Tide Turning for Korea's Auto Imports?

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Anyone who has spent time in the bustling streets of Seoul is familiar with the scene: commuters crowding into Daewoo buses, while salary men hurry home in their Hyundai sedans and motorcycle couriers navigate around the 386er families in Kia SUV's. Some signs are beginning to emerge that the landscape is changing, and that foreign-made cars will become an increasingly common sight on Korean highways.

The year 2005 marked the 50th anniversary of Korea's automobile industry. From its humble beginnings and low-tech assembly process in the 1960s, Korea has gone on to emerge as the world's fifth-largest automaker, having produced 3.7 million units (six percent of total global output) in 2006. The South Korean automotive industry exports to all key world markets. The Hyundai group (Hyundai and Kia) controlled 29 percent of the Korean market in 2006, with Hyundai exporting 69 percent of the passenger cars it produced in Korea. In terms of domestic consumption, the Korean market ranked 14th in the world by consuming 1.14 million units in 2005.

Cultural and Bureaucratic Resistance to Foreign Cars Declining

As cultural resistance to ownership of foreign cars has declined, car buyers in South Korea are increasingly seeking imported cars to stand out from the crowd. Although overall sales of foreign cars is still modest (about 5% of the total market), sales of imports grew 26.3 % in the first half of 2007. According to a *New York Times* article published in October, the rise in imported autos is attributable to a boost in aggressive promotions, lower prices, a stronger won, and the KORUS FTA, which will cut car taxes. Pricing for imports is further reduced by independent dealers, such as SK Networks, which are competing with official import dealers by selling imported cars below the official dealer price.

Although a large portion of foreign sales is currently in the higher-end of the spectrum, competition is increasing in the economy-class segment. In early 2007, Volvo introduced the sub-compact C30, and DaimlerChrysler began selling the B200 compact. Japanese imports, such as the Honda CR-V, are also being priced to compete against Korean models. During the first six months of 2007, sales for the CR-V jumped more than 150 percent.

According to a report by the International Trade Administration, Korea's auto imports have slowly increased over the past decade, beginning with memoranda of understanding signed in 1995 and 1998. These MOUs were negotiated to improve access of U.S. automakers to the Korean market. Prior to the first MOU, import sales in the Korean auto market totaled 0.3 percent of the total market in 1994, with U.S. auto makers comprising just over half of that total. By 1997, the total import share more than doubled to 0.7 percent, and continued to rise steadily following the 1998 MOU, with import sales in Korea representing just over four percent of the total market in 2006.

The U.S.-Korea Business Council has examined the benefits of the U.S.-Korea FTA and concluded that it goes "further than any other agreement in establishing a level playing field for U.S. autos in Korea." Specifically, it identifies the following key benefits relating to the U.S. auto industry:

- Immediately eliminates Korea's 8% tariff on U.S. vehicles.
- Eliminates discriminatory aspects of Korean auto taxes on the basis of engine size.
- Ensures that Korea will not adopt regulations that create unnecessary barriers to trade.
- Creates auto-specific dispute settlement mechanism.
- Establishes auto-specific working group.
- Addresses non-tariff barriers including emissions and safety standards.

The auto sector has been a contentious component of the KORUS FTA, with presidential candidate Senator Hillary Clinton having spoken against the FTA.

Prospects for Korea's Exports

Hyundai Motor Manufacturing Alabama is located in Montgomery, Alabama and currently has more than 3,300 employees, who are building Hyundai's next generation Sonata sedan and Santa Fe SUV. The plant has a production capacity to deliver 300,000 vehicles annually, having produced 17,735 vehicles in September 2007. Production in the Alabama plant comprised 14 percent of total Hyundai sales to U.S. customers in 2005 and 43 percent in 2006. In March 2006, Kia announced its first U.S. production plant—in West Point, Georgia—with plans for a $1.2 billion investment which is anticipated to create capacity for producing 300,000 units annually and employ 2,500 workers, with production scheduled to begin in 2009.

In addition to the prospect of the KORUS FTA's improving mutual market access in the automobile sector, the proposed Korea-EU FTA is being examined as it relates to auto trade. Korean carmakers sold 74,000 vehicles worth $9.1 billion in Europe last year. The Korea-EU FTA recently ended its fourth round of trade talks in Seoul. However, Yonhap news agency reported in October that South Korea's lead negotiator conceded that "both sides did not make headway in tariffs, especially in negotiations over auto trade and related regulations." A recent article in *The Wall Street Journal* stressed the importance of the United States' not stalling in ratifying the KORUS FTA, as Korea may view an FTA with the EU (Korea's second largest trading partner) as a viable alternative. Meanwhile, the article notes that "Korea is talking to India and Canada, and is studying a potential deal with its largest trading partner, China."

The overall appreciation of the won against the dollar has cut into Hyundai's profit margin, despite strong sales. After peaking at 9% in 2003, Hyundai's profit margin fell to 7.2% in 2004, 5.1% in 2005, and 4.5% last year, while Kia swung to a loss of $132 million last year from a profit of $78 million in 2005. It is increasingly difficult for the central bank to buy dollars to curb the pace of the won's appreciation, due to its vast foreign exchange reserves ($257 billion, the fifth largest in the world). However, prospects for a higher yen are prompting Korean exporters, who regard Japanese rivals as their chief competitors, to predict better profits ahead.