

# KOREA

## TRADE SUMMARY

The U.S. trade deficit with Korea was \$19.8 billion in 2004, an increase of \$6.7 billion from \$13.2 billion in 2003. U.S. goods exports in 2004 were \$26.3 billion, up 9.4 percent from the previous year. Corresponding U.S. imports from Korea were \$47.2 billion, up 24.0 percent. Korea is currently the 7th largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Korea were \$8.4 billion in 2003 (latest data available), and U.S. imports were \$4.4 billion. Sales of services in Korea by majority U.S.-owned affiliates were \$3.2 billion in 2002 (latest data available), while sales of services in the United States by majority Korea-owned firms were \$217 million.

The stock of U.S. foreign direct investment (FDI) in Korea in 2003 was \$13.3 billion, up from \$12.2 billion in 2002. U.S. FDI in Korea is concentrated largely in the manufacturing, banking, and finance sectors.

## IMPORT POLICIES

### Tariffs and Taxes

While Korea has a relatively low average weighted tariff rate of 4.5 percent for industrial products, the weighted average of Korea's bound tariffs on all agricultural products is 64.1 percent, which poses a significant barrier to the trade of agricultural goods. Although Korea bound 91.7 percent of its tariff line items in the WTO Uruguay Round negotiations, tariffs on most forestry and fishery products are not bound. The United States continues to press Korea to reduce its applied tariffs on agricultural and food products.

As part of Uruguay Round WTO Agreement on Agriculture, Korea agreed to lower duties on more than 30 agricultural products including mixed feeds, feed corn, wheat, vegetable oils and meals, and fruits and nuts between 1995 and 2004, and has fully phased in those tariff reductions. However, duties remain very high on many high-value agricultural and fishery products. Korea imposes tariff rates of 30 percent or higher on most fruits and nuts, many fresh vegetables, starches, peanuts, peanut butter, various vegetable oils, juices, jams, beer, and some dairy products. Many products of interest to U.S. suppliers, including table grapes, beef, canned peaches, canned fruit cocktail, apples, pears, and a variety of citrus fruits are subject to tariff rates of 40 percent or higher. In many instances Korea applies prohibitively high tariffs despite the absence of domestic production.

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As part of its Uruguay Round commitments, Korea also established tariff-rate quotas (TRQs) that were intended to provide minimum access to previously closed markets or to maintain pre-Uruguay Round access. (*See also "Quantitative Restrictions, TRQs and Import Licensing."*) In-quota tariff rates are zero or very low, but the over-quota tariff rates for some products are prohibitive. For example, natural and artificial honey are subject to an over-quota tariff rate of 243 percent; skim and whole milk powder, 176 percent; barley, 324 percent; malting barley, 513 percent; potatoes and potato preparations, more than 304 percent; and popcorn, 630 percent.

In order to protect domestic agricultural, fishery and plywood producers, Korea also uses "adjustment tariffs" and compounded taxes to boost applied tariff rates. Most of the adjustment tariffs are imposed on agricultural and seafood products, including frozen croaker and skate, which are products of interest to U.S. exporters. The U.S. Government has expressed concerns regarding these practices to the Korean government. In 2004, Korea eliminated adjustment tariffs on three textile products (silk yarn, woven silk fabrics, and woven cotton gauze fabrics other than narrow fabrics), renewed adjustment tariffs on 19 items, and reduced the tariff rates for 7 of these 19 items. In 2005, Korea eliminated the adjustment tariff on frozen poulp squid, renewed adjustment tariffs on 10 products, and lowered adjustment tariffs on 8 products.

Through its Uruguay Round commitments, Korea has also reduced bound tariffs to zero on most or all products in the following sectors: paper, toys, steel, furniture, semiconductors, and farm equipment. Korea has harmonized its chemical tariffs to final rates of 0 percent, 5.5 percent, or 6.5 percent, depending on the product. In addition, tariffs on scientific equipment have been reduced 65 percent from pre-Uruguay Round levels. On textile and apparel products, Korea has harmonized and bound most of its tariffs at the following levels: 13 percent to 16 percent for man-made fibers and yarns, 30 percent for fabrics and made-up goods, and 35 percent for apparel.

*(For discussion of the impact of auto tariffs on market access, see "Motor Vehicles" section.)*

## **NON-TARIFF MEASURES**

### **Internal Supports**

As part of its commitments under the WTO Agreement on Agriculture, Korea agreed to reduce its domestic support (Aggregate Measurement of Support, or AMS) for agricultural products by 13 percent by 2004. However, the Korean government substantially increased the level of domestic support it provided to its cattle industry during 1997 and 1998, thereby raising the overall level of support for agriculture. The issue of whether Korea's domestic support is in line with its WTO commitments on domestic subsidies was raised by the United States and Australia, along with other related issues, in WTO dispute settlement proceedings in 1999. While the panel ruled against Korea, the outcome of the dispute was inconclusive because the WTO Appellate Body was unable to make a specific finding on the consistency of Korea's subsidy level with the applicable obligations under the WTO Agreement on Agriculture. Nonetheless, the Appellate

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Body did conclude that Korea had not been computing the current level of domestic support in a manner compatible with the requirements of the Agreement. The United States will continue to monitor Korea's notification of its AMS to the Committee on Agriculture to ensure that the calculation is in conformity with its commitments.

### **Quantitative Restrictions - Tariff-Rate Quotas (TRQs)**

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

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

### **Rice**

In the Uruguay Round, Korea received a ten-year exception to tariffication of rice imports, and instead negotiated a Minimum Market Access (MMA) quota. Under the MMA quota, Korea's rice imports grew over ten years from zero to four percent of domestic consumption. The Korean government, through state trading enterprises, exercised full control over the purchase, distribution, and end-use of imported rice. While Korea did not purchase any U.S. rice in the early years of the MMA program, in recent years the U.S. share of Korea's total MMA rice imports increased to roughly one-fourth, and the United States became Korea's second largest supplier of imported rice (after China).

That MMA arrangement was set to expire at the end of 2004, but under WTO rules, Korea exercised its right to negotiate with WTO rice exporting countries, including the United States and eight other interested parties, to seek an additional ten-year extension. Korea's stated goal was to extend the MMA arrangement to coincide with a new ten-year agricultural adjustment program introduced in 2004 by the Roh Administration. The United States made clear it would only agree to extension of the MMA program if the program were amended to significantly expand commercial opportunities for U.S. rice exporters and offer them a genuine opportunity to develop meaningful relationships with Korean rice retailers.

Agreement on a ten-year MMA extension was reached in December 2004. For U.S. rice exporters, there are three major benefits to this agreement: Korea will double its total rice

imports over the next ten years (from four to roughly eight percent of domestic consumption); Korea has guaranteed at the WTO that it will purchase at least 50,076 metric tons of rice from the United States in each of the next ten years; and for the first time, imported rice will be made available to Korean consumers at the retail level. This new MMA arrangement was notified to the WTO in late December 2004 and will be implemented in 2005 once it is approved by the Korean National Assembly and by a consensus of WTO Members.

### **Import Clearance Procedures**

Despite the steps taken by the Korean government in the past few years, import clearance of agricultural products at Korean ports remains generally slow and procedures continue to be somewhat arbitrary. Surveys indicate that for most U.S. trading partners in Asia, import clearance for most agricultural products requires three to four days; in Korea, however, import clearance for new products still typically takes from 10 to 18 days, and six months to a year if a food additive is not specifically recognized in Korea's Food Additive Code for use in the imported product. (Food additives must go through a formal approval process before they can be approved for use in a particular food.) The United States will continue to urge the Korean government to improve its import clearance procedures until clearance times at Korean ports are comparable to those in other Asian ports, and until Korean procedures are based on science and are consistent with international trade rules and norms.

After WTO dispute settlement consultations initiated by the United States between 1995 and 1999, the Korean government revised its import clearance procedures by: (1) expediting clearance for fresh fruits and vegetables; (2) instituting a new sampling, testing, and inspection regime; (3) eliminating some non-science-based phytosanitary requirements; (4) revising the Korean Food and Food Additives Codes to bring, for example, Korean pesticide residue level standards for citrus into conformity with CODEX Alimentarius standards; and (5) requiring food ingredient listings by percentage for major, rather than for all, ingredients.

The Ministry of Agriculture and Forestry (MAF) and its agencies responsible for administering plant, animal, and animal product inspection, including the National Plant Quarantine Service and the National Veterinary Research and Quarantine Service, account for the greatest delays in import clearance. MAF imposes numerous requirements that restrict access or delay import clearance, such as incubation testing for non-quarantine pests and product detention if there are clerical errors on export certificates (e.g. incorrect zip codes for meat establishments). These practices add costs for importers and, ultimately, for consumers. Past improvements in expedited clearance of fruits and vegetables are slowly being eroded through various new testing and documentation requirements, extension of detention periods for pest identification, and an unreasonably high number of insects registered as potential pests subject to quarantine measures. (See also *"Standards and Conformity Assessment Procedures"* section.)

## **Customs Procedures**

The Korea Customs Service (KCS) frequently classifies "blended products" under the Harmonized System (HS) heading for the major ingredient of that product, rather than under the HS heading for the blended product, which usually has a lower tariff rate. Changes in classification are often based on arbitrary standards and are at odds with practices observed by other OECD members. (For example, for dehydrated potato flakes to be classified as a blended product, they must include at least 10 percent non-potato ingredients.) "Blended products" disadvantaged by this practice include potato flakes, soybean flakes, flavored popcorn, and peanut butter chips. KCS also classifies beef bones with meat attached as pure muscle meat, subject to a tariff of 40 percent, rather than as offal, which would be subject to an 18 percent tariff.

KCS's misclassification of potato preparations under HS heading 1105 restricts U.S. exports of these products to Korea. U.S. exports of dehydrated potato products to Korea should be allowed under the unrestricted HS 2005 heading, with an applied tariff rate of 20 percent and a bound rate of no more than 31.5 percent. KCS has issued tariff code classifications for commodities that diverge from classifications observed in other markets, such as the United States and the European Union. For example, the United States and the European Union classify "Citrus Pulp Pellets" under HS 2308. Due to the percentage of molasses content, however, Korea has classified them under HS 2309, and therefore they are subject to an import quota. In addition, KCS routinely rejects customs clearance applications on administrative grounds (wrong font size, erasure marks on application, etc.), thereby delaying the customs clearance process. Finally, Korean regulations often require local trade associations to certify or approve import documentation. In addition to requiring the importer to pay a processing fee, which is used to help fund the association, this rule requires importers to submit proprietary business information.

## **STANDARDS, TESTING, LABELING AND CERTIFICATION**

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

Korea maintains standards and conformity assessment procedures, such as sampling, inspection, testing and certification, which are overly burdensome and have a disproportionate impact on imports. Each year, in an attempt to harmonize its regulations with international standards, Korea makes revisions to its food-related standards and specifications. More work is needed, however, to bring Korea's food codes, food additive codes, and labeling standards up to international standards. For example, Korea has not effectively adopted the "generally recognized as safe" standard. Instead, Korea's standards are more restrictive than internationally recognized standards; consequently, imports of "generally recognized as safe" food are frequently detained. The Korean Food and Drug Administration (KFDA) defines product categories eligible to use specific food additives too narrowly; if a particular product does not fit in the defined product category, it is then classified within the "other products" category, making

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it considerably more difficult to obtain approval for microbial standards and food additives. Additionally, KFDA's extensive documentation requirements for functional foods and for food additives, and its determination that a product is new if formula ratios are changed or if substitute ingredients are used, set its procedures apart from other OECD countries.

A number of Korea's sanitary and phytosanitary requirements and certification procedures continue to limit market access for a variety of products. However, progress has been made in several areas. In April 2003, after lengthy consultations, MAF issued a final rule allowing access for all cherry varieties. (Prior to this ruling, only certain cherry varieties could be imported.) In November 2004, the Korean government indicated it would be prepared to accept imports of U.S. codheads that met U.S. sanitary standards, rather than significantly more stringent Korean standards which significantly exceeded international norms, thus opening the Korean market to U.S. codhead exports. The Korean government also noted it was prepared to change construction standards to allow houses of wood frame construction to be built to five stories rather than the previous height limit of three stories; this should expand the market for U.S. timber exports.

For non-agricultural products, Korean government agencies require prior approval to import pharmaceuticals, chemicals, computers, telecommunications equipment, and other products (including all food additives). While many other countries require prior approval for some products, the range of affected products is exceptionally broad in Korea, and companies must submit documentation that is extraordinarily detailed. Moreover, in the past, proprietary information provided by importers as part of the prior approval/certification processes often was not adequately protected.

## **Beef**

The U.S. has made the re-opening of the Korean beef market a top priority. Korea banned imports of U.S. beef in December 2003, after the detection of one positive case of an imported cow with Bovine Spongiform Encephalopathy (BSE) in the State of Washington. Prior to the ban, Korea was the third largest export market for U.S. beef and beef products and other ruminants, with annual exports valued at \$1.3 billion in 2003. The U.S. Government has repeatedly explained, including at the most senior levels, that U.S. beef is safe, emphasized that any decisions about beef trade should be based on science, and expressed concern at the slow pace and the lack of transparency of Korean steps to re-open the beef market. At the time of publication of this report, the U.S. and Korean Governments are engaged in discussions designed to lead to the re-opening of the Korean beef market as soon as possible. The United States has also expressed concern that Korea's ban includes products that are recognized in international standards as not carrying the BSE prion, such as muscle meat, milk, tallow and genetics products.

Korea's ban also includes other ruminant products in addition to beef and beef products such as sheep and goats, which international standards indicate can also be safely imported from

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countries with cases of BSE with appropriate risk mitigating measures. Korea's import ban on non-ruminant products such as poultry meal from countries where there have been BSE cases is also overly restrictive.

Korea has continued to permit the imports of certain products containing ruminant ingredients, such as pharmaceuticals and cosmetics, in view of the scientific data disproving any risk of BSE contamination from them. However, U.S. exporters of those products have noted that since the Korean ban on U.S. beef was imposed, Korea's document requirements for BSE-free certification have become increasingly burdensome, and have begun to impede the flow of U.S. exports to Korea.

### **Oranges**

In April 2004, Korea suspended navel orange imports from California's Tulare and Fresno counties (which together account for 80 percent of U.S. navel orange shipments to Korea). Korea alleged to have detected the presence of the fungal infection *septoria citri* in shipments of navel oranges from those two counties. The U.S. Government performed its own tests on the shipments of oranges rejected by Korea and did not detect the fungus in either California orchards or in laboratory tests of samples taken from infected shipments identified by the Korean government officials. This made the identification of appropriate mitigation measures difficult. However, the U.S. Government worked extensively with the California citrus industry to develop proposed mitigation measures for *septoria citri* to present to Korean officials. The U.S. Government submitted this new protocol to Korea in August 2004, to serve as the basis for Korea's resumption of navel orange imports, and the U.S. officials then participated in a series of bilateral technical discussions that followed to ensure the new protocol reflected only necessary and operationally feasible measures. In November 2004, the United States and Korea agreed to the new protocol, and California navel orange exports resumed in December 2004. The agreement is to remain in place for two years with a provision that refinement of mitigation measures may take place after the first year.

### **Poultry**

In 2004, Korea, in response to detection of low pathogenic avian influenza (LPAI) in Delaware and a subsequent case of highly pathogenic avian influenza (HPAI) in Texas, banned imports of raw poultry meat from the United States (although Korea continued to permit the import of live poultry and cooked eggs and cooked poultry meat from the United States). In 2003, U.S. exports of poultry meat to Korea totaled \$53 million. Throughout 2004 and in early 2005, U.S. officials met with Korean counterparts to explain the measures the United States had implemented to contain and eradicate H5 and H7 avian influenza incidents in Texas and the Middle Atlantic. In response, Korea's Ministry of Agriculture and Forestry announced, in February 2005, it was prepared to lift the ban on U.S. poultry, and later that month solicited public comment on a set of draft rules for the resumption of U.S. poultry imports.

## **Biotechnology**

Since 1999, the Korea Food and Drug Administration (KFDA) has had in place a voluntary safety assessment program for biotechnology crops for human consumption. In August 2002, as part of revisions to Korea's Food Sanitation Act, safety assessments of biotechnology crops were scheduled to become mandatory on February 26, 2004. The U.S. Government and U.S. industry expressed concerns that the requirement to complete mandatory safety assessments prior to February 26, 2004, could result in trade disruptions if resource constraints made it impossible for KFDA to process all applications prior to the deadline. In response to these concerns, KFDA revised the implementation timetable for its assessment guidelines: safety assessments for soybeans, corn, and potatoes still had to be completed by February 26, 2004; but the deadline for safety assessments for all other biotech crops was extended to February 26, 2005. To date, 26 biotech crops and 11 biotech additives have undergone KFDA safety assessments and have received KFDA approval.

Korea's approach to implementation of the Cartagena Protocol on Biosafety to the Convention on Biological Diversity (the Biosafety Protocol) and plans to introduce mandatory environmental risk assessments are of concern to the United States. A lack of clarity and transparency in the proposed regulations related to the Biosafety Protocol, and a lack of coordination among ministries involved in enforcement of the Biosafety Protocol, are expected to cause confusion, trade disruptions, and the duplication of requirements for imports at ports of entry. Environmental risk assessments for biotechnology crops will become mandatory when the Ministry of Commerce, Industry, and Energy's Live Modified Organism Act goes into effect in the second half of 2005 after Korea ratifies the Biosafety Protocol. So far, 17 applications have been submitted for voluntary environmental assessments (nine for corn, one for soybean, four for cotton, and three for canola) and seven assessments have been completed to date. The U.S. Government continues to urge Korea to notify the appropriate WTO Committee of revised requirements resulting from the implementation of the Biosafety Protocol; to provide an adequate grace period that will allow the completion of environmental risk assessments prior to the implementation of the Biosafety Protocol; and to implement minimally restrictive requirements, which avoid major disruptions of trade.

## **Maximum Residue Level (MRL) Testing**

In 2003, a new import inspection program was introduced by the Ministry of Health and Welfare (MHW) and the Korea Food and Drug Administration (KFDA), which has undermined Korea's earlier efforts to harmonize its import clearance programs with international norms. In January 2003, a draft version of Korea's revised Ministerial Ordinance of the Food Sanitation Act was notified to the WTO in G/SPS/N/KOR/123. The United States and other countries raised elements of the new import inspection regime in subsequent meetings of the WTO Sanitary and Phytosanitary Committee (in October 2003 and in March, June, and October 2004), questioning their consistency with Korea's national treatment obligations. Of particular concern, the new

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import inspection program mandates annual maximum residue limit (MRL) testing of agricultural products on a packinghouse basis. The fee for the inspection of approximately \$1,960 is to be borne by the importer. Domestic agricultural products, however, are subject only to random tests, which are paid for by the Korean government. In October 2003, KFDA, the agency charged with implementing the new import inspection program, initially indicated a readiness to lower the MRL testing fees to about \$242; however, the new requirements went into effect on August 18, 2003, unchanged.

In 2004, in response to concerns voiced by the U.S. Government and other Korean trading partners, KFDA reduced the number of chemicals subject to testing from 196 to 47, and cut the fee for MRL testing from \$1960 to approximately \$500 (although this revised testing fee is still twice as large as the fee proposed by KFDA in October 2003). KFDA has also stated that it will revise its current import inspection program to allow an exemption from mandatory laboratory inspection for food imports from foreign food processors with a clean record. Even if the exemption for products with a clean record is implemented, the fee associated with mandatory laboratory inspection will remain as a barrier to new-to-market products. The United States will continue to urge Korea to resolve this issue.

### **Functional Foods**

On June 28, 2003, KFDA announced new "Proposed Standards and Specifications for Health Functional Foods." The objective of the so-called "Functional Food Code" is to regulate health foods and nutritional supplements by listing products that can be classified as functional foods (i.e., foods that may provide health benefits beyond basic nutrition) and setting standards and specifications for them. Only products classified as functional foods can carry "efficacy claims" on their labels. In the proposed Functional Food Code, however, the limited number of functional food categories, as well as non-science-based upper limits on vitamin and mineral content, restricted entry of U.S. health foods and supplements into the Korean market. The U.S. Government and U.S. industry submitted comments detailing concerns about the potential for these proposals to restrict trade in health foods and nutritional supplements that are exported without similar complications to other markets. The KFDA amended the final version of its functional food regulations, which were implemented January 31, 2004, to address U.S. concerns regarding its proposed upper limits on vitamins and minerals. However, KFDA has not addressed U.S. concerns regarding the limited number of functional food categories, which currently do not provide for sport nutrition products or herbal products, categories that are widely accepted in other countries.

Regarding inspection of imported functional food, Korea has required mandatory laboratory testing for every shipment of functional food weighing less than 100 kilograms. In 2004, the U.S. Government repeatedly expressed concerns that this unusual weight-based testing requirement represented a barrier to trade. In response to U.S. Government concerns, Korea revised the current testing requirements to eliminate mandatory laboratory testing of subsequent

shipments of functional food shipments weighing less than 100 kilograms, if the first shipment of the same product passes laboratory tests.

### **Organic Foods**

In 2002, KFDA port inspectors detained many shipments of U.S. processed organic foods because the inspectors lacked clear guidelines from KFDA headquarters regarding the required documentation for clearance of imported processed organic food. After intervention by the U.S. Government, KFDA headquarters agreed to recognize an original transaction certificate issued by U.S. Government-accredited organic certifying agents for U.S. processed organic food. However, detention of U.S. processed organic food accompanied by the original transaction certificate issued by U.S. Government certifying agents continued because some regional KFDA inspectors still demanded unnecessary documentation.

In 2004, KFDA again changed its enforcement of regulations regarding imported organic foods. KFDA now requires that either governments or exporters provide copies of their country's organic certification regulations; after a review of the submitted regulations, KFDA decides whether that country's organic certification regulations meet Korean standards. After reviewing the National Organic Program (NOP) of the United States in 2004, KFDA decided to accept copies of NOP organic certificates issued by USDA-accredited certification agents located in the United States for import clearance of U.S. processed organic food. A list of USDA-accredited certifying agents that can issue organic certificates for products to be exported to Korea is posted on the KFDA website. However, KFDA only accepts certificates issued to producers, manufacturers, or processors. An original ingredient statement issued by the manufacturer must also be presented for import clearance. Insufficient communication between KFDA headquarters and regional KFDA offices about the changes in required import clearance documents, and the arbitrary interpretation of regulations by KFDA field inspectors, continue to cause delayed import clearance for imported organic products. The U.S. Government has noted its concern about these unnecessary delays and urged the KFDA to take steps to eliminate them.

### **Pharmaceuticals**

In June 2002, the KFDA implemented Drug Master File (DMF) requirements that oblige manufacturers to submit significant quantities of proprietary manufacturing data to the KFDA as part of the drug approval process. The Korean government says the requirements are designed to assure product quality. U.S. industry representatives, however, have expressed concern that because the requirements apply only to new drugs, they apply almost exclusively to foreign manufacturers of innovative pharmaceuticals, and not to local generic companies. U.S. companies fear that the requirements may delay market access and could jeopardize intellectual property protection. A KFDA task force is studying the concerns expressed by U.S. industry and other stakeholders.

In addition, KFDA approval for the sale of drugs developed outside Korea remains slow. The frequent need for companies to duplicate clinical trials in Korea that have already been completed elsewhere is of particular concern because such trials are costly and delay market access for U.S. products. Duplicate trials were expected to decrease following Korea's 1999 announcement that it would implement International Conference on Harmonization (ICH) guidelines. While the KFDA has made progress in accepting the concepts in the ICH E5 guidelines, the KFDA typically does not consider Koreans to be members of the general Asian population for drug testing purposes and presumes that the effect of drugs on Koreans is unique unless proven otherwise. The U.S. Government will continue to press Korea to adopt more streamlined clinical trial application processes.

Finally, the Korean government continues to require that each shipment of a drug imported into Korea for commercial purposes be tested once registered. This is expensive, inefficient, and scientifically unsound. The United States will continue to urge the Korean government to implement appropriate international guidelines, to accept foreign clinical test data, to make the approval process for new drugs more science-based, and to shorten the overall drug approval process in Korea.

*(See also "Intellectual Property Rights Protection" and "Pharmaceuticals.")*

### **Telecommunications Standards**

The U.S. Government is concerned about a pattern of exclusionary practices in the setting of standards for new technologies in the field of next generation communications. The Korean government appears to be continuing to encourage the development and selection of homegrown "Korea-only" technology standards. In addition, the government has, in some important areas, decided to mandate a single standard for emerging technologies, rather than allowing companies and consumers to freely choose the technology that best suits their needs. Such an approach can sharply limit opportunities for providers of proven foreign technologies. *(See also Telecommunications section.)*

### **Automotive Standards**

*(See "Automotive Standards Experts Working Group" in Motor Vehicles section.)*

### **Labeling Requirements**

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

On January 1, 2001, new Ministry of Environment (MOE) packaging and labeling standards for food went into effect. Aimed at protecting the environment by minimizing landfill material, the standards prohibited the use of PVC-shrink-wraps and promotional packaging that included more

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than 20 percent "dead space" in the container. MOE addressed U.S. Government concerns about the restricted use of PVC-shrink-wrap on some products, including frozen products. However, the U.S. Government continues to question Korea's rationale for restricting package size based on gross "dead space." The United States has argued that net space displaced by such containers, once collapsed and measured (MOE does not allow this), is minimal and well within the objective of the standard.

*Biotechnology:* Korea implemented mandatory biotechnology labeling requirements for corn, soybeans, and soybean sprouts in March 2001, and for processed foods containing biotechnology enhanced corn and soybeans in July 2001. In March 2002, MAF extended biotechnology-labeling requirements further to include fresh potatoes. MAF officials have indicated to the U.S. Government that U.S. fresh potatoes are exempt from biotechnology labeling requirements with no requirement for extra documentation as long as no biotechnology potatoes are produced in the United States. The United States expressed concern to Korea that new labeling requirements appear far more burdensome than necessary to achieve their stated goal of providing Korean consumers clear information, and appear to raise national treatment concerns as well. In September 2002, after lengthy consultations, Korea agreed to accept notarized self-declaration as certification that products meet the criteria for exemption from biotechnology labeling.

*Functional Foods:* New Korean-language labeling requirements for functional foods are also of concern to the United States. The labeling guidelines for functional foods indicate that labels must be printed on packages. Under the new labeling requirements for functional foods, no provision is made to affix labels by means of a sticker. Stickers, however, are allowed for over-the-counter pharmaceutical products. The U.S. Government has expressed concern that the requirement for Korean language packaging rather than a Korean language sticker on functional foods can serve as a deterrent to trade, and will continue to press the Korean government to simplify labeling requirements.

*Beef Labeling:* In 2004, some National Assembly members filed a draft bill that would require mandatory "country of origin" labeling for beef dishes served in restaurants. Similar efforts by the Korean government and the Korea Consumer Protection Board that took place prior to this legislative effort were not implemented. The U.S. Government expressed concerns to the Korean government that requiring "country of origin" labeling on menus would limit the flexibility of restaurant owners to choose the origin of beef that they wish to purchase based on market principles. The bill is still pending. The United States has also noted that the meat packaging requirements of the Korean Ministry of Environment (MOE) Extended Producer Responsibility (EPR) system, introduced in January 2004, could potentially serve as an impediment to trade, and is monitoring the implementation of the new system.

## **GOVERNMENT PROCUREMENT**

Korea joined the WTO Agreement on Government Procurement (GPA) on January 1, 1997, and agreed to cover procurement of goods and services over specific thresholds by numerous Korean

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central government agencies, provincial and municipal governments, and some two dozen government-invested companies. In accordance with its commitments under the GPA, procurement of satellites was included in Korea's coverage as of January 1, 2002. Over the past year, the U.S. Government has assented to the de-listing of some formerly state-run companies from which the Korean government has divested.

## **EXPORT SUBSIDIES**

Korea committed several years ago to phase out export subsidy programs that are not permitted under the WTO Agreement on Subsidies and Countervailing Measures. However, Korea continues to promote its economic development based on undue reliance on exports, particularly from its traditional export-oriented industries such as automobiles, semiconductors, shipbuilding, and steel. In addition, Korea is encouraging the development of export-oriented "next generation" industries, such as semiconductors and telecommunications. The U.S. Government continues to strongly urge Korea to ensure that its government support programs fully comply with its WTO obligations.

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

## **Government Support for Certain Industrial Sectors**

The U.S. Government continues to be concerned with support extended to Hynix Semiconductor, Inc. (Hynix), Korea's second largest semiconductor manufacturer, by Korean government-owned financial institutions. Because the Korean government continued to provide financial assistance to Hynix, a formal countervailing duty (CVD) investigation was conducted and completed by the U.S. Commerce Department and the International Trade Commission in 2003. As a result of this investigation, Hynix's exports to the United States have subsequently been subject to countervailing duties of 44.29 percent. In June 2003, Korea initiated dispute settlement proceedings in the WTO. In January 2004, a panel was established to review Commerce's subsidy determination. The EU has also conducted a CVD investigation and found injurious subsidization – which is being challenged in the WTO by Korea – and a Japanese CVD investigation is pending as well.

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The U.S. Government also continues to focus on concerns raised by the U.S. paper industry about targeted Korean government aid to its coated paper sector, including low-cost facility investment loans and loan guarantees, tax benefits for facility expansion, government-sponsored creation of a paper manufacturing complex and government sale of debt obligations. Since the United States and other trading partners constitute a significant export market for Korean coated paper, U.S. industry remains concerned that such support may be distorting international markets for certain paper goods. The U.S. Government has raised the issue repeatedly with Korean government officials over the past two years, including in an experts meeting on paper in Seoul in February 2004. However, the Korean government has not yet taken concrete steps to adequately address this issue. The U.S. Government will continue to consult closely with U.S. industry to determine the best course of action to address concerns in this sector.

With regard to government support across all sectors, the U.S. Government also has concerns about the role played by the government-owned Korea Development Bank (KDB). Traditionally, the KDB has been one of the government's main sources for policy-directed lending to favored industries. Lending and equity investments by the KDB appear to have contributed to current overcapacity of certain Korean industries, an overcapacity that causes distortion in trade. The U.S. Government will continue to monitor the lending policies of the KDB and other government-owned or affiliated financial institutions.

#### **INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION**

While important steps have been taken to improve the protection of intellectual property rights in Korea, there remain areas of concern to the United States. This has become of increasing importance in recent years, as the digitization of Korea's economy, including the highest broadband penetration rate in the world, has significantly increased the opportunity for unauthorized copying of copyrighted material. The U.S. has also noted that with Korean films and music increasing their popularity throughout the Asia-Pacific region, and Korea's industrial products and trademarks enjoying global success, Korean creators of intellectual property would benefit from the sort of improvements the U.S. has advocated, both to Korea's own intellectual property regime and internationally.

Korea was elevated from the Special 301 Watch List to the Priority Watch List in January 2004 as the result of an Out-of-Cycle Review (OCR), and then maintained on the “Priority Watch List” in the annual Special 301 determination in April 2004. During the OCR, Korea’s progress was assessed based on the following criteria, which were set out in the Special 301 report, including: (1) granting police authority to the Special Inspection Team (SIT) of the Ministry of Information and Communication (MIC) to conduct raids for software piracy; (2) submitting legislation to the National Assembly giving the exclusive right of transmission for sound recordings, including both the right of making available and the full right of communication to the public, seeking its enactment by the end of 2003; (3) providing additional data on the Korean government’s enforcement efforts in order to evaluate more fully the range of enforcement activities, including the imposition of deterrent penalties, and to allow right holders to have the opportunity to take action against infringers who are not convicted; (4) submitting legislation to the National Assembly to grant the Korea Media Rating Board (KMRB) all authority necessary to stop film piracy; and (5) implementing fully and faithfully its agreement on the Wireless Internet Platform for Interoperability (WIPI) intellectual property issue.

Throughout 2004, the U.S. continued to urge the Korean Government to address these issues. By early 2005, the Korean Government had taken steps to address each of these concerns (although amendment of Korea’s Copyright Act to provide comprehensive transmission rights legislation will require legislative action in Korea’s National Assembly, which as of this writing has not been scheduled but is expected in the first half of 2005).

The U.S. Government also continues to urge Korea to strengthen its legal regime for the protection of temporary copies, technological protection measures, Internet Service Providers (ISP) liability, reciprocity provisions regarding database protection, *ex parte* relief, the lack of full retroactive protection for pre-existing copyrighted works and copyright term extension. In addition, concerns remain on book piracy in universities, street vendor sales of illegally copied DVDs, counterfeiting of consumer products, protection of pharmaceutical data, and lack of coordination between Korean health and IPR authorities on drug product approvals for marketing. These issues will be revisited during the next Special 301 Review, which will be completed in April 2005.

### **Transmission Rights for Sound Recordings**

Important aspects of Korea's copyright regime have failed to keep pace with the market transformation resulting from digitization and high-speed access to the Internet. Because Korea has one of the highest levels of broadband Internet penetration in the world, the Korean government should show an effective response to the challenges posed by the changing nature of digital copyright piracy. The U.S. Government has expressed concern that on-line piracy rates will likely continue to grow and damage the revenues of both domestic and foreign recording industries, and has urged Korea to introduce legislation that provides a full set of transmission

rights for sound recording producers. New legal tools need to be adopted and to continue to improve.

The Copyright Act was amended on October 16, 2004 (effective January 2005), to provide transmission rights for sound recording producers and performers; this legislation provides phonogram producers “interactive transmission rights” to control the making available of recordings through means such as posting copies on websites for downloading on demand. Further Copyright Act amendments were introduced in the National Assembly in early 2005 which would, *inter alia*, provide transmission rights for non-interactive transmissions -- other methods by which sound recordings may be digitally disseminated to the public such as webcasting, streaming and digital broadcasting. The legislation is expected to be considered by the National Assembly within the first half of 2005.

### **Korea Media Rating Board**

Ratings by the Korea Media Rating Board (KMRB) are required for a motion picture to be distributed in Korea; in recent years, KMRB ratings granted to entities that were not legally authorized right holders (who submitted fraudulent applications for ratings) have facilitated the distribution of pirated copies. In December 2003, the Korean National Assembly passed legislation that the Korean government has stated grants the Korea Media Rating Board (KMRB) the authority to identify and stop the fraudulent rating of motion pictures. The KMRB announced implementing regulations which became effective from May 30, 2004. The U.S. Government worked with Korea to ensure the regulations would not place any undue burdens on legitimate rights holders to prove their rightful ownership. In addition, the Korean government clarified in October 2004 that KMRB itself has the authority to revoke ratings of titles which were fraudulently registered before the effective date of the new regulations, upon the evidence-supported request of a legitimate right holder.

In 2004, the KMRB unexpectedly applied the new regulations to other media, namely, music videos. Because the new regulatory scheme is specifically geared towards motion pictures, this has caused unnecessary complications and is a serious barrier to the importation of music videos from the U.S. into Korea. The U.S. has urged Korea to resume its previous and satisfactory process with regard to music videos; in early 2005, the KMRB agreed to introduce a streamlined application system for music video ratings.

### **IPR Enforcement**

Korea passed legislation in July 2003 to give police powers to the Standing Inspection Team (SIT) of the Ministry of Information and Communication. From October 18, 2003, the SIT inspectors have been authorized to conduct raids on commercial firms and other institutions suspected of using illegal software. In June 2003, the Ministry of Justice sent a directive to all regional prosecutor offices to work proactively in pursuing IPR infringement violations. As a result, the Korean police and prosecutors’ raids against software end-users have become more

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consistent with higher damages discovered than in previous years. Raids are more frequently initiated based on leads provided by the software industry. The United States remains concerned, however, about the transparency of the Standing Inspection Team's enforcement process, including whether the SIT acts on tips provided by industry, and whether right holders will be able to participate in raids to the maximum extent possible and be notified about all SIT raids, even when discovered infringements are minor.

The United States continues to urge Korea to further strengthen the penalties for IPR violations to increase their deterrent effect against piracy. In January 2001, the Korean government enacted amendments to the patent, trademark and utility model laws that increased both fines and terms of imprisonment for IPR violators. In response to requests by the U.S. Government in April 2002 that the Korean government provide detailed information on the results of IPR enforcement efforts, Korea has provided regular quarterly reports during 2003 and 2004 on the inspections of the SIT, the disposition of cases by prosecutors and on court verdicts (i.e. acquittals, convictions, punishments). In 2004, Korea began to provide data on the level of fine and jail times to which infringers were sentenced.

### **Temporary Copies**

The United States believes that both the Copyright Act and Computer Program Protection Act, Korea's two principal copyright laws, should be strengthened by revising the law to clarify that the copyright owner has the exclusive right to make copies, temporary or permanent, of a work or phonogram. Current Korean law does not extend the reproduction right to cover copies made in the temporary memory of a computer, an enormous and still growing manner for use of copyrighted works.

### **Copyright Act**

In April 2003, the Korean National Assembly passed revisions to the Copyright Act, with implementing regulations announced in July 2003. That package of revisions strengthened the Copyright Act in two important ways. First, the amendments improved the effectiveness of technological protection measures (TPMs) by prohibiting the production and trafficking of devices aimed at circumventing TPMs. Secondly, the framework for a "notice and take-down system" was introduced under which an Internet Service Provider (ISP) would be given a legal incentive to respond promptly to requests from rights holders to take down sites where pirated activities are taking place. Korea subsequently ratified the WIPO Copyright Treaty in June 2004. However, Korea still needs to take further steps in order to meet its treaty obligations and fully protect content in the digital age.

The Copyright Act revisions do not clearly protect those technical protection measures that manage who can access a work, nor does it prohibit the act of circumvention of TPMs, but only the creation or distribution of circumvention tools. A party who strips off protection and leaves the work "in the clear" for others to copy without authorization may escape liability. These

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changes need to be enacted for Korea to bring the TPM provisions into compliance with the global minimum standards embodied in the WIPO treaties.

While certain provisions of the Copyright Act defining Internet Service Provider liability were harmonized with the Computer Program Protection Act (CPPA) in 2003, further clarification is required. The Copyright Act amendments still leave unclear the scope of the underlying liability of service providers and the limitations on and exceptions from liability. In addition, there are concerns that the documentation requirements for the rights holders in a takedown request are too burdensome.

Concerning library exceptions under Korea's Copyright Act, the U.S. Government believes that a notice period of at least 30 days should be given to the right holders prior to the unauthorized digitization of their works to minimize any negative effects. Under the current law, library exceptions still apply only to literary works and not to broadcasts, performances and sound recordings.

The U.S. Government has also urged Korea to delete the reciprocity limitations relating to database protection in the Copyright Act, as it discourages the introduction of databases from countries without such legislation, including the United States.

The United States has also recommended that the Korean government clarify the availability of injunctive and *ex parte* relief in civil enforcement actions under the Copyright Act, as required under the TRIPS Agreement.

In line with international trends, the United States is urging Korea to extend the term of copyright protection for works and sound recordings to the life of the author plus 70 years or 95 years from date of first publication where the author is a legal entity. Korea currently provides copyright protection for the life of the author plus 50 years. Korea also remains in violation of its obligations under Berne Article 18 and TRIPS Article 14.6 to provide full retroactive protection for pre-existing works and sound recordings.

The U.S. Government has told the Korean government that the private copy exceptions in Articles 27 and 71 of the Copyright Act should be re-examined in light of the growth of digital technologies. These exceptions generally should not be applicable to the Internet environment, which by its very nature extends far beyond private home use. In the digital environment, the market harm threatened by the unauthorized creation of easily transmittable perfect digital copies far exceeds the harm threatened by analog personal copying. Legislation on this issue was introduced in early 2005. It is unclear what next steps may be taken.

### **Computer Program Protection Act (CPPA)**

The modernization of Korea's Computer Program Protection Act (CPPA) to meet current challenges as well as to comply with new global norms continues incrementally. In late

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December 2002, the National Assembly passed revisions to the CPPA that provided for transmission rights, a critical element of an effective copyright regime in the digital age. The CPPA amendments were signed into law on December 30, 2002, and took effect on July 1, 2003, with the implementing regulations becoming effective in August 2003.

The United States believes that the CPPA needs to be strengthened further and has urged Korea to revise the law to clarify that the copyright owner has the exclusive right to make copies, temporary or permanent, of a work or phonogram. Unlike the Copyright Act, the CPPA does have provisions on protection of TPMs used in connection with computer programs. However, these provisions need to be strengthened, including the narrowing of several broadly worded exceptions.

The United States has also recommended that the Korean government clarify the availability of injunctive and *ex parte* relief in civil enforcement actions under the CPPA, as required under the TRIPS Agreement.

### **Data Protection**

In October 2004, a new high priority issue of concern to U.S. industry emerged in the area of intellectual property protection for pharmaceutical firms. In response to pressure from Korea's domestic generic drug industry, the Korean Food and Drug Administration (KFDA) proposed eliminating Korea's current rules which protect proprietary data submitted by a company for marketing approval from unfair commercial use for a set period of time. In doing so, KFDA would allow generic companies to rely on such proprietary data for marketing approval without permission of the originator or owner of that data. The United States raised serious concerns regarding this proposal, noting that such an action would bring into question Korea's adherence to its bilateral and multilateral commitments. Under the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), Korea is required to protect undisclosed test data related to pharmaceutical products submitted for marketing approval against disclosure and unfair commercial use. While at the end of 2004 during bilateral consultations the Korean government affirmed it would not change the current system, in early 2005, the United States learned that such a change continued to be under active consideration. The U.S. Government has repeatedly made clear to Korea we expect that the Korean government will fully live up to its international obligations to protect undisclosed data from unfair commercial use. This issue will continue to be a high priority on the U.S. Government's agenda in 2005.

### **Book and Video-DVD Piracy**

In August 2002, the National Assembly enacted the "Publication and Printing Business Promotion Act", which became effective February 2003 and allows private sector involvement in enforcement measures against book piracy. The Act gives the Ministry of Culture and Tourism (MOCT) the administrative authority to inspect and dispose of illegal copies of copyrighted books, but to date this law has provided minimal practical benefit to U.S. publishers. In 2003,

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the Korean authorities carried out few effective enforcement efforts against ongoing book piracy, which remains a common practice on and near Korea's university campuses. In February 2004, the Ministry of Education wrote a letter to all Korean university presidents, requesting them not to tolerate copyright infringement on their campuses; in February 2005, the Minister of Education sent a follow-up letter to Korean university presidents, reminding them of their responsibilities to combat piracy and asking for an update on their efforts. The U.S. Government has urged Korean authorities to coordinate with foreign book publishers and right holders in order to provide effective enforcement, and will continue to monitor implementation of this law.

Pirated audio-visual materials in DVD format, sold on the street by illegal vendors, continue to be a serious problem in Korea. The Korean government needs to meet this digital piracy challenge with stronger enforcement efforts and deterrent penalties. Despite active enforcement efforts in 2004, video-DVD piracy in Korea is increasing due to the growing sophistication of pirate production facilities and advanced distribution technologies. Intensified and consistent enforcement activities on the part of Korea's law enforcement agencies is needed to cope with this problem.

### **Patent and Trademark Acts, and Trade Secrets**

Korean patent law is fairly comprehensive, offering protection to most products and technologies. In 2003, changes to the Patent Act strengthened and streamlined the application process. In 2002 the law was amended to streamline the procedures for foreign Patent Cooperation Treaty (PCT) members. From March 2003, the time limit for entering into the national phase of PCT international applications in Korea was extended for 30 months after the priority date. The revision also gave the Korean Intellectual Property Office (KIPO) more authority to protect technologies exchanged through the Internet. In December 2003, KIPO prepared an amendment to the law to improve collection regulations concerning patent fees, registration fees and commissions imposed in accordance with patent, utility model, design and trademark laws in order to improve the convenience for petitioners.

Despite the progress, U.S. industry still believes that some deficiencies remain in the interpretation of claims and in the treatment of dominant and subservient patents. While KIPO has amended relevant laws to address U.S. concerns regarding restrictions on patent term extension for certain pharmaceutical, agrochemical and animal health products (which are subject to lengthy clinical trials and domestic testing requirements), problems still remain. Of top priority has been the lack of coordination between Korean health and safety and intellectual property officials, which results in the granting of marketing approval for products that may infringe on existing patents.

Korea's Trademark Act has been amended over the years to strengthen provisions that prohibit the registration of trademarks without the authorization of foreign trademark holders, by allowing examiners to reject any registrations made in "bad faith." Despite this change, the complex legal procedures that U.S. companies must follow to seek cancellation proceedings acts

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as a barrier to effective enforcement by discouraging U.S. companies from pursuing legal remedies. In particular these problems still arise with respect to "sleeper" trademark registrations. ("Sleepers" are trademarks filed and registered by Koreans without authorization in the late 1980s and early 1990s, when KIPO was still developing a more effective and accurate trademark examination and screening process.) These registrations - although a clear infringement of the rights of legitimate trademark owners - are not challenged and removed. The Madrid Protocol, an international trademark application system, entered into force in Korea on April 10, 2003.

The U.S. Government continues to urge Korean authorities to increase efforts to halt trade in counterfeit goods. The Korean government agreed to cooperate with the USG "Strategy Targeting Organized Piracy (STOP!) initiative in October 2004. Also, in an effort to enhance border enforcement against the exports of counterfeit products, the Korean Customs Service has significantly upgraded its computer system. The United States has noted particular concern that while textile designs were afforded copyright protection (in addition to protection under Korean design law) through the 2000 Copyright Act revisions, enforcement over the last four years has not been consistent, and the protection of textile designs remains problematic. Some Korean companies allegedly pirate U.S.-copyrighted textile designs and export them to third countries where they compete with genuine U.S.-produced goods.

Korean laws on unfair competition and trade secrets provide a level of trade secret protection in Korea, but are insufficient in some instances. For example, some U.S. firms, particularly certain manufacturers of chemicals, pet food, and chocolate, face continuing problems with government regulations requiring submission of very detailed product information, such as formulae or blueprints, as part of registration or certification procedures. U.S. firms report that, although the release of business confidential information is forbidden by Korean law, in some instances, government officials do not sufficiently protect this proprietary information and the trade secrets were made available to Korean competitors or to their trade associations. In response to these concerns, the Korean Food and Drug Administration (KFDA) revised the Pharmaceutical Affairs Act implementing regulations to stipulate that submitted data must be protected from unauthorized disclosure when the submitting party requests protection.

## **SERVICES BARRIERS**

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

### **Construction**

The construction, architectural design, and engineering markets in Korea were first opened to foreign competition in 1996. Foreign companies may bid on public projects, including the massive capital projects designed to improve basic infrastructure in Korea. Foreign firms still

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report problems with attempts to renegotiate accepted bid prices, non-recognition of overseas performances, and excessively burdensome registration and bonding procedures.

### **Advertising**

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

### **Screen Quotas**

Korea maintains stringent screen quotas on imported motion pictures, requiring that domestic films be shown in each cinema a minimum number of days per year (currently 146 days with reductions to 106 days possible if certain criteria are met). The quota discourages trade and hurts the competitiveness of the Korean film industry – a criticism that has been made by the Korean Fair Trade Commission as well. In January 1999 and in December 2000 the National Assembly passed resolutions stating that a relaxation of the screen quota should only be considered if and when Korean films achieve a 40 percent market share. Since 2001, Korean films have far exceeded that goal, maintaining a market share of 53 percent in 2003 and 57 percent in 2004. In 1999, the U.S. and Korean governments suspended negotiations of a Bilateral Investment Treaty pending resolution of the screen quota issue. The Roh Moo-hyun Administration has indicated renewed interest in resolving this issue. In 2004, the Minister for Culture and Tourism opened a dialogue with the local film industry to amend the screen quota system but real, positive movement by Korea on this issue has yet to occur.

### **Foreign Content Quota for Free Terrestrial TV**

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

### **Foreign Content Quota for Cable TV**

Korea restricts foreign participation in the cable television sector by limiting per channel airtime for most foreign programming to 50 percent. Annual quotas for broadcast motion pictures are set at 70 percent and for animation at 60 percent. These restrictions limit foreign access and the development of Korea's film and animation industries. The Korean government also restricts

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foreign ownership of cable television-related system operators, network operators, and program providers to 49 percent. For satellite broadcasts, foreign participation is limited to 33 percent.

### **Satellite Re-Transmission**

The Integrated Broadcast Law mandates that Korean firms that wish to re-broadcast satellite transmissions of foreign programmers must have a contract with the foreign program provider in order to obtain approval from the Korean Broadcasting Commission (KBC). Foreign re-transmission channels are limited to 10 percent of the total number of operating channels. This artificial restriction limits the amount of international broadcasting which could otherwise be made available to Korean consumers and limits foreign investment in Korea in the broadcasting sector.

### **Restrictions on Voice-overs and Local Advertisements**

Presently, there are restrictions on voice-overs (dubbing) and local advertising for foreign re-transmission channels. These restrictions are written into the Korean Broadcasting Commission's guidelines for implementation of the Broadcasting Act, and as such, could easily be revised. Allowing voice-overs in the Korean language would make the broadcasts truly accessible to Korean consumers (especially for breaking news and children's cartoons, where the time-consuming requirement to create subtitles is particularly ill-suited to the target audience); it would also benefit the Korean economy by creating more studio-production jobs and foreign investment. The prohibition on local advertising for foreign re-transmission channels restricts the long-term viability of foreign re-transmission channels in the Korean market. Foreign re-transmission channels should be allowed to broadcast their content and add local advertising in order to ensure their financial stability as well as to show relevant advertising to their Korean viewers.

### **Accounting**

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

### **Engineering**

Although there are no restrictions on foreign engineering services specified in Korean law or regulation, procuring agencies (national, local, and private) can specify particular conditions

and/or requirements for engineers and engineering services depending on the nature of the project. Such specifications can be written to favor domestic engineering services firms.

### **Legal Services**

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

### **Financial Services**

As a condition of its post-Asian financial crisis IMF economic stabilization package, Korea agreed to bind its OECD commitments on financial services market access in the WTO. Korea's revised schedule of WTO financial services commitments entered into force in September 1999. After most foreign exchange transactions were liberalized in 2001, Korea's financial authority lifted almost all restrictions on the foreign exchange market, and foreign bank and financial subsidiaries do not have to receive Bank of Korea (BOK) permission on their financial transactions, even capital account transactions. The U.S. Government will continue to work with Korea to ensure that it meets its WTO and OECD financial services commitments and to establish more liberal treatment of foreign financial services providers.

### **Insurance**

Korea is the second largest insurance market in Asia after Japan, with \$51 billion in premiums paid in the fiscal year ending March 31, 2004. The environment for foreign insurance companies has improved considerably since Korea implemented a series of regulatory changes following its 1996 OECD accession.

The 1997-1998 financial crisis led to an ambitious restructuring of the Korean insurance industry. In 1998, the newly established Financial Supervisory Commission (FSC), the Korean government's financial watchdog and center for financial reform, revoked the licenses of some insurance companies, forced the merger of others on the grounds of insolvency, and assisted 16 insurance companies through FSC-supervised workout programs.

The Korean government is gradually liberalizing foreign entry into the life and non-life insurance markets and has lifted some restrictions on partnering with Korean financial

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companies and on hiring Korean insurance professionals. In April 1998, Korea liberalized insurance appraisals and activities ancillary to the management of insurance and pension funds. Korea's brokerage market was opened to foreign firms in April 1998. Several foreign reinsurance firms have since entered the market. In April 2003, the National Assembly passed a new insurance act that effectively reduced regulations and requirements for foreign insurance companies. The act reduces the minimum working capital requirement for on-line insurance companies, changes from a permission system to a notification system for offering new insurance products and entry into side businesses, and softens regulations related to asset management by insurance companies. Despite these improvements, a considerable gap remains between Korea's practices and those found in more developed insurance markets.

## **Banking**

In the aftermath of the Asian financial crisis, the Korean government injected over 86.7 trillion won (\$72.3 billion) in public funds into the commercial banking system, effectively nationalizing it. The IMF and the U.S. Government have repeatedly urged Korea to privatize state owned banks to allow market forces to more efficiently allocate financial resources and increase investor confidence in the Korean economy. Responding to IMF recommendations, Korea has begun to privatize state-owned banks to allow market forces to more efficiently allocate financial resources and increase investor confidence in the Korean economy. In 2004, the Korean government sold its share (21 percent) of Hana Bank. As a result, at the end of September 2004, foreign investors' stake in Hana had risen to 68.3 percent as compared to 37.9 percent at the end of 2003.

At the beginning of 2002, Korea modified its regulations to allow foreign bank branches to borrow from their head offices and to include the net borrowing as Class B capital. However, the Korean government did not allow the foreign branches to use head office capital to meet regulatory lending limit requirements and continues to restrict the operations of foreign bank branches based on branch capital requirements.

These restrictions limit: (1) loans to individual customers; (2) foreign exchange trading; and (3) foreign-bank capital adequacy and liquidity requirements. Foreign banks are subject to the same lending ratios as Korean banks, which require them to allocate a certain share of their loan portfolios to Korean companies other than to the top four chaebol conglomerates and to small and medium enterprises.

Foreign banks are permitted to establish subsidiaries or direct branches. Since 1998, the Korean government opened capital markets to foreigners, permitting foreign financial institutions to engage in non-hostile mergers and acquisitions of domestic financial institutions.

All banks in Korea continue to suffer from a non-transparent regulatory system and must seek approval before introducing new products and services - an area where foreign banks are most competitive. The April 1999 Foreign Exchange law introduced the first phase of foreign

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exchange and import-export transaction liberalization. The second phase of foreign exchange liberalization became effective on January 1, 2001, and deregulated foreign exchange and capital account transactions for individuals, but a few restrictions on foreign exchange transactions and derivatives trading by corporations and financial institutions still remain, which are applied to domestic and foreign institutions.

In 2005, members of Korea's National Assembly introduced draft legislation that would impose nationality and residency requirements for members of the boards of directors of Korea's banks. The United States has noted that the adoption of these or similar measures would send a negative signal to foreign investors in Korea's financial sector.

### **Securities**

On June 24, 2000, the Korean government removed limits on local currency issues of stocks and bonds by foreign firms. The Korean government places no limits on foreign ownership of listed bonds or commercial paper, no longer restricts foreign ownership of securities traded in local markets, and has removed almost entirely foreign investment ceilings on Korean stocks. By the end of October 2004, foreigners owned more than 43.8 percent of the shares on Korean stock exchanges, according to Korean government statistics. Despite this liberalization, foreign securities firms in Korea continue to face some non-prudential barriers to their operations.

### **INVESTMENT BARRIERS**

The Roh Moo-hyun government has continued to voice a commitment, shared by the previous administration, to create a more favorable investment climate and to facilitate foreign investment in Korea. In 2004, FDI increased to \$12.8 billion, much of it mergers and acquisitions in the financial sector. The Citigroup purchase of KorAm Bank and Shanghai Motor's acquisition of Ssangyong Motor in December 2004, contributed significantly to FDI, which had decreased in 2003. There were also some announcements by U.S. companies regarding plans for investment in Korea, including: GE Capital's plans to buy a 38 percent share of Hyundai Capital for 1 trillion won (about \$900 million) in 2006; and Phillips's plans to invest 25 trillion won (about \$23 billion) by 2014 in LG-Phillips. The more positive attitude toward foreign investment on the part of the Korean government, many in private industry, and by a growing number of Koreans, is helping to open the Korean economy. However, while progress has been made in recent years, additional steps are needed to more fully improve the environment for foreign investment, including the removal of remaining structural barriers such as labor market inflexibility (e.g., better pension mobility, more flexibility in hiring and firing workers, expanded unemployment compensation, less rigid worker visa rules, and better job training and placement services), labor-management disputes, and insufficient regulatory transparency.

The 1998 Foreign Investment Promotion Act, in addition to simplifying investment procedures, providing more tax incentives, and establishing Foreign Investment Zones, increased the number of business sectors open to foreign investment. Nonetheless, two sectors – television and radio

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stations – remain fully closed to FDI, and 27 remain partially closed. Capital market reforms have eliminated or raised ceilings on aggregate foreign equity ownership, individual foreign ownership, and foreign investment in the government, corporate, and special bond markets. These reforms have also liberalized foreign purchases of short-term financial instruments issued by corporate and financial institutions. However, the Korean government still maintains foreign equity restrictions with respect to investments in various state-owned firms and many types of media, including basic telecommunication service providers, cable and satellite television services and channel operators, as well as schools and beef wholesalers.

The Korean government has taken several important steps to privatize state-owned corporations, although there were no new privatizations in 2004. The Korean government has also removed restrictions on the direct purchase of land by foreigners through the 1998 revision of the Alien Land Registration Acquisition Act. Foreigners, however, still cannot produce certain agricultural products for commercial purposes nor remove agriculturally zoned land from agricultural production.

As an additional liberalizing measure, the Korean government has opened Free Economic Zones (FEZs) with an extensive range of incentives including tax breaks, tariff-free importation, relaxed labor rules, and improved living conditions for expatriates in areas such as housing, education, and medical services. While establishing these zones is an important step in making Korea's business environment more open, liberal, and responsive to economic needs, the FEZ's will likely not address many of the key factors inhibiting additional foreign investment in Korea.

## **ANTICOMPETITIVE PRACTICES**

### **Competition Policy**

The Korean government's enforcement of its competition policy, although historically weak, has been strengthening. The Korea Fair Trade Commission (KFTC) has been playing an increasingly active role both in enforcement of Korea's competition law and in advocating for regulatory reform and corporate restructuring. KFTC's powers to conduct investigations and to impose tougher penalties were enhanced in January 1999, with the revision of the Monopoly Regulation and Fair Trade Act. The Act was subsequently revised in December 2000, to broaden KFTC's authority in corporate and financial restructuring and to raise substantially the administrative fines for violations or for failure to cooperate with KFTC investigations. In support of the KFTC's more aggressive stance, in October 2003, the Roh Administration submitted legislation to the National Assembly that would extend the KFTC's monopoly regulation authority under that act to allow it to trace the bank accounts of domestic companies through 2007. The National Assembly approved that bill on December 9, 2004. This legislation also increases the maximum surcharge against cartels to 10 percent (from the previous 5 percent maximum), facilitates private damage actions, authorizes payment for information from informants, exempts certain transactions from pre-merger reporting requirements, limits large conglomerates' (chaebol) voting rights in their affiliates to 15 percent from the current 30

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percent starting in 2008, and reintroduces the KFTC's authority to monitor chaebol bank accounts for evidence of illegal inter-subsidiary dealings.

## **ELECTRONIC COMMERCE**

Korea is considered to be a global leader in technology trends and was among the first countries to see widespread use of wireless phones. Korea has more high-speed Internet connections per household than any other country, and the government has actively pursued legislation to encourage electronic commerce.

The Korean government has been working to address data privacy issues by drafting a Basic Privacy Act and revising or adding sector-specific laws. Korea's Presidential Committee on Government Innovation and Decentralization and National Assembly are drafting the Basic Privacy Act, which is expected to pass in early 2005 following a one-time public hearing to gather input from industry experts. Industry-specific issues will be addressed separately by regulations to be put in place over a period of six months to two years following the passage of the Basic Privacy Act. As much of the draft Act addresses information held by the government, not the private sector, each relevant ministry will be responsible for devising associated regulations. The United States will work with Korea to try to ensure that is concerned that Korea does not develop a labyrinth of overly-burdensome regulations that inhibit the cross-border flow of information, which would negatively impact Korean and American companies and would limit consumer choice.

Numerous privacy issues have been discussed on the margins of the APEC Privacy Framework, to which Korea has contributed. NGOs in Korea are asking for stricter requirements in a number of areas which may impact cross-border data flows, thus hindering e-commerce. Korea is also considering establishment of a central office responsible for data privacy, similar to the data protection authorities that exist in other countries.

These efforts build upon actions the Korean government has already taken to encourage electronic commerce. For example, in December 2003, the Korean government teamed up with the private computer security industry to cope with the emergence of digital threats. The Ministry of Information and Communication launched a national cybersecurity agency under its roof, aimed at protecting critical infrastructure and enhancing Internet security. The new organization, the Korea Internet Security Center (KISC) is similar to the Computer Emergency Response Team in the United States, which provides timely alerts, coordinates information among private companies and government agencies, and monitors backbone Internet networks. The Basic Law on Electronic Commerce establishes the validity and enforceability of digital signatures as well as the admissibility of electronic messages.

Korea has also strengthened its regulation of spam. New laws, enacted in July 2003, require online marketers in Korea to flag their e-mails as advertisements and to set up a free telephone hot line so people can opt out of future e-mails. The laws also forbid marketers from scanning

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web sites for e-mail addresses. The Ministry of Information and Communication can impose a fine of up to 10 million Korean Won (USD 9400) on spam violators. The law also provides criminal penalties for the use of illegal technology or the distribution of maleficent advertisements to minors.

## **OTHER BARRIERS**

### **Regulatory Reform and Transparency**

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, including the automotive, pharmaceutical, agricultural and telecommunications sectors, and continues to be one of the principal problems cited by U.S. traders and investors seeking to compete in the Korean market. In an effort to address these systemic issues, beginning in 2004, the United States and Korea deepened their focus on regulatory reform and transparency issues.

Korean laws, regulations, and rules often lack specificity, and implementing regulations frequently diverge from the stated objectives of the law. Korean officials exercise a great deal of discretion in applying broadly drafted laws and regulations, resulting in inconsistency in their application and uncertainty about how to comply with them within businesses. Compounding this problem is the frequent failure by various Korean ministries to provide to all stakeholders specific and timely notification of planned or actual changes to laws and regulations. When public comments are solicited, the timeframe for their submission is frequently unreasonably short. In addition, in many instances, final legislation and regulations do not reflect the extensive comments provided by stakeholders. Moreover, vague laws or regulations are sometimes reinterpreted and then applied retroactively, penalizing companies that have sought to fully follow Korean government guidance.

As more U.S. companies increase their presence in Korea, these administrative practices, which frequently involve "domestic" Korean regulations rather than traditional trade measures like tariffs or quotas, will have a greater impact on U.S. firms' access to the Korean market. During bilateral trade consultations in 2004, the United States outlined for Korean officials how Korea's administrative practices have affected U.S. companies operating in Korea, and pressed for improvements in the Administrative Procedures Act (APA) particularly related to: more explicit government-wide guidance on how the APA should be adhered to and enforced by various ministries; expanded use of notice-and-comment procedures, including for subordinate statutes; and the publication of administrative actions.

Related to the pharmaceutical sector specifically, the United States also provided Korea with a list of concrete suggestions on how Korea's system for pricing and reimbursing innovative medicines could be made more transparent. Among other things, the U. S. Government urged Korea to establish an independent appeals process, thereby providing companies with an avenue

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to appeal questionable regulatory and pricing decisions to an authority other than the original decision-making body.

These bilateral efforts on regulatory transparency coincide with a Korean government focus on regulatory reform. The Roh Government has charged the Deregulation Taskforce Team, the Corporate Difficulties Resolution Center, and the standing Regulatory Reform Committee all to focus on different aspects of regulatory reform, both systemic and sector-specific. During trade consultations in 2004, the United States sought to identify how regulatory issues of concern to the United States might be brought to the attention of these three organizations. In 2005, the U.S. Government, in coordination with the U.S. business community, will continue to press Korea to adopt forward-leaning changes and to create a more transparent rule-making system that fully involves all stakeholders throughout the process.

### **Motor Vehicles**

While the Korean auto industry has developed into the fifth largest auto industry in the world, access to the Korean market for foreign motor vehicles remains limited. While Korean auto sales in the U.S. market in 2004 were a record-high 688,670 vehicles, or 4.1 percent of the U.S. market, U.S. manufacturers sold only 5,415 vehicles in Korea. Furthermore, while sales of imported cars in Korea also hit a record in 2004, total auto imports into Korea represented only 2.1 percent of the market, or 23,345 vehicles. The U.S.-Korea auto deficit of \$10 billion represented roughly half of the overall U.S.-Korea trade deficit in 2004.

The United States and Korea concluded a Memorandum of Understanding (MOU) in October 1998, designed to improve market access for foreign motor vehicles. Although the Korean government has implemented many of its commitments under the 1998 MOU, the United States continues to have serious concerns about the lack of progress toward the fundamental goals of the agreement, including substantially increasing market access for foreign motor vehicles and establishing the conditions to allow Korea's motor vehicle sector to operate by market principles. The United States has urged the Korean government to take additional meaningful actions to open the automotive sector, including eliminating or at least reducing Korea's eight percent tariff on imported automobiles, which is more than three times the U.S. tariff. The effect of the tariff is compounded by the cascading effect of multiple automotive taxes calculated on top of the tariff, which raise the effective rate to above 12 percent. The combination of relatively high tariff and taxes renders imported automobiles significantly less price competitive in Korea. A Korean study showed that if the auto tariff were reduced to 2.5 percent, foreign auto imports could increase to 12 percent of the Korean market within five years – an import level much closer to that of Korea's main auto trading partners. The Korean government has responded that it will likely defer any tariff reductions until the completion of the WTO Doha Development Agenda negotiations.

The United States has also expressed concern that Korea's current system of auto taxes discriminates against the larger vehicles that exporters tend to sell in the Korean market. Noting

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the MOU commitment to restructure and simplify the automotive tax regime in a manner that enhances market access for imported vehicles, the U.S. Government has urged the Korean government to lower the overall tax burden, reduce the number of taxes assessed on vehicles, and move away from engine-displacement taxes towards a value-based system. The U.S. Government has stressed that these commitments should be met through the development of a transparent and comprehensive plan, which would allow manufacturers and consumers adequate time to make adjustments. While the Korean government has taken some specific actions on automotive taxes over the last several years, to date, it has produced a transparent plan to meet the long-term MOU goals. In 2003, the U.S. Government presented a proposal requesting the Korean government to consider basing the calculation of Korea's multiple cascading automobile taxes on the actual value of imported vehicles at port of entry (CIF) rather than on the CIF value plus the tariff, as under the current system; however, the Korean government replied it has no current plans to modify the cascading auto tax system. The U.S. Government will continue to press for Korea to lower automotive tariffs and to undertake reforms of its overall automotive tax system in an open and transparent manner that fully involves all stakeholders throughout the process and enhances market access for U.S.-made vehicles.

The United States and Korea have also worked together in the bilateral “Automotive Standards Experts Working Group” (created in 2001) to address a range of motor vehicle standards issues, consistent with Korea’s commitment in the 1998 MOU to simplify and streamline its safety and environmental standards and certification procedures. The meetings of this group have been productive, and the United States believes this forum offers the potential to build a stronger cooperative relationship on standards and certification issues. During 2004, the auto standards working group made progress in resolving concerns including: the implementation of self-certification procedures for vehicles imported into Korea; environmental testing of 4x4 vehicles within Korea; and the implementation of Korea’s new Average Fuel Economy (AFE) system. U.S. auto exporters had expressed concern about a lack of transparency in the development of the Korean AFE regulations and the speed with which the requirements were to be implemented. Discussions in the standards experts group regarding AFE laid the foundation for a successful compromise on a mutually acceptable timeframe for implementation, and for ensuring that Korea’s proposal to introduce a new style and shape of license plate would not disfavor U.S.-made autos or require costly modifications.

The U.S. Government also looks forward to continued efforts by the Korean government to address any anti-import sentiments and negative perceptions that could serve as barriers to the purchase of an imported automobile.

In 2001, General Motors of the United States bought a controlling share in Daewoo Motors, Korea’s third largest auto manufacturer. In 2004, Daewoo Motors accounted for roughly 16 percent of Korea’s vehicle production (for domestic and export markets combined).

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## **Motorcycles**

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

## **Pharmaceuticals**

The U.S. remains seriously concerned about Korean government measures that result in unnecessary delays in market access for innovative medicines, do not appropriately value innovation, and diminish the contribution of Korea to research and development of innovative pharmaceutical products. The Korean government often develops its policies in this sector in a non-transparent manner without adequate input from domestic or foreign stakeholders. The resulting policies often harm U.S. companies, discourage investment in Korea, and impede the development of advanced biomedical research in Korea thereby hindering Korea's ability to achieve its goal of becoming a "biotechnology hub" for Asia.

The U.S. and Korean governments worked extensively in 1999 through a consultative process to address a number of priority issues in this sector. One result of this process was that U.S. and other international pharmaceutical companies were for the first time allowed to have their products listed under the Bureau of National Health Insurance's reimbursement guidelines. However, while some progress has been made in this sector in recent years, several important concerns remain.

**Transparency:** The lack of transparency in Korea's procedures for pricing and reimbursing innovative medicines under its national healthcare system was a key focal point of bilateral discussions in 2004. While the Korean government has agreed to consider new ways to increase the transparency of the drug pricing and reimbursement system, there are signs – including in the recommendations of a Korean government-commissioned health insurance reform study released in September – that progress could be reversed. The U.S. Government believes that developing policies that improve health care for all Koreans is best pursued by consulting with all domestic and foreign stakeholders, including foreign industry and governments. The U.S. Government will continue to urge the Korean government to consult regularly with foreign industry, ensure the use of public comment procedures, allow for appeal of MHW decisions on drug pricing, and combat corruption.

In addition to U.S. Government efforts in this important area, a bilateral Pharmaceuticals Working Group was formed in 2002, with the goal of increasing transparency in drug policy. The group is composed of Korean and U.S. pharmaceutical companies and Korean government officials, with U.S. Embassy staff serving as observers. While the Working Group's meetings have helped set a more positive tone for dialogue between the Korean government and the research-based pharmaceutical industry, there was no significant progress on any of the substantive issues U.S. industry raised during the two meetings that were held in 2004. The U.S. Government continues to work with Korea to ensure that the Working Group is useful in facilitating discussion and formulating possible solutions to bilateral issues.

**Pricing:** Other major obstacles to U.S. companies in the Korean pharmaceuticals market remain the absence of a fair and transparent pricing regime and the lack of transparent reimbursement guidelines. In 1999, Korea agreed to price innovative drugs at the average ex-factory price of A-7 countries (United States, United Kingdom, Germany, France, Italy, Switzerland, and Japan). All other drug prices would be determined using the Actual Transaction Price ("ATP"). While there was initially good progress in implementing the new system, problems have surfaced. Korea has not adequately implemented or enforced the A-7 or ATP systems. This has led to market distortions and corrupt prescribing practices, which have kept prices of generics artificially high and created incentives for doctors to prescribe for profit. Further, Korea has implemented a problematic "triennial repricing system" without adequate consultation with stakeholders.

**A-7 Pricing:** Despite Korea's 1999 agreement to use A-7 pricing, Korean authorities have been restrictive in granting new pharmaceuticals A-7 status and have used non-transparent criteria for determining whether a new pharmaceutical qualifies as "innovative." Korea's Health Insurance Review Agency (HIRA) has rejected – with no explanation – nearly two-thirds of the medicines that U.S. pharmaceutical companies have submitted since 2000 for A-7 pricing. The Korean government has not provided applicants for A-7 pricing an explanation as to why their products were determined to be ineligible. In December 2004, reinforcing a proposal that U.S. industry put forward earlier to achieve greater transparency and accountability, the U.S. Government proposed that the Korean government issue a one-page justification for its decisions not to

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provide A-7 pricing. The Korean government agreed to do so in January 2005. The U.S. Government welcomed this step and will continue to monitor the situation relating to A-7 pricing policies.

***Actual Transaction Price:*** The United States was pleased when Korea reinstated ATP in 2004 after a brief period of using a “Lowest Transaction Price” system. ATP, which bases reimbursement prices on a sales weighted average from the previous quarter, was intended to end hospital practices of demanding a discount from pharmaceutical manufacturers when purchasing drugs and then receiving a full reimbursement from the national health insurance system. However, Korea’s poor enforcement of ATP has meant that reimbursement prices have not fallen. Further, Korea currently allows wholesalers to bundle their sales of drugs to hospitals and doctors. As a result, it is difficult to accurately determine the individual transaction cost of pharmaceutical sales. Bundled products that are sold include both low-margin and high-margin products in one package. The U.S. Government will continue to press Korea to better enforce the ATP system.

***Triennial Repricing:*** The Triennial Repricing system, which took effect on January 1, 2003, affects all drugs registered on the national reimbursement list as of the end of 1999. All registered drugs will be subject to repricing every three years under this system. In 2003, out of 344 items subject to triennial re-evaluation, prices were reduced for 82 items by an average 7.5 percent. The repricing system does not allow for price increases when data supports such action. The repricing system was implemented without meaningful consultation, and the lack of transparency in the selection and pricing of drugs continues to be a concern.

***Reimbursement Guidelines:*** As part of its efforts to trim health-care costs, the Health Insurance Reimbursement Agency (HIRA) has imposed restrictive reimbursement guidelines on the innovative drugs of foreign pharmaceutical companies without a rigorous transparent scientific review. These guidelines are initially set by the Korea Food and Drug Administration, but can later be modified by guidelines established by HIRA. The process by which HIRA establishes these modified guidelines is non-transparent. Although an appeals process exists, it is not codified by law and appeals are not made to an independent appeals panel but to the same office that made the initial ruling. The U.S. Government has raised concerns regarding the guidelines with the Ministry of Health and Welfare (MHW) and HIRA, and continues to urge the Korean government to develop a transparent process for revising reimbursement guidelines. In addition, the Pharmaceuticals Working Group initiated a task force to look at improving transparency in the reimbursement guideline-setting process. The Working Group has also submitted a list of recommendations for amending the reimbursement guideline-setting system, and U.S. members have reported some progress to date; however, more needs to be done.

## **Corruption**

Corruption continues to be a widespread problem in the Korean healthcare system. As noted above, the complex distribution system and lack of transparency in government decision-making

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are large contributors to this problem. In 2005, the U.S. Government will continue to work with the Korean government to bring about a more transparent, fair science-based health care system that provides predictability for our companies in pharmaceutical pricing, reimbursement guideline setting, and regulatory affairs.

### **Medical Devices**

The United States continues to be concerned about reimbursement pricing practices (particularly related to orthopedic devices and cardiovascular/endovascular devices), hospitals' buying practices, problematic provisions of the Medical Devices Act, and a proposal for third party review of product approvals. There is a need for a more transparent and streamlined regulatory approval process. In late 2002, the Ministry of Health and Welfare (MHW) approved proposed price reductions on medical products from between 2 to 75 percent, depending on the product and category. These reductions, effective January 1, 2003, are especially burdensome for all categories of orthopedic devices, for which reimbursement prices have been reduced between 14 percent and 60 percent.

In October 2003, the Korea Health Industry Development Institute (KHIDI) completed a study containing various recommendations for pricing, re-pricing, and disposable medical device management (including re-use and processing of human organs for surgical treatment). On pricing, KHIDI recommended setting price ceilings for new medical products at 90 percent or below the prices of similar products; using cost data (manufacturing costs for local manufactured products and import Free On Board prices for imported products) for calculations; setting a ceiling of 10 percent above the current market price for new medical technology; using prices in other countries (including Japan, France and Taiwan) as pricing benchmarks; and conducting re-pricing every two years. U.S. industry has expressed concern about these study results. The Medical Device Act (MDA) was passed by the National Assembly in May 2003, and took effect on May 29, 2004. The MDA establishes a new legal framework for the regulation of medical devices, separate from the Pharmaceutical Affairs Act. The new legislation established a new four-class system which is consistent with global trends and will allow U.S. device firms to use global data for registration approvals with less need for data specific to Korea. In compliance with WTO obligations to eliminate tariffs on medical products, the Korean government eliminated tariffs on orthopedic devices in 2000 and eliminated tariffs on other medical products in 2004.

### **Telecommunications**

As one of the world's most advanced telecommunications markets, Korea is actively commercializing a variety of cutting-edge wireless technologies, such as cdma2000, 1x EV-DO, W-CDMA, and portable wireless broadband Internet, as well as introducing terrestrial and satellite-based digital TV broadcasting. Given the tremendous commercial opportunities provided by this market, ensuring that Korea maintains fair and open competition in its telecommunications market is of paramount importance.

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Despite rapid growth in the sector, U.S. suppliers have been negatively affected by excessive governmental influence over private operators' selection of technologies and interference in issues such as foreign licensing, royalty payment arrangements, and technology transfers. This governmental influence on the equipment and technology choices of private companies also often manifests itself in the licensing process for operators and in localization policies for procurement. The Korean government's control over tariff rate approvals, equipment certification, and other regulatory authority provide additional means by which it can exert strong influence over industries' selection of specific standards or technologies.

The Korean government has sometimes discouraged use of foreign-sourced goods and services for certain telecommunications applications, while simultaneously supporting development of applications based upon a domestic technology. In 2004, for example, the Korean government initially backed domestic technologies at the expense of proven foreign technologies in the development of standards for mobile phone applications and portable broadband wireless Internet. The Ministry of Information and Communications funds the development of domestic telecommunications technologies primarily through its research and development arm, the Electronics and Telecommunications Research Institute (ETRI), and through grants to universities and other research institutes. The U.S. Government has recently stepped up efforts to urge Korea to allow fair and open competition in this sector. In particular, the U.S. Government has urged the Korean government not to mandate specific technologies or intervene in private sector negotiations. A continuation of such practices runs counter to the Roh Administration's policies and its goal of encouraging foreign direct investment in Korea.

An important issue for U.S. industry and the U.S. Government in 2004 was Korea's plans to mandate the domestic Wireless Internet Platform for Interoperability (WIPI) standard for mobile phone applications. As originally envisioned, WIPI would have been the exclusive technology for downloading content from the Internet onto cell phones, thereby shutting out competing systems, including a U.S. system that already had over 7 million Korean subscribers. The U.S. Government, which opposes mandating exclusive standards such as WIPI, strongly objected to Korea's plans. As a result of extensive negotiations in 2003-2004, the Korean government agreed to allow other applications platforms to coexist in with WIPI in the market. The U.S. Government will continue to monitor implementation of the agreement.

The Korean government also recently announced that it plans to reallocate the 2.3-gigahertz spectrum to a new portable broadband Internet system and that it will only permit one technology standard to be used for this service. Licenses for the system were allocated in January 2005. At the insistence of the United States, the Korean government provided a written justification for its one-technology preference in January 2004. The U.S. Government and private sector found serious flaws in Korea's justification, some of which called into question Korea's adherence to its bilateral and WTO commitments. In June 2004, the Korean government modified its position and officially announced that all license holders will have to use a technology compatible with the International Institute of Electrical and Electronics Engineers

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(IEEE) 802.16(e) Rev. D (or any subsequent version) air interface standard, as well as to satisfy some minimum performance requirements. Although less trade restrictive than mandating a "home grown" Korean standard – as the Korean government originally planned – this decision nevertheless remains overly trade restrictive, as it closes the market to several firms trying to market commercially-ready proprietary systems and inappropriately restrains operators' technology choices in a way not necessary for realizing the government's ostensible policy goals. The U.S. Government will continue to urge Korea to ensure that competition in services and technologies is allowed to thrive in its telecommunications market.

More generally, the U.S. Government is concerned that the Korean government's ambitious plans for promoting the information and communications technology sector, described in the Ministry of Information and Communication's "IT 839 Strategy" (8 services, 3 infrastructures, 9 new growth engines) could put a strain on U.S.-Korea trade relations if they are implemented in a discriminatory fashion. Responding to political pressure from the National Assembly, the Korean government recently publicly espoused a policy of reducing royalty payments made to foreign firms and encouraging the development of domestic standards and core technologies. While the government has since seemed to discontinue rhetoric calling for reducing royalty payments to foreign firms, it continues to actively promote the domestic development of technology, leading to concerns that it will seek to facilitate the commercialization of such technologies by protecting its home market. The U.S. Government views this development as discriminatory against foreign technology producers. The U.S. Government has expressed repeatedly its concerns that decisions to limit permissible services to a single technology are overly trade restrictive.

The Korean government divested the government's final holdings in Korea Telecom (KT) in May 2002. The United States believes that full privatization should inject much-needed competition into the market and allow more U.S. suppliers to qualify for KT procurement through locally qualified agents and distributors. In the telecommunications services sector more generally, foreign ownership restrictions, including a ceiling of 49 percent foreign ownership for facilities-based (Type 1) carriers, also impede the access of foreign firms to the Korean market.