

# Korea-U.S. FTA in its Third Year: Current Status of Implementation and Issues

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## 1. Introduction

Since the Korea-U.S. (KORUS) FTA entered into force on March 15, 2012, both sides have reviewed the status of its implementation and related issues. During the first three years, trade and investment between the two countries have both experienced a positive impact thanks to the KORUS FTA. However, practical measures to enhance the FTA's impact (which displays severe deviation among industries) are called for.

As the KORUS FTA has been in force for three years, this paper will evaluate the current state of its implementation. The report will also explore matters that were raised during the TPP preliminary bilateral talks between Korea and the U.S.

## 2. Trade in Goods

**(1) Growth in Bilateral Trade Volumes since the KORUS FTA Entered Into Force**

Three years after the KORUS FTA came into effect, Korea's exports to the U.S. have increased 31.54% relative to the same period of the previous year-range. Furthermore, imports from the U.S. have also increased, by 10.77%. Therefore, the trend of surplus in balance of trade is becoming higher; the value gained in Korea-U.S. trade under the FTA is 25 billion dollars.

Moreover, an analysis of each factor of the KORUS FTA showed an increase in FTA impact on exports, of 82.4%. The possibility of a decrease in exports to the U.S. was thus very real if the KORUS FTA did not go into effect. According to industrial analysis, the KORUS

FTA has had the effect of virtually doubling Korea's exports of automobiles and parts (127.96%) and metals (109.16%), though increases in exports of other manufacture (2.85%) and chemicals (8.49%) to the U.S. have remained below 10%.

On the other hand, during the 34 months following the KORUS FTA's entry into force, the increase in imports due to the FTA was 8.44%, and this would be a significant factor in the increase of overall imports (10.77%), from the U.S. Imports from the U.S. of automobiles and parts (132.1%) and products of other manufacturing (16.77%) industries were also significantly affected by the KORUS FTA.

**Table 1. Composition of change in Exports and Imports in Korea-U.S. Trade**

(Unit: %)

Industries		Korea's Exports to the U.S.			Korea's Imports to the U.S.		
		Net Change	F/X Effect	KORUS FTA Effect	Net Change	F/X Effect	KORUS FTA Effect
Agriculture, fisheries, and mining		15.36	-	96.01	△30.68	4.93	-
Manufacturing	Textiles	8.05	1.30	65.17	6.98	6.55	-
	Chemicals	32.65	-	8.49	16.29	3.88	-
	Metals	79.78	-	109.16	22.12	7.06	-
	Other machinery	36.73	-	63.39	13.90	5.13	-
	Electronics	△21.42	-	55.12	19.32	8.51	-
	Automobiles and parts	78.28	7.88	127.96	82.86	-	132.10
	Other manufacturing	23.47	1.91	2.85	8.96	4.22	16.77
<b>Total</b>		<b>31.54</b>	<b>0.86</b>	<b>82.40</b>	<b>10.77</b>	<b>4.45</b>	<b>8.44</b>

Note: '-' indicates estimations that showed no statistical significance.

Source: Calculated by the author based on sources from the Korea Customs and Trade Development Institute.

## (2) Changes In Export/Import Diversity and Utilization rate

Three years after the KORUS FTA came into effect, there are apparent signs of im-

provement with respect to Korea's export and import diversity. When Korea's trading products with the U.S. and those with the world were analyzed relative to the gamut

of trade products, it was found that the KORUS FTA contributed to the extensive margin of trade between Korea and the U.S., by effecting a 2.1% increase in the portion of exports to the U.S. and a 1.9% increase in the portion of imports from the U.S.

As the utilization rate of exports and imports improved in general, Korea's utilization rate with respect to imports from the U.S. is higher than the U.S. utilization rate for imports from Korea. Therefore, estimates show that Korean importers have made better use of the KORUS FTA compared to their counterparts in the U.S.

As for the utilization rate of the KORUS FTA, the analysis shows that the utilization rate of Korean imports was 60.7% (Jan.-Dec. 2014), which was higher than the export utilization

rate of 43.8% (Jan.-Dec. 2014), demonstrating that the KORUS FTA was more useful for imports from the U.S. (see Table 2 below). In particular, the KORUS FTA has recorded the highest increase in its utilization rate in the automobile and parts industry in 2014, in terms of imports from the U.S.

On the other hand, while the majority of industries showed higher utilization rates for Korean exports to the U.S. than imports from the U.S., the automobile and parts industry showed a particularly low rate of utilization for U.S. imports from Korea. This implies that the automobiles and parts sector has yet to see advantages from the price competitiveness expected from the preferential tariffs applied, when the products are exported to the U.S.

**Table 2. Utilization Rate of Preferential Tariff Application under the KORUS FTA**

(Unit: %)

Industries	Rate of Utilization for Korea's Imports from the U.S.			Rate of Utilization for U.S. Imports from Korea		
	Mar.-Dec. 2012	Mar.-Dec. 2013	Mar.-Dec. 2014	Mar.-Dec. 2012	Mar.-Dec. 2013	Mar.-Dec. 2014
Agriculture, fisheries, and mining	85.9	87.1	72.8	86.1	91.1	92.6
Manufacturing (total)	50.0	60.5	59.6	41.7	47.4	43.8
Textiles	39.9	48.2	52.6	62.3	62.8	62.2
Chemicals	59.9	75.4	76.2	77.3	88.6	90.0
Metals	43.1	44.5	38.0	64.8	73.4	75.9
Other machinery	29.8	35.7	30.9	65.8	75.6	74.2
Electronics	28.9	29.8	24.8	50.8	64.2	67.6
Automobiles and parts	50.0	80.6	83.1	19.4	23.9	20.8
Other manufacturing	52.0	60.8	63.0	48.0	53.8	53.4
<b>All industries</b>	<b>52.4</b>	<b>62.2</b>	<b>60.7</b>	<b>41.8</b>	<b>47.5</b>	<b>43.8</b>

Source: Calculated by the author based on sources from the Korea Customs and Trade Development Institute and USITC (<http://dataweb.usitc.gov/>).

### 3. Investment

The rate of FDI growth from the U.S. after the KORUS FTA effectuation is higher than that

from the world, meaning FTA performance has improved. Since the KORUS FTA entered into force (April 2012- Dec. 2014), FDI from the U.S. was 10.4 billion dollars and rose

sharply by 89.6% compared to the same time period in the previous year (5.5 billion dollars). However, as FDI from the world only in-

creased by 29.9%, the portion of FDI from the U.S. compared to overall FDI is expanding.

**Table 3. Trends of FDI Inflow to Korea after the KORUS FTA Effectuation**

(Unit: USD million dollars, %)

	1 <sup>st</sup> year of KORUS FTA		2 <sup>nd</sup> year of KORUS FTA		3 <sup>rd</sup> year of KORUS FTA	
	Pre- effectuation	Post- effectuation	Pre- effectuation	Post- effectuation	Pre- effectuation	Post- effectuation
	04.11-12.11	04.12-12.12	04.10-12.11	01.12-12.13	04.09-12.11	04.12-12.14
Gross FDI	11,668	13,940 (19.5)	25,205	28,488 (13.0)	36,553	47,491 (29.9)
FDI from the U.S.	1,904	3,247 (70.5)	4,306	6,773 (57.3)	5,475	10,382 (89.6)
Proportion	16.3	23.3	17.1	23.8	15.0	21.9

Notes: 1) '( )' indicates percentage change compared to the same period of the previous year.

2) Proportion refers to the proportion of FDI from the U.S. compared to gross FDI.

Source: FDI statistics, Ministry of Trade, Industry and Energy.

FDI from the U.S. stabilized after a sharp increase following FTA effectuation, and likewise, overall FDI inflow has also increased. Immediately following the effectuation of the KORUS FTA (April-Dec. 2012), investment from the U.S. to Korea rose to 3.2 billion dol-

lars, and has held steady afterward, at 3.5 billion dollars in 2013 and 3.6 billion dollars in 2014. However, overall FDI grew 30.6%, from 14.5 billion dollars in 2013 to 19.0 billion dollars in 2014.

**Table 4. Korea's Inward FDI Trends**

(Unit: USD million dollars, %)

	2009	2010	2011	2012	April-Dec.	2013	2014
Gross FDI	11,484 (-1.9)	13,073 (13.8)	13,673 (4.6)	16,286 (19.1)	13,940 (19.5)	14,548 (-10.7)	19,003 (30.6)
FDI from the U.S.	1,486 (11.9)	1,975 (32.8)	2,372 (20.1)	3,674 (54.9)	3,247 (70.5)	3,525 (-4.0)	3,609 (2.4)
Proportion	12.9	15.1	17.3	22.6	23.3	24.2	19.0

Notes: 1) '( )' indicates percentage change compared to the same period of the previous year.

2) Proportion refers to the proportion of FDI from the U.S. compared to gross FDI.

Source: FDI statistics, Ministry of Trade, Industry and Energy.

Major sectors in terms of FDI inflow from the U.S. after the KORUS FTA came into effect would be transport vehicles and business services, from the manufacturing and services

sectors respectively. FDI from the U.S. in manufacturing grew to 3.25 billion dollars (an increase of 77.9% relative to the same period of the previous year) since the FTA entered

into force. Especially, FDI from the U.S. in transport vehicles was 44 million dollars before the FTA but has increased to 1.71 billion dollars (an increase of 3,790% compared to the same period of the previous year) after the FTA in spite of the decrease in overall FDI to transport vehicles by 24.4%.

Moreover, FDI from the U.S. in services jumped to 6.51 billion dollars (an increase of 79.1% compared to the same period of the previous year) since the FTA entered into force. In the case of business services, invest-

ment from the U.S. was 340 million dollars before the FTA but has risen 455% after its effectuation, specifically to 1.88 billion dollars, despite the increase of only 136% in overall FDI.

In addition, the real estate industry received 1.73 billion dollars in FDI from the U.S. before the FTA, which increased to 2.6 billion dollars (increase of 50.1% relative to the same period of the previous year) after effectuation, though overall FDI of business services only grew by 27.7%.

**Table 5. Korea's FDI from the U.S. by Industry**

(Unit: USD million dollars, %)

Industries		World's FDI			U.S. FDI		
		Before FTA	After FTA	△Percentage	Before FTA	After FTA	△Percentage
		04.09-12.11	04.12-12.14	04.12-12.14	04.09-12.11	04.12-12.14	04.12-12.14
All industries		36,553	47,491	29.9	5,475	10,382	89.6
Agriculture, fisheries, and mining		75	26	-65.6	1		-99.5
Manufacturing	Manufacturing (total)	15,129	16,915	11.8	1,828	3,252	77.9
	Textiles	90	395	340.7	2	13	482.1
	Chemicals	3,711	5,370	44.7	273	597	119.0
	Metals	1,232	687	-44.3	17	214	1,180.5
	Other machinery	1,057	1,531	44.9	70	229	224.6
	Electronics	4,424	2,055	-53.5	1,233	312	-74.7
	Transport Vehicles	3,417	2,584	-24.4	44	1,709	3,790.3
	Other manufacturing	1,198	4,292	258.1	190	179	-5.9
Services	Services (total)	20,409	29,802	46.0	3,637	6,514	79.1
	Wholesale, Retail	4,609	2,688	-41.7	162	357	119.6
	Transport, Food, Lodging	958	3,077	221.2	44	507	1,062.8
	Finance, insurance	3,752	6,674	77.9	641	1,035	61.5
	Real Estate	5,476	6,991	27.7	1,732	2,601	50.1
	Business Services	4,054	9,593	136.6	339	1,881	455.4
	Other Services	1,560	780	-50.0	718	133	-81.5
Electricity, Gas, Water, Construction		940	748	-20.4	9	615	6,752.7

Notes: 1) FDI volumes since the KORUS FTA effectuation are calculated for the period of April 2012 - December 2013.

2) Blank cells indicate no investment or investment of less than USD 1 million.

Source: FDI statistics, Ministry of Trade, Industry and Energy.

## 4. Legal Issues

### (1) Overall

Korea has faithfully implemented the FTA by revising all relevant domestic laws, with a few exceptions which are currently in their 2<sup>nd</sup> or 3<sup>rd</sup> phase of liberalization, all expected to be completed by 2017. Wendy Cutler, the former chief negotiator for the U.S. in the KORUS FTA negotiations, expressed her satisfaction in 2013. The current status was also highly regarded by the USTR in the 2014 National Trade Estimate Report, which stated that the KORUS FTA has improved Korea's investment environment.

### (2) Proposed Automotive Regulation

Korea reduced its tariffs on US-built passenger vehicles and also simplified its tariff categories. So far, U.S. automakers have not expressed any complaints regarding Korea's implementation. The government of Korea proposed a new regulation on auto sales as an incentive for consumers purchasing cars with lower greenhouse gas emission levels. This incentive system is also known as the Korean version of the "bonus-malus" system of France. The U.S. raised concerns regarding the incentive system by mentioning the possibility of the system violating the spirit of the KORUS FTA. In September 2014, Korea postponed enforcing the incentive system until the end of 2020, due to the heavy burden caused by the system on Korea's domestic industries. This issue has not been settled and remains dormant at present. The Korean Ministry of Environment argues that the regulated objects and measures are irrelevant to the FTA, and therefore do not come in conflict with the spirit of the FTA. Constant bilateral discussions are required in the event that new and relevant issues are raised.

### (3) Origin Verification

U.S. exporters complained that the Korea Customs Service (KCS) requires excessive documentation, and that this undermines the effectiveness of the FTA by eliminating U.S. exporters' tariff benefits on frozen concentrated orange juice, cars, chemicals, and other products. As for frozen concentrated orange juice, the KCS conducted on-the-spot investigation in the U.S. and decided to accept the certificate of origin issued by the U.S. government. With regard to cars, U.S. exporters expressed concerns as the KCS preliminary ruling found US-exported Toyota automobiles did not meet what was stipulated in the Agreement of the KORUS FTA rules of origin. However, the issue has been resolved as the automobiles were accepted as U.S. products at the stage of its final ruling. Similar issues are expected in the future, thus necessitating preparations.

### (4) Pharmaceutical Patent Linkage

An agreement was reached during the KORUS FTA negotiations to implement a patent linkage system on pharmaceutical drugs. Accordingly, Korea amended its pharmaceutical affairs law in 2001 by introducing the 'notification' system. Korea's National Assembly passed the law to regulate and prevent the marketing of patented drugs on March 5<sup>th</sup> 2015, thus settling a contentious issue related to the execution of the agreement. It is unlikely that the pharmaceutical patent linkage will raise any concerns henceforth, as the U.S. has not presented any particular objections regarding the execution.

### (5) Price Reduction Policy of Pharmaceuticals

Since 2006, Korea has reinforced a series of policies to lower the price of pharmaceuticals, which led to decreases in the proportion of



pharmaceuticals in total medical expenses. The policies resulted in the reduction of the national health insurance expenditure. USTR demanded a reform of such policies as they lack consideration of stakeholders' profits. Thus, additional conditions are being reviewed. Revision of these policies is recommended, to put to rest questions as to whether such policies violate FTA duties.

### **(6) Financial Data Transfer**

During the KORUS FTA negotiations, Korea and the U.S. agreed to allow the off-shore transfer of financial data two years after FTA implementation, and Korea is establishing relevant regulations in connection with the agreement. The U.S. argued that the Korean Financial Services Commission (FSC) has a low rate of acceptance for applications while the application process itself is complicated and slow. The U.S. also voiced concerns over the possibility of abuse of discretionary power by the Korean government. In conclusion, both countries have agreed to conduct quarterly reviews on its commitments.

### **(7) Express Delivery Packages**

The KORUS FTA agreed on exempting taxes and formal entry documents for express delivery packages under \$200 in value. However, the U.S. raised objections claiming that the KCS has restricted the entry of some express delivery packages, such as items that are purchased online, which may slow down shipments. Measures for a smoother customs clearance process are currently being negotiated.

### **(8) Certification System for Processed Organic Food**

Although this was not a topic for KORUS FTA negotiations, Korea modified various related laws and regulations. The organic

equivalency arrangement for processed organic food was signed on June 30th, 2014 and was implemented on July 1st in the same year. However, friction arose between the two sides during discussions on permitting GMO ingredients. The discussion was settled with a conclusion to ban the usage of GMO in the production and handling of processed organic food. The U.S. deemed that the equivalency arrangement has reduced unnecessary trade barriers. Nonetheless, it can be anticipated that the U.S. may demand further relaxation of regulations regarding GMO in the future.

## **5. Conclusion**

March 15, 2015 marks the third year since the entry into force of the KORUS FTA. The effect of the FTA has been positive in trade and investment. During the 34 months since its entry into force, Korea saw an increase of 31.54% in exports to and 10.77% in imports from the U.S. The effect of the trade increase under the KORUS FTA was 82.4% for exports and 8.44% for imports. In analyzing the portion of Korean trading products with the U.S. in overall trade products, the KORUS FTA was considered as to have contributed not only to the intensive margin, but also the extensive margin, with a 2.1% increase in the portion of exports to the U.S. and a 1.9% increase in the portion of imports from the U.S.

Although the utilization rate has increased after FTA effectuation, the rate for exports was 43.8% and that of imports was 60.7% in 2014. In order to overcome the severe deviation in industrial impact, we need to find a solution involving active utilization in industries that were insufficiently affected by the KORUS FTA. There should therefore be an attempt to improve the environment for appropriate FTA application to mitigate this deviation.

tion.

Continuous monitoring is necessary from the present moment on. There are differences in the two countries' perspectives concerning the contents and levels of implementation, and newly imposed measures by Korea could become problematic with respect to KORUS FTA implementation.

Issues such as origin verification, express delivery packages and financial data transfer also

reveal the divergence of views between Korea and the U.S. Detailed regulations or specific agreements are called for.

A close review is also required for newly enforced measures in Korea, including the incentive-penalty system based on automobile emission figures, policies to reduce the price of pharmaceuticals and the verification system for processed organic food, to verify whether or not these measures are consistent with the KORUS FTA's objective and purpose. **KIEP**