

Anatomy of a Deal: The KORUS FTA

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With negotiations running down to the wire, Korean and American negotiators announced that they reached a deal just before President George W. Bush's trade promotion authority expired at 11:59 pm on April 1. Under the agreement, nearly 95 percent of consumer and industrial products will become duty-free within three years of the agreement's coming into force. The agreement also works towards addressing politically sensitive concerns for the United States in the automotive and agricultural industries.

Early reports indicate that the overall deal is one which addresses many of the concerns of both parties and protects interests on both sides, but provides neither country with everything it was looking for. The two countries currently enjoy a trade relationship that topped \$78 billion in 2006, and is expected to substantially increase under the FTA.

The following is a partial summary of reported results for some of the more politically sensitive issues for the United States and Korea from the FTA negotiations. For more detailed information, check out KEI's website at www.keia.org as well as USTR's website.

Automobiles: Throughout the negotiations, autos were one of the most politically sensitive issues. Under the agreement, Korea will immediately remove its eight percent tariff on U.S. autos, and eliminate its tax based on engine displacement. Korea has also agreed not to impose any new engine displacement taxes. The agreement provides protections for U.S. automakers by establishing an Autos Working Group to address specific non-tariff barriers and contains an innovative expedited dispute settlement process for auto-related measures that violate the FTA. In an effort to discourage backsliding by Korea, the agreement also includes a "snapback" provision that allows the United States to restore its tariff on autos if Korea is found to have violated the FTA in the dispute settlement process. The United States will immediately remove its 2.5 percent tariff on automobiles with engine sizes under 3000cc, while those on engines above 3000cc will be phased out over three years.

Agriculture, Beef, and Rice: One of the most significant areas of opportunity for the United States in the FTA has long been the agricultural sector. The FTA is estimated to remove \$1 billion in agricultural tariffs, immediately creating duty-free access for a wide range of agricultural products including wheat, hides and skins, cotton, feed corn, and soybeans. This immediate access would also extend to high value agricultural products such as whiskey, wine, orange juice, grape juice, raisins, and frozen french fries. Products such as avocados, lemons, and dried prunes will see a two year phase-out of tariffs, while items such as chocolate and chocolate confectionary, sauces and preparations, and grapefruit will see a five year tariff phase-out. Access was also expanded for additional agricultural products through increased tariff rate quotas.

Prior to the start of the FTA negotiations, the United States had reached an agreement on the return of boneless beef under the age of 30 months to the Korean market. Throughout the FTA negotiations, this has been a politically sensitive sticking point, as previous shipments of boneless beef had been rejected by Korea due to small numbers of bone chips. However, news reports indicate that the potential exists to resolve this issue once the World Organization for Animal Health officially give U.S. beef "controlled risk" status, leading to the import of all types of beef from the United States by Korea. Korea has also agreed to reduce its 40 percent tariff on beef over a fifteen year period. For Korea, the most politically sensitive area in the FTA was rice, and this commodity is excluded from the agreement.

Sanitary and Phytosanitary Issues: Sanitary and phytosanitary (SPS) measures are one of the most significant barriers to trade in agricultural products. The two sides agreed to establish a body to deal with these issues, but to carry out scientific risk assessments and technical consultations before bringing SPS issues before the body.

Pharmaceuticals: Shortly after the announcement of negotiations, Korea announced that it would convert its pharmaceutical reimbursement system from a "negative" list system to a "positive" list system whereby only drugs deemed cost effective would be reimbursed. Under the FTA, there is commitment to transparency in the pricing and reimbursement process for pharmaceuticals, and an agreement by Korea to establish and maintain an independent body that reviews recommendations and determinations regarding the pricing and reimbursement of

pharmaceutical products. Korea will not guarantee the minimum price of new U.S. pharmaceuticals. However, the agreement does require Korea to develop a system for assessing the violation of patents when it reviews the applications of local pharmaceutical makers for copied pharmaceuticals.

Textiles: The textile industry was one of the key areas of interest for the Korean negotiators. In this sector, both sides will immediately provide reciprocal duty-free access for most textile and apparel goods, with Yonhap News reporting that the United States will eliminate 61 percent of its tariff in terms of import value. The agreement contains a “yarn forward rule,” which stipulates that the fabric utilized must be from the country of origin to receive the duty-free benefits, but the same Yonhap News story indicates that major Korean exports such as men’s shirts and women’s jackets will be excluded from the “yarn forward rule.” However, the agreement also contains a textile safeguard provision that would allow the United States to impose tariffs on certain items should injury occur due to an import surge.

Services: Accounting and legal services will gain additional access to the Korean market, with Korea opening up to foreign legal consulting services and committing to phase in the ability of foreign lawyers to provide a broader range of services. In financial services, U.S. financial institutions will have the right to establish or acquire financial institutions in Korea to supply a complete range of services. They may establish branches of U.S. banks, insurance companies, and asset managers, while also having the right to supply specified cross-border financial services. In telecommunications, the two sides agreed to allow for 100 percent ownership of program providers after a three year phase-in for U.S. firms that establish a Korean subsidiary. Korea will not open its education and medical care services markets.

Investor Protections: The FTA establishes a legal framework for protecting U.S. investors in Korea, while ensuring that all forms of investment are protected. These investments are protected through a transparent, binding international arbitration mechanism under which investors can bring their own claims against a government.

Transparency: The FTA contains strong transparency provisions in both the obligations of the national governments and the operation of the FTA. Both governments are committed to publish proposed regulations in advance, to allow a reasonable opportunity for comments, to address substantive comments, and to publish final regulations in an official journal with national circulation. The FTA’s dispute settlement mechanism provides open hearings, public access to documents, and the ability of third parties to submit views.

Kaesong and North Korea: One of the more important issues for Korean negotiators, and a politically sensitive issue for the United States, was the status of goods from the Kaesong Industrial Complex in North Korea. The complex, part of South Korea’s engagement strategy with the North, hosts South Korean firms that utilize North Korean labor. While rejecting Korea’s request that goods from Kaesong enter the United States duty free, both sides did agree to create a “Committee on Outward Processing Zones on the Korean Peninsula” that would consider such ventures at a later date.

After only last week objecting to the United States and South Korea’s entering into a free trade agreement and describing such an agreement as a “yoke of subordination,” North Korea quickly changed its tune after the agreement’s conclusion. With the prospect of goods from the Kaesong Industrial Complex at some later date being included in the deal, the North Korean management team at Kaesong issued a statement welcoming the deal.

Let the Criticism Begin

The strongest criticism of the deal came from supporters of the beef and auto industries in Congress. Senator Baucus, a long-time proponent of the deal, said that “This is an entirely unacceptable outcome, I will oppose the Korea Free Trade Agreement, and in fact I will not allow it to move through the Senate, unless and until Korea completely lifts its ban on U.S. beef.” Similarly, Senator Stabenow said that the KORUS FTA is a “bad deal for American workers and American businesses,” and vowed to defeat the deal. The National Cattlemen’s Beef Association and the American Farm Bureau have released statements saying that they cannot support the FTA until the beef trade has resumed, while both Ford and Chrysler have said that they cannot support the agreement in its current form.

While there was criticism of the deal, the U.S. Chamber of Commerce, the National Pork Producers Council, and the National Association of Manufacturers were among a group of U.S. interests, along with Congressman Vito Fossella, co-chairman of the House of Representatives' Korea Caucus, to express positive views of the agreement.

What Comes Next for the KORUS FTA

Now that the two sides have reached an agreement, we have entered into the ninety day post notification period. The following is a general guide to the next steps in bringing about the passage of the agreement under TPA. During the time between the notification and the official signing, both sides' lawyers will give the text of the agreement a legal scrub, and an examination of the translations will take place to ensure there are no misunderstandings or misinterpretations at a later date. USTR will also provide the International Trade Commission with the details of the agreement so it can conduct an impact study on the agreement. Once the agreement is signed on June 30, the last day an agreement can be signed under the current grant of TPA, the administration will need to submit implementation legislation to Congress. There is no deadline on when the administration must submit the implementation legislation. Once it does, both the Ways and Means and Finance committees have 30 legislative days to report the legislation out of their respective committees. The Finance Committee has an additional 15 legislative days to report out the legislation after the Ways and Means Committee has done so. If the committees have not reported the legislation out by the deadline, it is automatically discharged. Once the legislation has been discharged by the respective committees, the House and Senate have 15 legislative days to vote either up or down on the implementation legislation.