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Korea

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International Economic Affairs-Walsh, Helen

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Background Material on Korea

1. NEC inserts for POTUS memo
 - Note: These probably did not make it into final memo.
2. Current Economic and Political Situation (1pg)
3. Korea Chapter of USTR's 1995 Trade Estimate Report
4. State Paper on Korea's Position on WTO Telecom

Korea

NEC Insert for POTUS Memo for Korea:

OECD

-- The U.S. and Japan are the two countries that have worked to ensure that the OECD is not Euro-centric. We have been strong supporters of having countries like South Korea become members. However, Korea still needs to meet the membership criteria.

-- The process for membership can be shortened if Korea takes the liberalization steps recommended by the OECD committees.

If Pressed:

-- The timing of OECD membership is really up to you since membership depends on Korea's ability to meet the OECD standards. The same standards are being applied to other aspiring entrants, e.g., Poland.

Background on OECD:

Korea formally applied for OECD membership in March 1995. President Kim has publicly indicated his intention for Korea to become an OECD member by the end of this year, and may seek your commitment to achieve this. Our position is that Korea must meet the OECD's high standards and that the timing is really up to Korea, since entry would require Korea to take further liberalization steps to meet those standards. The OECD's review process thus far suggests that the areas likely to be the most difficult for Korea are investment and capital markets policies and labor standards.

Korean Autos

-- Pleased with the implementation of the U.S.-Korea Auto Agreement that we negotiated last fall.

-- As you know, this was a first step in liberalizing Korea's auto market, and we want to build on that liberalization in the June talks.

Background on Korean Autos:

You should flag our interest in further progress in the U.S.-Korea auto talks, since Korea's negotiators will attach less importance to it if they hear it was not discussed. Korea's car market remains relatively closed to foreign autos (with foreign share of the market an imperceptible 0.45%). Last September, we negotiated a modest agreement with Korea on market access for foreign auto producers, which Korea has faithfully implemented.

We now want to build on that progress, as envisioned in the agreement, by putting forward further proposals in June, when the agreement is to be reviewed by both sides.

Korea's economy:

Korea had another spectacular year in 1995. Real GDP soared by 9.5% while inflation fell to 4.7%. Although Korea ran a trade deficit of \$9.9 billion (2% of GDP) in 1995, it reflects primarily an explosion in imports of machinery and capital equipment, which is a healthy sign of strong domestic investment. Korea also ran a trade deficit with the United States of about \$500 million.

Korea

Current Economic and Political Situation

Economic Situation:

Korea recorded another spectacular year in 1995. Real GDP increased by 9.5% and inflation fell to 4.7%. The yen appreciation at the beginning of 1995 boosted Korea's exports in markets where Korea competes with Japan, but contributed to a dramatic increase in Korea's bilateral trade deficit with Japan. [Korea's exports to Japan increased somewhat with the yen appreciation, however, this was not enough to offset the increased price of Korea's imports from Japan.] Korea also had a bilateral trade deficit with the United States of \$522 million (using c.i.f. import data), and an overall annual trade deficit of \$9.9 billion (2% of GDP), resulting from an explosion of machinery and capital equipment imports. The Korean government is projecting 1996 economic growth of 7.5% and inflation of 4.5%. The stock market has fallen over 15% since October, due to political scandals and dampened investor sentiment about the "slowdown" in the economy.

Political Situation

President Kim has been successful in avoiding personal involvement in the bribery charges for which former presidents Roh and Chun are on trial. However, his NKP party faces difficult National Assembly elections in April and is not expected to maintain a majority. The outcome of the elections will determine President Kim's ability to move forward with his "globalization" agenda.

It is unclear how the economic policies of the opposition party differ from those of President Kim; however, some opposition politicians have expressed that the costs of OECD membership may be too high in terms of the adjustment costs that would result from the necessary liberalization measures.

Drafted by: MGrewe/INA
April 1, 1996

REPUBLIC OF KOREA

In 1995, the U.S. trade surplus with the Republic of Korea was \$1.2 billion, a shift from a \$1.6 billion trade deficit in 1994. U.S. merchandise exports to Korea were \$25.4 billion in 1995, \$7.4 billion or 41 percent more than in 1994. Korea was the United States' fifth largest export market in 1995. U.S. imports from Korea totaled \$24.2 billion in 1995, a 23 percent increase over those in 1994.

Korea was the United States' third largest market in 1995 for agricultural products, up from fourth in 1994. Korea was the United States' third largest market for beef.

The stock of U.S. foreign direct investment in Korea was \$3.6 billion in 1994, or 15.6 percent more than in 1993. U.S. direct investment in Korea is largely concentrated in banking, manufacturing and wholesale.

IMPORT POLICIES

Tariffs

Korea will bind 92 percent of its tariff lines as a result of the the Uruguay Round negotiations. The average bound rate for industrial products will be 8.2 percent once the commitments are fully implemented. The average applied tariff rate is 7.9 percent.

Except for rice, all agricultural products are bound. In January, 1995, Korea began implementation of its Uruguay Round commitments to lower duties on over 30 agricultural products of primary export interest to the United States, including such intermediate and high-value products as vegetable oils and meals, processed potatoes, mixed feeds, feed corn, wheat, fruits, nuts, popcorn, frozen french fries and breakfast cereals. Duties on these products will be reduced by 40 percent from the 1993 applied levels in 10 equal installments between 1995 and 2004.

Korea also established tariff-rate quotas that established minimum access to a previously closed market, or maintained pre-Uruguay Round access (see also Quantitative Restrictions below). Within-quota tariff rates are to be maintained at zero or low levels. However, as a result of this "tariffication" of previous non-tariff trade barriers, the over-quota tariff rates on some products are quite high.

For example, there are a number of agricultural products that have out-of-quota tariff rates of over 200 percent. Products with significant export interest from U.S. suppliers include natural and artificial honey, skim and whole milk powder, barley and barley malt, popcorn, ginseng root and some ginseng processed products.

Korea is in the process of phasing-in tariff reductions to zero tariffs on most of all products in the following sectors: paper, toys, steel, semiconductors, and farm equipment. Korea is also in the process of harmonizing tariffs on chemicals to final rates 0, 5.5 or 6.5 percent depending on the product, and reducing tariffs on scientific equipment by 65 percent from pre-Uruguay Round levels.

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Korea harmonized and bound most tariffs on textile and apparel products at least at the level of U.S. rates: 7.5 percent for man-made fibers, 15 percent for yarns, 30 percent for fabrics and made-up goods and 35 percent for apparel.

However, duties still remain very high on a large number of high-value agricultural and fisheries products. Korea imposes tariff rates above 45 percent on most horticultural products of interest to U.S. suppliers, such as shelled walnuts, table grapes and citrus.

Products subject to a tariff rate of at least 30 percent or higher include certain meat, poultry, offal, most fruits and nuts, many fresh and processed vegetables, all flour and starches, peanuts, various vegetables oils, juices, jams, peanut butter, soups, beer and distilled spirits and dairy products.

U.S. firms continue to report that the combination of current tariffs and non-discriminatory value-added taxes for agricultural and manufactured products is often sufficient either to keep imports out of the market or raise their prices such that competitiveness is significantly diminished.

For example, Korea reduced its tariffs on distilled spirits (other than grape brandy) to 20 percent on January 1, 1996. However, imported distilled spirits are still assessed higher taxes than local spirits. While the local *soju* is taxed at 35 percent, whisky and brandy is taxed at 100 percent, other distilled spirits are taxed at 80 percent, and liquors are taxed at 50 percent.

Korea's "education tax" further compounds the discrimination between imported and domestic distilled spirits. An "education tax" of 30 percent is imposed on distilled spirits that are taxed at a rate of 80 percent or higher, but only a 10 percent tax is imposed on spirits which are taxed at under 80 percent.

Another example is foreign passenger vehicles, which are subject to an applied rate of 8 percent, more than three times that of the United States. Korea then levies a "cascading" system of high taxes on top of the 8 percent tariff, three of which are based on engine size. As a consequence, foreign autos are prohibitively expensive. (Korea is the only auto producer in the world that has not bound tariffs on passenger vehicles).

In September 1995, the United States and Korea reached an agreement that will result in a 15 percent reduction in the overall tax burden. The United States will continue to seek fair market access.

Korea has used "emergency tariffs" to respond to import surges and protect domestic producers. While Korea has not imposed any new emergency tariffs since 1994, previous tariff increases have not been phased-out. For example, in 1992 Korea raised the tariff on all carbon zinc and alkaline cell batteries from 11 percent to 30 percent. The surcharge expired in 1994, but Korea extended it for another year. While the United States negotiated a reduction from 30 to 20 percent, Korea has still not restored tariffs to the 1992 level.

Quantitative Restrictions

Korea implements quantitative restrictions through its import licensing system. All goods entering Korea require a Foreign Exchange Bank-issued import license. The Export-Import Notice contains lists of products which are approved, restricted or prohibited. Approximately 99 percent of imported goods receive routine

automatic approval. Remaining tariff line items (mostly agricultural and fishery products) are restricted for import, i.e., subject to quotas or tariff rate quotas with prohibitively high rates which can range up to 900 percent.

Korea selects products for "national promotion" which are routinely denied an import license. The list is revised on a quarterly basis at the request of Korean producers, and usually includes about 80 high technology products, including information technology and agricultural machinery.

Under a 1989 agreement relating to liberalization of Korea's GATT balance-of-payments (BOP) measures, an additional 283 items (again, primarily agricultural and fishery products) must be liberalized between 1992 and 1997. Of these products, 42 were liberalized in 1992, 44 in 1993, 45 in 1994, and 49 in 1995. Another 31 will be liberalized in 1996.

In 1989, a GATT panel ruled that Korea's quantitative restrictions on beef imports were inconsistent with Korea's GATT obligations. The panel directed Korea to consult with its trading partners, including the United States, on how Korea would eliminate the import restrictions or otherwise bring them into conformity with GATT provisions cited in the GATT panel report.

A bilateral agreement on beef imports was signed in 1990, and in July 1993 the United States and Korea concluded the second of three agreements aimed at fully establishing free-market conditions for the importation and distribution of imported beef in Korea. (The third agreement was negotiated in the Uruguay Round. See below.)

Called the "Simultaneous Buy Sell" (SBS) system, the agreement establishes annually increasing minimum access levels, guarantees direct commercial relations between foreign suppliers and Korean retailers and distributors (such as five-star hotels and supermarkets) and guarantees that growing volumes of beef will be sold through that channel instead of through a government corporation. New retailers and distributors are added to the direct access system over the term of the SBS agreement. Each year the United States and Korea meet on a quarterly basis to ensure full implementation of the agreement's provisions.

Under the Uruguay Round Agreement, the minimum import quota for beef is to expand from the current 106,000 ton quota to 225,000 tons by the year 2000, while at the same time expanding the proportion of the quota imported through the SBS system. Korea has agreed to remove all non-tariff barriers to beef imports, including state trading, by January 2001.

Also as part of its Uruguay Round commitments, in January 1995 Korea began phasing-out all import restrictions on a number of important U.S. agricultural exports, including beef, pork, frozen chicken, oranges, orange juice, grape juice and fruit juice beverages, dairy and whey products.

Korea's administration of the tariff-rate quotas for certain products agreed under the Uruguay Round raises new market access problems. In 1995, the United States expressed its concerns with Korea regarding the fair operation of quotas on several products. For example, Korea established a quota for oranges of 15,000 metric tons in 1995. This quota will expand to 20,000 metric tons in 1996, 25,000 metric tons in 1997, and thereafter by 12.5% annually until 2004.

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Of the 1995 15,000 metric ton orange quota, Korea designated a Korean citrus cooperative as the sole importer for 14,000 metric tons. The United States has expressed its concern that such an arrangement can present a conflict of interest. In fact, a number of problems arose with the first shipments of U.S. oranges in 1995, including delays at the port (see also Import Clearance). The Korean producer cooperative delayed the importation of oranges until after the local crop was marketed, and stored the imported oranges for up to five months before they could be marketed. As a result, the quality of the imported oranges had deteriorated.

In the case of Korea's poultry tariff-rate quota, the government held an auction to allocate the 7,700 metric ton quota, but the delayed timing led to missed opportunities for U.S. suppliers. The auction was not held until mid-March, when domestic poultry prices had fallen. The delay made imported poultry less price competitive, particularly given the added costs of auction bids. Several local importers defaulted on their contracts as a result, and Korea actually imported 1,984 metric tons less than the 1995 quota. Lost export sales are estimated at \$2 million.

Korea lifted its import ban on rice in 1995 and established a quota for 51,307 tons. This quota will increase to 205,228 tons by 2004. However, Korea limited the end-use of the rice to processing through a state trading organization. The United States has raised its concerns over the end-use restriction.

Since 1987 Korea has maintained the Import Diversification Law which is effectively a ban on Japanese products (see also Motor Vehicles). Japan has declined to challenge the GATT-inconsistent law in exchange for lucrative contracts with Korean companies.

However, U.S. companies which source their products or parts from Japan or use Japanese components have also been adversely affected by the ban. In December, 1995, after the United States had raised its concerns for more than a year, Korea agreed to remove laser printers and notebook computers from the list. Other products of significant export interest still remain on the list, such as heavy equipment and auto parts. Korea should eliminate the law in light of Korea's plans to join the OECD in 1996.

Import Clearance

Korea's import clearance process is among the most frequently cited trade barrier to U.S. exports. Clearance procedures are still excessively slow and arbitrary, despite Korea's 1992 promises of reform.

Surveys of U.S. trading partners in Asia indicate that import clearance for most agricultural products requires less than 3-4 days. The lone exception is Korea, where import clearance typically still takes two to four weeks.

The greatest delays are attributed to the Ministry of Health and Welfare (MOHW) and the Ministry of Agriculture, Forestry and Fisheries (MAFF), which share responsibility for health, food safety and sanitary-phytosanitary inspections at Korea's ports of entry. Both ministries impose numerous requirements that prohibit access or inhibit import clearance while adding costs to importers (see also Standards, Testing, Labeling and Certifications).

U.S. companies report fewer problems with the Korean Custom Service (KCS). Korea passed legislation

in early 1994 which facilitated the streamlining and automation of customs clearance procedures. The KCS advanced its original timetable for reform, from 1998 to late 1996. The United States actively monitors Korean implementation of the steps in a working group co-chaired by U.S. and Korean customs officials.

In May, 1995, the United States initiated consultations under the World Trade Organization's (WTO) dispute settlement procedures after U.S. citrus exporters complained in March, 1995 that grapefruit and orange shipments had been detained at the port for up to three weeks, causing catastrophic levels of decay. Instead of using random or "suspect" sampling techniques, Korea inspects and tests 100 percent of all containers. Testing all containers for pesticide and other chemical residues results in lengthy delays. In response to the U.S. request for WTO consultations, Korea administratively revised inspection procedures to allow fresh fruit and vegetables to clear customs within five working days. While this step appears to have reduced some of the delays at the port for perishable products, delays for less perishable products still remain unacceptably high at two to four weeks.

Another frequently cited cause of delay is testing requirements administered by MAFF's National Plant Quarantine Service (NPQS). The NPQS often subjects imported fruit to fumigation for insects commonly found in Korea, which adds significant time and cost to the import clearance process.

Also of concern is the NPQS requirement of "zero-decay" for imported fruit and vegetables. All spoiled fruit must be removed from containers and all remaining product must be repackaged before the containers leave quarantine, even though the import contract specifies acceptable spoilage limits which have not been exceeded. The practice is costly and can add another three to four days at the port; it also does not appear to be enforced equally for domestic fruits and vegetables.

Korea indicated to the United States in May 1995 that it planned to reform its testing and inspection system by March 1996. The United States has been monitoring this effort and will continue to conduct consultations under the WTO's dispute settlement procedures.

U.S. exporters also cite as barriers to import clearance Korea's country-of-origin regulations for imported agricultural products and processed foods, which impose unnecessarily burdensome labeling requirements. For example, if agricultural imports are to be distributed in packaging other than as they appear at customs clearance, each item requires a separate "inner packaging" label.

Korea's country of origin and general labeling requirements for products change frequently, often without notice. Shipments will have already arrived at the port when an exporter discovers that the products must be unpacked and relabeled at considerable expense. U.S. suppliers then are hindered from fulfilling contract obligations on time to their Korean customers.

Korea stated to the United States that its country-of-origin labeling system is designed "to prevent unfair transactions such the disguised sale of cheap imported products."

Also of concern are unannounced, unpublished, and arbitrary changes in customs classifications.

STANDARDS, TESTING, LABELING AND CERTIFICATION

While formal barriers to imports have fallen, Korea has numerous secondary barriers that effectively prevent the liberalization envisioned in the major trade reform initiatives of the late 1980s.

Lack of transparency or adequate notification is still an ongoing trade barrier. Korea often fails to meet its obligations to notify under the WTO, or allow adequate time for comments. Korea increased the number of its notifications in 1995, but often did not describe the change, nor grant extensions for comments as requested by the United States to allow for translation.

Most Korean laws are very general and discretionary; the implementation is embodied in unpublished "internal guidance" developed by relevant ministries. Actual changes to regulations are rarely notified in a timely manner to importers or exporters. Implementation periods are unrealistically short, which tends to disrupt trade.

Regulations supposedly intended to protect health and safety often deviate substantially from international practices in both substance and method. They do not appear to be founded on any scientific basis or risk assessment, and are often drafted in such a way that they affect only imported goods.

For example, the Korean Food Code lists specific products which are familiar to Korean regulators. Unless a product is included in the Food Code, it is considered "new" and subject to regulatory review prior to import. So-called "new" products have ranged from peanut butter to popcorn.

Extensive product information is required of importers under this system, known as "self-specification". The system is especially restrictive for new-to-market products, which are more likely to be imported. Often review criteria is unspecified, or not based on legitimate health or safety criteria. Some of the required information is either of a proprietary nature or simply unavailable.

In 1995, Korean authorities detained shipments of U.S. popcorn for more than six months, then rejected the shipments on grounds that it had high levels of e-coli bacteria. No test results were provided to the U.S. exporter. The U.S. exporter, who had retested original samples taken from the shipment, was denied the right to resubmit the negative test results. Korea also rejected arguments that high temperatures used in making popcorn would kill any bacteria.

After investigation, Korea stated it was the fault of the Korean importer who had "self-specified" that shipments of U.S. popcorn had tested negative for e-coli bacteria. Yet Korean inspectors apparently interpreted "negative" as zero tolerance, and in fact no standards even existed for e-coli bacteria on popcorn in the Korean Food Code. A year later, the Korean importer still was unable to sell the popcorn, and the small U.S. exporter had lost over \$50,000 dollars.

As part of the WTO consultations, Korea stated it planned to abolish the self-specification program by "incorporating the self-specifications into the Korean Food Code." It is unclear what this means. Presumably product specifications that resulted from importers' self-specification submissions -- which were not necessarily based on science or which may conflict with another importers' submissions -- are now part of the Korean Food Code.

Korea's Food Additive Code also restricts food imports by failing to recognize additives already approved by the Codex Alimentarius Commission of the Food and Agricultural Organization (FAO), the joint FAO - World Health Organization expert committee on food additives, or the U.S. Food and Drug Administration. Contrary to international practice, Korea approves food additives on a case-by-case basis, rather than allowing additives which are "generally recognized as safe" to be used in all food products.

Korea's Imported Food Products Management Guidelines also restrict imports. The Guidelines require that every container of every shipment be inspected and tested, contrary to the international practice of "suspect" or random testing. Domestic food products are not subject to this level of inspection and testing.

Also contrary to international practice, Korea often subjects imported fruit to treatment for insects commonly found, and untreated, in Korea. Korea also requires incubation testing for 100 percent of certain imported fruit, even if the fruit has been in transit for weeks. Requiring fruit to be unnecessarily tested and treated is costly, discourages imports and often leads to rapid deterioration and eventual destruction of the fruit.

A number of U.S. horticultural products are effectively banned because of Korea's use of unscientific phytosanitary standards. These include apples, pears, and stone fruit. Korea's National Plant and Quarantine Service has repeatedly agreed to undertake risk assessments for these commodities since 1994, but little progress has been made to date.

The WTO SPS Agreement has greatly increased U.S. ability to challenge unfair regulations and testing procedures imposed on U.S. agricultural exports to Korea.

For example, pursuant to a November, 1994, Section 301 petition filed by the U.S. beef and pork industry, the United States initiated consultations in May, 1995 under WTO dispute settlement procedures. Of particular concern was Korea's government-mandated shelf-life restrictions, which effectively prohibited shipping because expiration dates were so short that by the time a product cleared Korean customs, the date had expired. Korea's shelf-life requirements were not based on scientific studies nor enforced equally for domestic products.

This led to a bilateral settlement in July 1995. Korea agreed to phase-in the common international practice of manufacturer- determined "sell-by" dates for most food products including meat, beginning in October, 1995 and completed by July 1996. Savings are estimated at \$250 million a year for the U.S. beef industry alone.

However, Korea continues to restrict shelf-life for sterilized milk products, such as UHT milk, and bottled water. The United States has reserved its right to request a panel under WTO dispute settlement procedures.

U.S. cosmetic producers cite Korea's replicative testing requirements and unscientific standards for imported cosmetics. Korea requires replicative testing for each shipment, including animal testing. Importers of cosmetics are still required to share confidential business information with local trade associations who are their competitors.

Non-transparent standards also affect imports of industrial products, such as medical equipment and veterinary instruments. U.S. suppliers report that product approval requirements not only lack clarity but

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are being applied inconsistently across product categories and by the several Korean test agencies designated to register and test medical devices.

After consultations in 1995, Korea agreed to reform its standards for medical equipment based on international standards. The United States will continue in 1996 to work with Korea to ensure that these standards are adopted.

GOVERNMENT PROCUREMENT

The Office of Supply, Republic of Korea (OSROK) is responsible for procurement on behalf of government agencies and at times on behalf of public corporations or other enterprises in which the government holds a majority share. The ministries concerned formulate their government agency procurement needs.

The Ministry of Trade, Industry and Energy no longer officially screens requirements to determine whether they can be met from local sources. However, U.S. firms report that Korea still encourages local procurement through a variety of less explicit means. As a result, U.S. participation in attractive public sector projects is often precluded.

In addition, U.S. companies continue to report that bids including offsets are encouraged, albeit no longer required outright. Offsets are still a condition of sale for major military procurement. In Korea offsets can range from 30 to 50 percent of the total contract value.

Korea completed its accession negotiations to the WTO Government Procurement Agreement and will implement its new obligations on January 1, 1997. Korea agreed to cover goods and services procurement (including construction) by central government entities, sub-central entities and many government-owned commercial enterprises. Korea also agreed to provide access to its computer network procurement. Among the major government-owned enterprises covered by Korea are the Korea Electric Power Corporation, the Korea Petroleum Development Corporation, the Korea General Chemical Corporation and Korea Telecom; in the case of Korea Telecom telecommunications commodity products and network equipment were excepted.

Under the terms of the 1992 bilateral telecommunications agreement with Korea, U.S. providers of commodity products and network equipment should be able to compete. The United States annually reviews Korea's compliance with this bilateral agreement, as required under Section 1377 of the 1988 Trade Act. Each year, U.S. companies increasingly report non-compliance with the 1992 agreement, including excessive type approval requirements, lack of trade secret protection, and de facto buy local policies. The United States will be considering its options under U.S. trade law in accordance with Section 1377.

Korea has not yet fully liberalized mobile communications services, or "Special Service Providers." The current Korean regulatory structure and practice continue to restrict foreign access to various mobile services, including cellular, paging and various trunking services.

EXPORT SUBSIDIES

Traditionally, Korea has aggressively promoted exports through a variety of policy tools, although the use

of these policies and programs has declined. Korea has committed to phase-out the remaining programs which are not permitted under the GATT Agreement on subsidies and countervailing measures, to which it is a signatory. Korea will retain permissible programs under the WTO Agreement on Subsidies, principally in the form of tax incentives and targeted credit, and focused on small and medium sized enterprises.

Shipbuilding Support

Traditionally, the Korean Government has provided large subsidies to its shipbuilding industry. U.S. shipbuilders have operated without U.S. Government subsidies since 1981. In response to continuing foreign shipbuilding subsidy practices, the Shipbuilders Council of America filed a section 301 petition in 1989 seeking the elimination of subsidies and trade distorting measures for the commercial shipbuilding and repair industry. As a result, a Shipbuilding Agreement was negotiated under the auspices of the OECD. On December 12, 1995, Korea, the European Union and Norway formally ratified the OECD Shipbuilding Agreement, which is designed to eliminate all subsidies and to create a new antidumping mechanism to address the predatory pricing of ships. The Agreement was scheduled to enter into force on January 1, 1996, after its ratification by all Parties to it. This did not happen because Japan and the United States failed to complete their respective ratification processes last year. The Government of Japan has indicated that its delay in ratification was entirely procedural and has expressed full confidence that its process will be completed within the first half of 1995. Consequently, the Parties to the Agreement agreed to extend the ratification date to June 15, 1996, and entry into force to July 15, 1996.

LACK OF INTELLECTUAL PROPERTY PROTECTION

Since 1993, Korea has made a modest effort to strengthen its intellectual property rights laws and enforcement of those laws. Korean officials placed priority on prosecution and increased penalties. The government has continued this campaign, dedicating extra-budgetary resources and sponsoring public awareness seminars. As a result, Korea was not placed on the Special 301 foreign priority country list in 1995.

In 1995, the Korean National Assembly adopted amendments to Korea's copyright, computer software and customs laws in order to comply with its obligations under the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs). Some of these laws will not be implemented for up to two years. Of particular concern is a provision that shortens retroactive copyright protection eleven years less than required under the TRIPs Agreement.

There has been some improvement over the past two years in removing pirated and counterfeit goods from the Korean market. In particular, Korea significantly curtailed the copying and sale in Korea of U.S. copyrighted works created before 1987 and therefore not protected under Korea's copyright law.

Korea also established "special enforcement periods," in which significant resources were devoted to raids, prosecution and other copyright enforcement activities. While enforcement against audio and video piracy has improved considerably, U.S. software publishers continue to seek more aggressive Korean government action. U.S. software publishers are particularly concerned about the lack of enforcement against large end-user infringers.

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Also of concern to the software industry is Korea's customs valuation of software based not on the medium but on the full value of the content. This method is not transparent and leaves great room for discretion.

Korea has taken steps to reduce the number of cases in which Korean companies register trademarks similar to U.S.-owned marks. The Korean Industrial Property Office (KIPO) has also worked to resolve individual cases more expeditiously. However, since the collapse of legitimate licensing contracts, U.S. firms report an increase in unauthorized use. Korea does not recognize trade dress. These practices are contrary to a 1986 bilateral Record of Understanding.

Korea has long been a source of exports of infringing goods. While progress has been made in improving customs procedures and cooperation with the U.S. private sector to identify and stop these exports to third countries, the United States continues to seek more active involvement of Korean government officials in this area.

Some Korean companies pirate U.S.-copyrighted textile designs and export them to third countries, competing with U.S.-produced goods.

Although Korean laws on unfair competition, trade secrets and semiconductor chips provide some trade secret and mask works protection in Korea, they remain seriously deficient. For example, U.S. firms face significant problems with government regulations requiring submission of very detailed product information (i.e. formulae or blueprints) as part of registration or certification procedures. U.S. firms report that although such information is business confidential, it is not given sufficient protection by government officials and, in some cases, is made available to Korean competitors.

U.S. officials are also concerned that recent amendments to the Audiovisual Works Act and the Computer Program Protection Law will make it more difficult for U.S. software publishers to do business in Korea due to onerous registration, deposit and censorship requirements. U.S. concerns can, however, be addressed through implementing regulations.

U.S. pharmaceutical companies report significant delays in obtaining final approval from the Ministry of Health and Welfare (MOHW) for the local sale of new products developed outside of Korea. The process is staged, starting with the presentation of a certificate of free sale from a third country, then a 145-day delay in registration approval, followed by a required clinical trial of about one year. MOHW officials have often refused to accept applications for registration of new imported products without a certificate, delaying approvals still further. The total process can last two years.

U.S. companies operating in Korea also report that they do not receive national treatment with respect to drug reimbursement under the Korean health insurance system. This effectively discourages hospitals and other large end-users from buying imported drugs.

Korea does not recognize some famous U.S. cartoon characters. Korean courts have exonerated Korean infringers of famous U.S. characters, including Mickey Mouse.

Korea does not have effective laws or procedures to protect various industrial designs. Even though some U.S. product designs or machinery layouts have been copied by Korean competitors, U.S. firms have no legal

recourse.

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. Korea continues to restrict foreign investment in the following sectors of interest to U.S. companies: courier services, language training services, cable television and insurance brokerage.

Korean restrictions on the availability of television and radio advertising time limits the ability of companies — especially new-to-market companies — to make consumers aware of products.

Audiovisual (see also Other Barriers)

Foreign Content Quota for Free TV: Korea restricts foreign activities in the audiovisual sector by limiting the percentage of weekly broadcasting time that may be devoted to imported programs, not to exceed 20 percent.

Screen Quota: By requiring that domestic films be shown in each cinema a minimum number of days per year, Korea effectively imposes a screen quota on imported motion pictures. The quota acts as a deterrent to cinema construction, which is needed to expand theatrical distribution in Korea.

Foreign Content Quota for Cable TV: Cable channels may devote only 50 percent of air time to foreign sports, science and documentary programs. All other types of foreign programming, including movies, are subject to an even stricter quota of 30 percent. These quotas are applied on a per-channel basis. There are only two movie channels (one basic and one premium), which, together with strict content quota, severely limits the market for foreign products.

The United States will consult with Korea in light of its commitments under the WTO General Agreement on Trade in Services. Estimated losses due to services barriers alone are at \$5 million annually.

Financial Services

Insurance: Korea is the second largest insurance market in Asia after Japan, and is the sixth largest in the world, with more than 38 billion dollars in premiums.

Korea has made some progress since its initial opening of the market in 1986 under a bilateral agreement with the United States. Guidelines effective in 1992 permit the issuance of non-par products and the acquisition of real estate by foreign firms, but only under highly restrictive conditions.

Korea plans to deregulate premium rates, but firms will not have the full freedom to set rates until the late 1990's. While Korea simplified the approval process for insurance products already available in the Korean market, U.S. life insurers are still not permitted to sell personal accident insurance. U.S. firms continue to experience delays in receiving approvals for new-to market products.

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In 1995, Korea announced plans for liberalization in its effort to join the OECD in 1996 that will be implemented over time. However, the process of reform is far from complete for a country at Korea's advanced stage of economic development. The U.S. industry continues to cite as major problems an economic needs test, restrictive rate and form regulation, limitations on investment, lack of transparency and due process, distribution barriers, including broker restrictions, and reinsurance restrictions.

Banking: Foreign banks continue to face numerous obstacles which impede their operations in Korea. Foreign banks are permitted to establish branches, only after one year has passed following the establishment of a representative office and subject to onerous individual branch capitalization requirements. Foreign banks face issuance limits for certificates of deposit based on branch vs. global capital, limiting their ability to obtain local currency funding. Foreign banks also face discriminatory treatment in the interbank market. Foreign banks are disadvantaged by a relatively non-transparent regulatory system, and must seek approval for introducing new products and services.

Securities: Foreign securities firms also face serious market access barriers in Korea. Subsidiaries of foreign securities firms are not allowed, although the scope of business for branches has recently been expanded. Foreign equity in joint ventures is limited to less than 50 percent. Only branch offices of foreign securities firms are permitted, subject to capitalization requirements that are high by international standards. Further, multi-branching is not allowed.

Foreign ownership of listed shares is restricted to a ceiling of 4 percent per foreign investor and 18 percent in aggregate. Foreign firms are not allowed to participate in the domestic securities over-the-counter (OTC) market, and brokering is limited to listed stocks. Membership on the Korea Stock exchange by foreign firms is permitted, but prohibitively expensive. With regard to securities investment trust enterprises (SITEs), only representative offices are allowed and foreign equity in existing domestic SITEs is limited to 50 percent. Similar restrictions apply to foreign equity in domestic investment advisory firms.

Korea's tightly controlled financial sector has a direct impact on trade and investment issues facing U.S. firms in other sectors of the Korean market. The United States is pursuing these issues through the U.S.-Korea Financial Policy discussions between the U.S. Treasury Department and Korean Ministry of Finance, and through Korea's accession process to the OECD in 1996.

INVESTMENT BARRIERS

As of January 1, 1994, 87 percent of the sectors in Korea's standard industrial classification system were open to foreign equity investment in principle (including 98 percent of the manufacturing sectors and 76 percent of the service sectors).

However, foreign investors' effective access to the Korean market continues to be conditioned under law and regulation, as well as administrative guidance and practice that are opaque and subject to variable interpretation.

As part of a 1989 bilateral agreement on investment, Korea agreed to revise or eliminate many of its discriminatory practices affecting the establishment and treatment of U.S. and other foreign investors in Korea. Once established in Korea, foreign investments are entitled to be treated in an identical manner to

100 percent Korean-owned investments (i.e., national treatment), except in certain limited areas such as land acquisition or exploitation for national security.

The Korean government can only reject a foreign investment proposal in any sector not on the government's "negative list" or not specifically identified in the agreement for one of five reasons (protection of national security; maintenance of public order or protection of public health, morality, or safety; fulfillment of obligations relating to international peace and security; if the investment will result in monopolistic or predatory practices in the domestic market; or violation of Korea's Antitrust and Fair Trade Law) and only within 60 days of notification to the government. In all other cases, foreign investors are free to proceed with investments in these sectors.

Korea does have an investment screening process and investment "notifications" in Korea require government approval. Although the government has reduced documentation required for investment applications, notification and approval procedures remain burdensome and often require submission of proprietary information, including contracts.

The 1989 agreement also requires Korea to eliminate all local equity participation requirements imposed by "individual laws" (apart from requirements imposed for reasons of land acquisition, exploitation of land or other resources, or national security) and to refrain from imposing any "performance" requirements (e.g., technology transfer, local content, or local manufacture). Korea has not fully eliminated local equity participation requirements. U.S. telecommunications companies reported in 1995 that Korea's Ministry of Information and Communications, Korea Telecom and other companies have imposed a de facto "buy local" policy.

The Korean government has revised its Alien Land Acquisition Act to permit foreign-invested firms to purchase land for business purposes, including staff housing. The United States remains concerned, however, that other laws provide disincentives for foreign investment by placing overly strict limits on the purchase, use and sale of land by foreigners. In some situations, Korean land-use laws could result in heavy taxes on unused land and possible sale of land at below-market prices if legal requirements are not met within a specified period.

As of November 1992, U.S. investments in Korea with more than 50 percent foreign ownership are no longer subject to Korea's "going public" policy. Those with less than 50 percent foreign ownership and that filed after January 1, 1989, remain subject to the policy. This policy can require local and foreign-invested firms established for three or more years and identified by the Korean Securities and Exchange Commission to sell at least 30 percent of their stock to the public. No U.S. firms have yet reported that they have been affected by the law. The United States continues to urge Korea to abolish its "going public" policy with reference to foreign firms, many of which are privately held.

In light of these and other factors, U.S. companies continue to experience difficulties in establishing investments in Korea, contributing to Korea's reputation as a particularly difficult market in which to invest.

Despite improvement in the past few years, Korea's investment regime is still far from OECD standards and more restrictive than many other Asian economies. In September 1995, Korea's Ministry of Finance and Economy announced two reform initiatives designed to conform Korea's system more closely to

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international standards, including those of the OECD. The changes are slated for implementation beginning in 1997, and will abolish the investment approval system.

Korea did not notify the WTO of any Trade-Related Investment Measures (TRIMs).

ANTICOMPETITIVE PRACTICES

The government-affiliated Korean Broadcasting Advertising Corporation (KOBACO) has been given a monopoly over the allocation of television and radio advertising time. U.S. firms have asserted that they were unable to obtain access to prime time television advertising slots because of the locked-time allocation system and a variety of other KOBACO rules, a result that unfairly impedes the ability of foreign firms to gain consumer acceptance in the Korean market. As of October, 1995, KOBACO eliminated the locked time allocation system. However, KOBACO rules continue to prevent market forces from operating normally in this area.

Industry associations are delegated, through both formal and informal means, substantial regulatory authority in Korea. In a number of instances, industry associations have abused their powers by discriminating against non-members and potential competitors, including American firms. In 1994 Korea investigated 68 industry associations and found that 48 of the associations had been engaging in anticompetitive or unfair practices. Another 60 associations were scheduled to be reviewed in 1995. Of particular concern to the United States is the anticompetitive behavior of the Korean insurance and cosmetic industry associations.

Although Korea has stated that it will seek to remedy the anticompetitive and unfair practices uncovered in its investigation, legislative changes necessary to correct the practices have not been initiated, and may be years away. In addition, hundreds of other associations that likely engage in similar kinds of anticompetitive practices have not yet been reviewed by Korea.

In the past two years, the Korean Fair Trade Commission has been strengthened considerably and has made significant improvements in its enforcement policy. Nevertheless, a major enforcement effort will be required in order to deter and eliminate chronic anticompetitive practices in the Korean market.

OTHER BARRIERS

Motor Vehicles

Korea's auto industry moved from the ninth largest motor vehicle manufacturer in the world in 1991 to fifth place in 1995. Korea is the world's third largest auto exporter after Japan and the European Union; in 1995, Korean exports accounted for 41 percent of total Korean motor vehicle manufacturing. Korea's home market is also the fastest growing market in Asia.

Yet no other major auto-producing country imports fewer cars than Korea. In 1995, total import sales accounted for only 0.45 percent of the market.

Korea has maintained a severely closed "sanctuary" market with an array of trade barriers, including an

import ban on Japanese cars. Of major concern to U.S. companies is the prohibitively high, "cascading" system of taxes, which are calculated on top of an eight percent tariff. The tariff is unbound in the WTO and more than three times that of the United States. Burdensome automobile standards and certification procedures make it difficult and costly to introduce new models to the Korean market. Pervasive anti-import sentiments have limited marketing opportunities and intimidated potential customers. Restrictions on television advertising and retail financing also adversely affect foreign automakers.

In September 1995, as a result of bilateral consultations held under Super 301, Korea signed an agreement with the United States to increase access for U.S. and foreign passenger vehicles. The agreement reduced by fifteen percent the overall tax burden on cars with larger engines, liberalized many Korean standards and certification procedures, lifted some restrictions on advertising and retail financing and obtained the Korean Government's assurances that it would no longer promote an anti-import bias among consumers.

Korea has already implemented most of its commitments in good faith. However, until more foreign cars are sold in Korea, it remains to be seen whether the provisions of the agreement covering standards and certification will be implemented at a working level.

The United States views the agreement as a first step in liberalizing one of the most protected auto markets in the world. We will continue to monitor the implementation of the agreement and seek further market opening measures from Korea in 1996.

Audiovisual

Video Importation: Korea prohibits foreign companies from becoming registered producers of videotapes. Only video duplicators are eligible to import video masters, making the importation of master video tapes by foreigners illegal. Foreign companies which have established video distribution subsidiaries in Korea are forced to use local companies to import and duplicate their videotapes, resulting in increased costs.

Cable TV Law: Korea's Cable TV Law went into effect in 1992, and Korea's first cable systems became operational in 1995. The restrictive nature of the regulations creates a cable system different from that found in virtually any other country. The regulations effectively eliminate retransmission of regional satellite channels, which is how U.S. companies often distribute programming for pay TV services. Market access is further restricted by the inadequate supply of local programming.

The estimated cost to the U.S. industry of these barriers is \$10 million.

Disincentives to Trade, Investment

U.S. firms continue to report that Korea remains one of the most difficult markets in the world in which to trade and invest. A number of factors are cited to support this conclusion. Excessive government regulation and broad administrative discretion on the part of government officials results in costly additional bureaucratic processes and arbitrary treatment of individual firms, both foreign and domestic.

Also of concern is Korean harassment of U.S. companies which seek U.S. government assistance in addressing even normal "doing business" issues. Some U.S. companies reported that one Ministry in

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particular advised them against raising concerns with the U.S. government. A state-owned enterprise also reportedly requested a U.S. company to include a provision in its contract which would have effectively precluded such contact with United States officials. Frequently even experienced U.S. exporters report that they do not want their company name or products mentioned in U.S. Government representations to Korean officials for fear of retribution by Korean functionaries or negative, "scare" reports by some in the Korean media.

Steel

In July, the United States and Korea established a consultative mechanism designed to ensure that Korea's steel sheet pricing is commercially driven, and that steel sheet and pipe and tube exports are not voluntarily restrained. Data provided to date demonstrate that Korea's domestic hot rolled sheet prices do not fluctuate in response to demand and other economic factors, and may be below prevailing regional market prices. This trend may provide Korea's down stream industries, such as pipe and tube producers, with an advantage in international markets. Further consultations on this issue will take place.

BACKGROUND: KOREA AND THE WTO BASIC TELECOM NEGOTIATIONS

WTO telecom negotiations end April 30. We currently have 39 offers on the table (including the U.S. and the 15 member states of the EU)- many of which need to be improved before the negotiating deadline. We have made the following requests for improvement of Korea's offer:

- o Eliminate all foreign investment restrictions;
- o Allow full market access in international services;
- o Allow domestic and international resale; and
- o Eliminate the market access limitations linking licensing of services suppliers to compliance with mandatory technical standards.

In an April 4 Embassy Seoul demarche on the Minister of Information and Communication, the ROKG indicated they would be willing to revise their offer to allow competition in international services and would remove the limitation on licensing being linked to technical standards. The ROKG said that it would allow resale in 2001 and that since Japan has not lifted its foreign investment restrictions, it would not lift its own beyond those already scheduled.

However, Japan announced April 5 it will revise its offer to allow 100% foreign investment in telecom firms other than NTT and KDD and to allow domestic and international resale. Therefore, we should press the Koreans to make the same commitments as the Japanese have agreed to effective January 1, 1998 (the proposed date for implementation of the WTO telecom agreement).

Suggested Talking Points:

- We were pleased to hear from the Minister of Information and Communications that Korea will revise its offer in the WTO basic telecom negotiations to allow competition in international services and remove the limitation on licensing being linked to technical standards.
- We urge Korea to make further improvements to the offer by allowing resale before 2001 and lifting the foreign investment limits.
- We need these changes in order to ensure a successful agreement by April 30.

(If needed):

- We have committed in our offer to allow 100% indirect foreign investment and full market access in local, long distance, and international services.

KDD and to allow domestic and international resale.

- The European Union expects to revise its offer at its April 22-23 Telecom Ministers Council meeting and remove many of the Member State restrictions.
- We believe Korea should make the same high-quality commitments that we, Japan, and the E.U. have made.

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