a few countries that do not accept U.S. testing and certification of medical diagnostic equipment, and requires local testing by a Korean company of imported equipment. Similar problems exist in the services industries. For example, Korea maintains complex requirements for obtaining approval for marketing new products or services. Insurance providers must get approval for risk rates used to determine premiums. U.S. trade negotiators should include in the FTA enforceable provisions that eliminate such discriminatory and overly-burdensome regulatory procedures.

"Korea maintains standards and conformity assessment procedures, such as sampling, inspection, testing and certification, which are overly burdensome and have a disproportionate impact on imports."

—USTR Foreign Barriers to Trade Report (2005)

Discriminatory Treatment. Korea provides preferential treatment to some domestic industries by providing favorable regulatory, tax, financing, and import regimes. For example, Korea's domestic tax structure creates a "tax-on-tax" system for imports by calculating the consumer tax based on the value of the product, plus the insurance,

freight and tariffs. For goods with significant tariff rates, this system favors domestic production by creating a prohibitive tax burden on imported products. In the automobile sector, this tax-on-tax system magnifies Korea's relatively high automobile import tax and consumer tax and can add as much as 70 percent to the price of a U.S. produced car, placing U.S. exporters at a serious disadvantage. In addition, in the automotive sector, Korea bases its automobile purchase tax on engine size, which disproportionately burdens foreign automobile producers.

Beyond taxes, laws and regulations also provide favorable financing to certain Korean industries. In 2002, Korea passed legislation that enables the Export-Import Bank of Korea to undertake risks that commercial banks are reluctant to incur and extend credit to Korean exporters that otherwise may not have been able to obtain credit. In addition, the Korean Development Bank has engaged in policy-directed lending to favored industries, contributing to overcapacity in certain Korean industries that distorts trade, both in the U.S. and Korea.

Korea's regulatory authorities also discriminate against foreign goods, services and investments in the development, implementation and enforcement of regulations and government policies.

Much of this discrimination is subtle and informal – although remarkably effective. The discriminatory treatment arises from a historical preference for domestic goods and firms in Korea's regulatory structure and economic policy, and also, to significant extent, from the close cooperative relationship that has developed between regulators and regulated industries. In Korea, regulatory agencies and regulators are frequently co-opted by the industry they are intended to regulate. As an illustration, Korea's cumbersome drug reimbursement system is rife with examples of discrimination. According to the U.S. pharmaceutical industry, 50 percent of new products registered with the Korean food and drug administration by U.S. and EU companies were denied reimbursement. A report by the ITC identified situations in which reimbursement for the same drug differed based on the company of manufacture.

In addition, Korean authorities sometimes engage in extra-regulatory actions that explicitly favor Korean industries over U.S. imports – according to industry reports, food and drug regulators have urged doctors to favor Korean drugs. Similarly, government campaigns to discourage the import of foreign motor vehicles are not uncommon. Such discrimination cannot be addressed using traditional trade negotiations; the U.S. negotiators must identify discriminatory practices and develop FTA language that ends such discrimination and prevents it in the future.

Protection of Intellectual Property. In recent years, Korea has taken significant steps to improve its intellectual property protection regime and to bring its laws and policies into conformity with the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). **However, regulatory procedures undermine those commitments and place U.S. intellectual property holders at significant risk of piracy, disclosure of confidential business information, and loss of legally mandated patent protection.** For example, foreign pharmaceutical firms are required to submit very detailed product information and testing data for registration of products. Despite prohibitions on the release of such confidential data, U.S. firms have reported leaks of such information to Korean competitors. Processed food producers have reported similar problems. In addition, pharmaceutical producers report problems with so-called “patent linkage”; despite legal protection for patented products under Korea’s IPR regime, regulatory authorities have approved marketing of infringing drugs while U.S. or EU companies’ patents remain in force. U.S. negotiators should carefully craft the provisions of the U.S.-Korea FTA to ensure that gains made in TRIPS and in the Intellectual Property chapter of the FTA are not undermined by failures of the regulatory system.

Customs and Import Procedures. Korea's customs and import procedures also create significant barriers to imports due to unpredictable and inconsistent valuation and clearance procedures that depart from international norms. Korea does not always comply with international harmonized tariff classifications, causing confusion about applicable tariff codes, and making it more difficult for goods to enter the Korean market. Furthermore, customs valuation of goods entering Korea can be burdensome and result in overpayment of duties. U.S. negotiators should ensure that Korea's customs procedures are specifically addressed in the FTA.

B. Durable Market Access: Building Regulatory Transparency into the U.S.-Korea FTA

The myriad regulatory barriers faced by U.S. businesses attempting to access the Korean market are the result of a regulatory and enforcement regime that lacks openness and transparency. The discriminatory regulations and inconsistent enforcement endured by exporters and foreign investors are, more often than not, the result of rules and policies promulgated without input from (and often without the knowledge of) interested foreign companies.

This lack of transparency in the regulatory process has led to the creation of regulations and policies that favor domestic Korean companies over foreign producers, service providers, and investors. Regulations and policies, created without the benefit of open and transparent participation by relevant foreign stakeholders, impose major barriers to U.S. goods, services, and investment.

“The lack of transparency in Korea’s rule making and regulatory system is a cross-cutting issue affecting U.S. firms in many different sectors.”

–USTR Foreign Barriers to Trade Report (2005)

Past experience teaches that a failure to reform Korea's regulatory system will undermine gains achieved in trade negotiations. For example, Korea has the ninth largest domestic market for automobiles in the world; however, it remains a nearly impenetrable market for foreign car producers. Korea had traditionally banned auto imports to support its domestic industry. However, in a series of negotiations in the 1980s and 1990s, the U.S. secured an opening of the market and significant tariff reductions on imports. Nevertheless, foreign sales in the Korean market are still less than three percent of total sales. Foreign automakers report that unreasonable and unduly burdensome standards, combined with discriminatory taxes, and both official and unofficial policies favoring the domestic industry make importation of foreign vehicles into the Korean market all but impossible. To ensure durable market access, the U.S.-Korea FTA must go beyond merely eliminating existing regulatory barriers to U.S. trade and investment; it must guarantee that Korea's regulatory regime becomes open and transparent to ensure that future regulatory decisions do not eviscerate the benefits negotiated in the FTA.

Lack of public participation in the regulatory process allows regulatory barriers to trade and investment to proliferate in Korea. Korea's regulatory regime lacks a standardized structure for notice and comment on new regulations. U.S. companies complain that regulations and changes in interpretations of regulations are enacted without notice or with very little time to provide comments. Korean ministries often fail to provide stakeholders with timely information regarding planned or actual changes to laws and regulations. In the rare instance that stakeholders are permitted to participate in the rulemaking process, foreign companies often are not aware of that opportunity and are left out of the process altogether. Even when regulatory bodies do receive comments from interested parties, there is no guarantee that those opinions are in fact considered or addressed.

In a similar vein, businesses across goods and services sectors report problems arising from inappropriate regulator interaction with domestic industry. In particular, industries point to the practice of delegating regulatory decisionmaking to industry trade associations. Such processes often produce regulations or interpretations that unduly burden industry or that favor domestic industry. In the insurance industry, for example, delegation of rulemaking to industry associations allows industry groups to regulate such issues as advertising material or to dictate decisions that should be left to the discretion of companies.

Inconsistent enforcement and application of Korea’s regulatory programs also affects U.S. ability to export to, and invest in, Korea by creating market insecurity, especially for foreign businesses.

For example, in the arena of competition policy, U.S. producers report that although Korean rules are not facially discriminatory, their enforcement is. Foreign businesses report that Korea’s antimonopoly laws are not enforced against the large Korean conglomerates, known as “Chaebols,” making it difficult for foreign producers to compete in the Korean market. On the other hand, foreign companies report that the same competition laws are used against them to help Korean producers in ways that provide no benefit to Korean consumers. Similarly, dispute resolution and adjudication in the insurance industry lacks transparency and creates unnecessary costs and risks for companies by failing to disregard blatantly frivolous claims.

The FTA must contain strong transparency provisions that ensure more open and effective public participation in the regulatory process and consistency in the enforcement and application of laws and regulations. The U.S.-Korea FTA must go beyond the technical barriers to trade provisions and the transparency commitments found in the WTO agreements and in previous U.S. agreements. While the U.S.-Australia agreement chapter on technical barriers to trade offers an important starting point for negotiations, the U.S.-Korea FTA must go beyond that agreement to ensure that Korea’s regulatory procedures are fair, open, transparent and consistent.

Conclusion

The U.S.-Korea FTA promises to strengthen the already beneficial trading relationship between our countries. The importance of this FTA requires, however, that U.S. negotiators look beyond the traditional topics of a bilateral FTA, because a traditional FTA will not produce meaningful liberalization in Korea. To ensure that the U.S.-Korea FTA yields real and long lasting results for American businesses and workers, U.S. negotiators must work to identify all existing barriers to market access in Korea, particularly those found in Korea's domestic regulatory regime. A meaningful FTA with Korea will require detailed and comprehensive provisions to open Korea's market and ensure continued access. The U.S. is operating under a tight deadline to complete this FTA, thus it is important that USTR have adequate resources to identify and negotiate the unique features of the far-reaching and comprehensive FTA that is necessary to bring the U.S.-Korea trading relationship to a new level of mutual benefit.

Continued expansion of international trade and investment opportunities will be vital for future U.S. economic growth. An FTA with Korea offers significant economic benefits while strengthening the U.S. economic position in Asia. As a representative of the chief executive officers of leading U.S. companies, Business Roundtable is committed in its support of a **comprehensive** U.S.-Korea FTA. The bar has been raised for U.S. negotiators, but the long-term benefits will be well worth the effort.



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