



# The EU-South Korea Free Trade Agreement and Its Implications for the United States

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## Summary

On October 6, 2010, the 27 member European Union (EU) and South Korea signed a bilateral free trade agreement (FTA). The agreement is expected to go into effect on July 1, 2011, pending approval by the European Parliament and the South Korean National Assembly. If enacted, the South Korea-EU FTA (KOREU FTA) would be the largest FTA in terms of market size that South Korea has entered into. The KOREU FTA reflects the EU and South Korean trade strategies to use FTAs to strengthen economic ties outside their home regions. It also builds upon the surge in trade and investment flows between South Korea and the EU over the past decade. This agreement has possible implications for U.S. trade with South Korea and congressional action on the proposed U.S.-South Korea FTA (KORUS FTA).

The proposed KOREU FTA is very comprehensive. It would reduce and eliminate tariffs and other trade barriers in manufactured goods, agricultural products and services and would also cover such trade-related activities as government procurement, intellectual property rights, labor rights and environmental issues.

Most studies done on the potential impact of the KOREU FTA estimate that the agreement will have a small but positive effect on the economies of the EU and South Korea as a whole and that the larger *relative* impact would be on the South Korean economy. The greatest economic impact of the KOREU FTA would be on specific sectors in each economy. EU services providers would be expected to experience gains from the agreement, especially in the areas of retail and wholesale trade, transportation services, financial services, and business services. In terms of trade in goods, EU exporters of pharmaceuticals, auto parts, industrial machinery, electronics parts, and some agricultural goods and processed foods would be expected to gain from the KOREU FTA's implementation. At the same time, South Korean manufacturers of cars, ships, wireless telecommunications devices, chemical products, and imaging equipment would be expected to increase their exports to the EU market.

The KOREU FTA is similar to the proposed KORUS FTA in many respects. Both agreements are comprehensive and both would eliminate tariffs on most trade in goods soon after they enter into force. However, they differ in other respects. Phase-out periods for tariffs on some manufactured goods differ. In addition, the KOREU FTA does not cover foreign direct investment. Unlike the KORUS FTA, the KOREU FTA would not allow trade sanctions to be applied where violations of the workers' rights, and environment provisions have been deemed to occur. In addition, the KORUS FTA would cover a broader range of trade in services than would the KOREU FTA. It is not clear whether these differences in the structures of the FTAs would result in appreciable differences in outcomes in terms of economic gains and losses.

U.S. and European firms are close competitors in a number of sectors and industries, particularly autos. Some business representatives argue that enactment of the KOREU FTA before enactment of the KORUS FTA would give European competitors commercial first mover advantages, since EU firms, such as those in the auto industry or the services sector, could gain greater market opportunities in South Korea not afforded to U.S. firms. On the other hand, other factors could also mitigate such advantages. For example, U.S. multinational firms operating in the EU could benefit from the KOREU FTA. Nevertheless, the content and fate of the KOREU FTA could influence the pace and tone of any debate in the United States on the KORUS FTA in the 112<sup>th</sup> Congress.



## Contents

Introduction .....	1
EU-South Korean Economic Ties .....	2
Merchandise Trade.....	2
Trade in Commercial Services and FDI Flows.....	4
The KOREU FTA and EU and South Korean Trade Strategies.....	5
South Korea’s Strategy.....	6
An Overview and Key Provisions of the KOREU FTA.....	6
Trade in Manufactured Goods .....	7
Auto Trade.....	7
Other Manufactured Goods .....	11
Cross-Cutting Manufactured Goods Provisions .....	12
Agriculture.....	13
Market Access for Agricultural Products .....	13
Sanitary and Phytosanitary Commitments .....	14
Geographical Indications for Agricultural Products .....	15
Services Trade.....	15
Other Provisions .....	17
Trade Remedies .....	17
Government Procurement.....	18
Intellectual Property Rights .....	18
Trade and Sustainable Development—Labor and Environmental Standards.....	19
Potential Economic Impact of the KOREU FTA.....	19
Next Steps—Ratification.....	20
Potential Implications of the KOREU FTA for the United States.....	21

## Figures

Figure 1. EU and U.S. Total Merchandise Trade with South Korea, 2000-2009.....	3
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## Tables

Table 1. Relative Importance of EU and U.S. to South Korea .....	4
Table 2. Comparison of Automobile Tariff Reductions.....	9
Table A-1. Selected Economic and Tariff Indicators for European Union, United States, and South Korea, 2009.....	24
Table A-2. EU and U.S. Trade with South Korea, 2009.....	25
Table A-3. EU FTAs Since 2006.....	26
Table A-4. South Korea’s FTAs .....	27

## **Appendixes**

Appendix. Selected Economic Indicators, Tariff, and Trade Tables ..... 24

## **Contacts**

Author Contact Information ..... 27

## Introduction

After more than two years of negotiations, the European Union (EU) and South Korea signed a bilateral free trade agreement (FTA) on October 6, 2010. The agreement is expected to go into effect provisionally on July 1, 2011, pending approval by the European Parliament and the South Korean National Assembly. If enacted, the South Korea-EU FTA (KOREU FTA) would be the largest FTA in terms of market size that South Korea has entered into. The proposed U.S.-South Korea FTA (KORUS FTA) would be South Korea's second largest if approved. The KOREU FTA reflects the EU and South Korean trade strategies to use FTAs to strengthen economic ties outside their home regions. It also builds upon the surge in trade and investment flows between South Korea and the EU over the past decade, a period of time in which the 27 member states of the EU countries collectively passed the United States in economic importance to South Korea.<sup>1</sup>

The proposed KOREU FTA is very comprehensive, generally mirroring the scope of the KORUS FTA, with some exceptions. As with the KORUS FTA, the KOREU FTA would reduce and eliminate tariffs and other trade barriers in manufactured goods, agricultural products, and services and would also cover such trade-related activities as government procurement, intellectual property rights, labor rights, and environmental issues. However, the two agreements contain some basic differences in coverage, reflecting differing circumstances and priorities. For example, unlike the KORUS FTA, the KOREU FTA does not include a specific chapter on foreign direct investment,<sup>2</sup> and would not allow trade sanctions to be applied where violations of the labor and environment provisions have taken place. Differences also exist in how sensitive sectors such as automobiles are treated. For example, the KOREU FTA includes a duty drawback mechanism<sup>3</sup>, while the KORUS FTA has added a special safeguard for motor vehicles in the event of a surge in South Korean automobile exports to the United States.

The KORUS FTA was signed on June 30, 2007, but has not been submitted by the Obama Administration to Congress for consideration, due in part to opposition of some members of Congress to taking it up until their concerns over South Korea's restrictive treatment of imports of U.S.-made cars and U.S. beef and some other issues are resolved. On December 3, 2010, President Obama announced that cabinet-level negotiations and his discussions with South Korean President Lee Myung-bak produced modifications in the KORUS FTA that he believes addresses his concerns and those of Congress. The President is expected to send implementing legislation early in the 112<sup>th</sup> Congress.

The KOREU FTA has drawn the attention and interest of U.S. policymakers, including members of Congress and the U.S. business community. If enacted, the KOREU FTA could have an impact on U.S.-South Korean trade by possibly diverting some South Korean trade away from the United States to the EU and could provide the EU with a "first mover" advantage. The agreement,

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<sup>1</sup> The 27 member states of the EU are Austria, Belgium, Bulgaria, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom.

<sup>2</sup> However, South Korea has bilateral investment treaties with 20 EU member states: Austria; Belgium; Czech Republic; Denmark; Finland; France; Germany; Greece; Hungary; Italy; Latvia; Lithuania; Netherlands; Poland; Portugal; Romania; Slovakia; Spain; Sweden; and the United Kingdom.

<sup>3</sup> Duty drawback permits the refund of duties paid on parts used for the production of a final product to be refunded when the final product is exported.

particularly if it goes into effect on July 1, 2011, could also influence the pace and timing of the congressional debate on the proposed KORUS FTA in the 112<sup>th</sup> Congress.

This report is designed to shed some light on the KOREU FTA for Congress.<sup>4</sup> It briefly reviews EU-South Korean economic ties and the respective EU and South Korean objectives regarding the KOREU FTA. It then discusses the KOREU FTA in general and examines some of its major provisions in more detail, with special focus on autos and some other manufacturing sectors, agriculture, services, and labor—areas of particular interest to U.S. policymakers and the U.S. business community. The report does not attempt to determine if one FTA is better than the other. That determination can largely be subjective, since the priorities of the EU and the United States differed in some respects. In addition, the models used in measuring the quantifiable effects of the two agreements likely differ leading to incompatible measurements. Nevertheless, where possible and relevant, the report draws general comparisons and contrasts with the proposed KORUS FTA. Finally, the report analyzes the prospects for the KOREU FTA and the agreement's potential implications for the United States.

## EU-South Korean Economic Ties

Trade in goods and services and two-way foreign direct investment (FDI) are generally the most important aspects of the EU-South Korea relationship.<sup>5</sup>

### Merchandise Trade

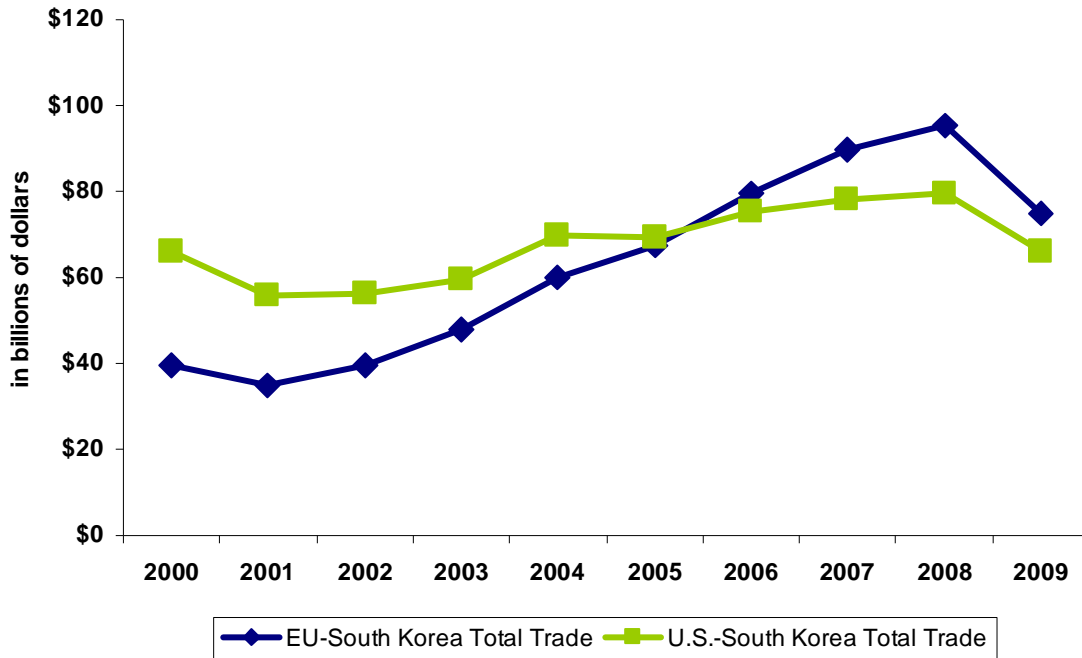
South Korea, with 48.6 million consumers and a gross domestic product (GDP) of \$1.4 trillion, is a much smaller market than either the U.S. or EU markets. In 2009, it accounted for 2% of EU merchandise exports, ranking 12<sup>th</sup> as an export market, and accounted 3% of EU merchandise imports, ranking 9<sup>th</sup> as a source of EU imports. On the other hand, the much larger EU market of 492 million people with a GDP of \$14.4 trillion is much more important to South Korea. In 2009, the EU was the second largest market for South Korean merchandise exports, with a 13% share of total South Korean exports, second to China with a 24% share. The EU was the third largest source of South Korean imports in 2009 with a 10% share of South Korean merchandise imports behind China with a 17% share and Japan with a 15% share. In contrast, the United States accounted for 10% of South Korean exports and 9% of South Korean imports. (See **Table 1**.) Over the last 10 years (2000-2009), EU-South Korean trade (exports plus imports) has increased an average of 8.4% per year and exceeds total U.S.-South Korea trade. (See **Figure 1**.) Among the EU-27 member countries, South Korea's largest trading partners are Germany, France, and the United Kingdom. (For additional comparative data, see tables in the **Appendix**)

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<sup>4</sup> The report supplements other CRS reports on the KORUS FTA, including CRS Report RL34330, *The Proposed U.S.-South Korea Free Trade Agreement (KORUS FTA): Provisions and Implications*, coordinated by William H. Cooper, CRS Report R41389, *Pending U.S. and EU Free Trade Agreements with South Korea: Possible Implications for Automobile and Other Manufacturing Industries*, by Michaela D. Platzer, and CRS Report RL34528, *U.S.-South Korea Beef Dispute: Issues and Status*, by Remy Jurenas and Mark E. Manyin. See also CRS Report R41544, *Trade Promotion Authority and the Korea Free Trade Agreement*, by Emily C. Barbour.

<sup>5</sup> In contrast to the 19<sup>th</sup> and early 20<sup>th</sup> centuries, when European colonial powers were formative influences in Northeast Asia, the EU and its members currently play somewhat secondary or tertiary roles in security issues on the Korean Peninsula and in East Asia. For instance, the EU is not a participant in the Six-Party Talks over North Korea's nuclear programs. However, it has supported the process diplomatically and financially. During the Korean War, ten European countries contributed to the United Nations' military forces that were deployed to assist South Korea.

Figure I. EU and U.S.Total Merchandise Trade with South Korea, 2000-2009



Source: Global Trade Atlas.

Note: Total trade is defined as exports plus imports.

Manufactured goods dominate EU-South Korean trade. In 2009, 80% of EU exports to South Korea consisted of manufactured goods. Within that category, 49% were of machinery and transportation equipment, 18% of chemical products, and 13% of other manufactured goods.<sup>6</sup> Similarly, in 2009, 87% of South Korean exports to the EU consisted of manufactured goods. Of that group, 72% were of machinery and transportation equipment, 10% were other manufactured goods, and 5% were of chemical products. The dominance of manufacturing in trade in both directions suggests the presence of intra-industry trade and reflects the existence of transnational production networks where various stages within a production cycle are performed in different countries before the final product is assembled, marketed, and sold.<sup>7</sup>

<sup>6</sup> The data were obtained from Eurostat.

<sup>7</sup> Intra-industry trade is the export and import of the same products or similar products within one industry. The products are distinguished by model, style, price, or other factors or by their place in the production process, for example, auto parts versus a fully assembled car. For more information on intra-industry trade and global supply chains see CRS Report R40167, *Globalized Supply Chains and U.S. Policy*, by Dick K. Nanto.



**Table I. Relative Importance of EU and U.S. to South Korea**

	EU	U.S.
Share of South Korean Merchandise Exports (2009)	13%	10%
Share of South Korean Merchandise Imports (2009)	10%	9%
Share of South Korean Inward FDI (2008)	32%	20%
Share of South Korean Outward FDI (2008)	10%	15%

Source: Derived from official South Korean data.

## Trade in Commercial Services and FDI Flows

EU-South Korean services trade has also increased over the years but still accounts for a small share (15.8% in 2008) of total bilateral trade.<sup>8</sup> EU exports of services to South Korea increased 42% between 2004 and 2008 (latest data available), and South Korean exports of services to the EU increased 36% during the same period.<sup>9</sup> Among the leading types of EU services exports to South Korea in 2008 were transportation services, business services, travel, receipts and royalties from the use of intellectual property, financial services, and construction. Leading South Korean services exports in 2008 to the EU included transportation, business services, travel, receipts and royalties, and insurance.<sup>10</sup>

Besides trade in goods and services, the EU and South Korea are building economic ties through foreign direct investment (FDI). From 2004 to 2007, the value of EU FDI in South Korea increased 62.8% before decreasing 10.8% in 2008, possibly a result of the global economic downturn. However, EU FDI in South Korea accounted for only 0.3% of total EU FDI in 2008 based on current value. South Korean FDI in the EU increased 80.4% from 2004 to 2007 before declining 20.6% in 2008. They accounted for about 0.1% of total FDI in the EU.<sup>11</sup> On the other hand, the EU is a significant source of FDI in South Korea. In 2008, it accounted for 32.3% of total FDI in South Korea, and as a group was the largest source of FDI in South Korea. The EU-27 also accounted for 10.3% of South Korean FDI abroad in 2008 and was the second largest target next to the United States.<sup>12</sup>

<sup>8</sup> CRS calculations based on data found in European Commission, DG Trade, *Bilateral Trade with South Korea*, September 15, 2010.

<sup>9</sup> The data were obtained from Eurostat and values were converted into dollars using prevailing exchange rates during the relevant years.

<sup>10</sup> WTO, *International Trade Statistics*, 2010, p.123-158.

<sup>11</sup> CRS calculations based on Eurostat data.

<sup>12</sup> CRS calculations based on official South Korean data as reported to the OECD.

## The KOREU FTA and EU and South Korean Trade Strategies

The KOREU FTA reflects the larger trade strategies that the EU and South Korea have pursued. Prior to the mid-2000s, both were reluctant to enter into bilateral FTAs, preferring to conduct trade through the World Trade Organization (WTO) and, in the case of the EU, through regional preferential trade arrangements with former colonies. However, over the last decade, they both have not only been negotiating FTAs, but have done so at an accelerated pace. (See **Table A-3** and **Table A-4** for lists of EU and South Korean FTAs.)

The EU was a pioneer in negotiating preferential trade arrangements (PTAs)—a general term applied to an arrangement in which member countries agree to eliminate barriers to commerce among them. The EU itself is a single market, one of the most comprehensive PTAs, but has also used PTAs to anchor trade relations with neighboring countries, such as members of the European Free Trade Area (EFTA—Iceland, Lichtenstein, Norway, and Switzerland) and as a transition mechanism in trade relations with countries slated to accede to the EU. The EU has also employed PTAs to preserve preferential trade relationships with former colonies among developing countries. However, the EU imposed a moratorium on the formation of FTAs and other PTAs from 1999-2006 to focus attention on the Doha Development Agenda (DDA) negotiations.<sup>13</sup>

The FTA with South Korea is part of a new wave of EU FTAs and part of an overall strategy—referred to as Global Europe—which the European Commission’s Directorate General for Trade announced in 2006. The strategy was developed to respond to the challenges faced by EU members in a rapidly globalizing economy. An objective of that strategy is to work towards reducing tariff and non-tariff barriers in trade and to liberalize markets for foreign investment. The EU also places a priority on multilateral negotiations in the WTO and concluding the DDA to accomplish this objective.

However, the EU also has determined that some barriers are currently too complex for multilateral negotiations or are otherwise beyond the purview of the WTO, for example, competition policy, regulatory issues, government procurement, and stronger intellectual property rights enforcement. As part of the Global Europe strategy, the EU has engaged in FTA negotiations with the objective that the FTAs are more appropriate vehicles to address these more complex issues and can serve as building blocks toward a more robust multilateral trading system. The Global Europe strategy sets down two main criteria for selecting FTA partners: (1) that the partner country offers sufficient market potential and (2) a sufficient level of growth opportunities that would result from the removal of tariff and non-tariff barriers as a result of the FTA. Based on these criteria, along with the fact that South Korea had negotiated an agreement with the United States (a chief EU competitor) the European Commission identified South Korea as a priority country for an FTA.<sup>14</sup> The EU has FTAs in force with Chile and Mexico and has been

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<sup>13</sup> For an analysis of the European Union’s FTAs in the context of its trade strategy, see CRS Report R41143, *Europe’s Preferential Trade Agreements: Status, Content, and Implications*, by Raymond J. Ahearn.

<sup>14</sup> European Commission Directorate-General for Trade, *Global Europe: Competing in the World*, 2006, pp. 10-11.

negotiating FTAs with Canada, India, and South Africa. (See **Table A-3.**)<sup>15</sup> The KOREU FTA would be the EU's first completed FTA in Asia.

## **South Korea's Strategy**

For nearly a decade, South Korea has been transforming itself into an FTA hub in Northeast Asia. (See **Table A-4.**)<sup>16</sup> Signing a network of FTAs has been a key part of the national economic strategy of President Lee Myung-bak, a conservative, and his predecessor, the left-of-center Roh Moo-hyun. Both presented FTAs as necessary for advancing South Korea's economic well-being. Ongoing competitive pressure from Japanese firms, increased competition from Chinese enterprises, and the rapid ageing of the South Korean workforce have heightened the sense of urgency about boosting national competitiveness. President Lee has set a goal of building a "free-trade network" that by 2014 would enable over 70% of South Korean exports to enjoy duty free access. He has explicitly tried to diversify the composition of South Korea's FTA partners, simultaneously negotiating FTAs with large advanced economies as well as with natural resource-rich developing countries.<sup>17</sup> The KOREU FTA also fits into Lee's goal of creating a "Global Korea" by expanding South Korea's engagement with and presence in the international community.

## **An Overview and Key Provisions of the KOREU FTA**

Similar to the KORUS FTA, the KOREU FTA is a comprehensive pact that covers the broad range of economic activities in the EU-South Korean bilateral economic relationship. The KOREU FTA is organized into 15 chapters plus special sector specific annexes, which cover automotive products, pharmaceuticals, chemicals, and consumer electronics. If enacted, the KOREU FTA would eliminate tariffs on virtually all manufactured goods in South Korea-EU bilateral trade within seven years and would reduce or eliminate many nontariff barriers (NTBs). The agreement would also establish rules and procedures in trade in goods and services and would address trade-related activities pertaining to intellectual property rights (IPR), labor rights, and environmental protection.

Similar to the objectives of the KORUS FTA, the provisions in the pending KOREU FTA are intended to boost goods and services exports from the EU to South Korea by eliminating South Korean import duties and other barriers to trade in industries from autos and pharmaceuticals to

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<sup>15</sup> CRS Report R41143, *Europe's Preferential Trade Agreements: Status, Content, and Implications*.

<sup>16</sup> In addition to completing FTA negotiations with the EU and United States, South Korea has entered into FTAs with Chile, Singapore, European Free Trade Area (EFTA), the Association of Southeast Asian Nations (ASEAN), and India and has just concluded an agreement with Peru. ASEAN is comprised of Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar (Burma), Philippines, Singapore, Thailand, and Vietnam. South Korea continues to negotiate FTAs with Canada, Mexico, Australia, New Zealand, Peru, Colombia, and Turkey and is considering FTA negotiations with China, Japan, (as well as a South Korea-China-Japan trilateral arrangement), MERCOSUR, Russia, Israel, and the South African Customs Union (SACU).

<sup>17</sup> Office of the [South Korean] President, *Global Korea. The National Security Strategy of the Republic of Korea*, June 2009, p.29; South Korean Ministry of Foreign Affairs and Trade, "Building [sic] Global FTA Network," in *2009 Diplomatic White Paper*.

consumer electronics and textiles and apparel. Exports from South Korea to the EU might increase in various manufacturing sectors but are not expected to surge since many EU tariffs are already relatively low and the EU's NTBs are for the most part not as significant as in South Korea. The KOREU FTA also is intended to increase FDI flows between the two partners, especially EU investment in South Korea.

The following discussion provides an overview of the KOREU FTA as a whole but also focuses on possible areas of particular importance with implications for the ongoing debate in the United States over the future of the proposed KORUS FTA. These areas include trade in certain manufactured goods sectors (the automobile sector in particular), agricultural products, and services, and issues pertaining to IPR, worker rights and environmental protection. Where feasible and appropriate, the following discussion includes references to and comparisons of the KOREU FTA with relevant provisions of the KORUS FTA.

## **Trade in Manufactured Goods**

A major portion of South Korea-EU trade in both directions is in manufactured goods. Thus, an important element of the KOREU FTA consists of the removal of tariffs and NTBs on manufactured goods. In negotiating their respective FTAs with South Korea, the United States and the EU worked to ensure that provisions in their agreements responded to concerns expressed by those vocal constituencies about free trade and imports (e.g., the U.S. and EU automotive sectors).

### **Auto Trade**

- Bilateral trade in cars has been a major point of contention in EU-South Korea trade relations and consequently a major sticking point in negotiations on the KOREU FTA, as has been the case in the KORUS FTA. The sensitivity of the issue has only grown as South Korea has become a major producer and exporter of cars in competition with European manufacturers of cars, especially smaller cars, and has attained expanding shares of the European market for passenger cars.<sup>18</sup>
- During the negotiations, South Korea sought to obtain the elimination of EU tariffs on imports of South Korean cars in order to increase their market share. The EU sought not only the elimination of South Korean tariffs on cars but also changes in regulations, including safety and emissions regulations, that EU manufacturers have complained are discriminatory and impede their access to the South Korean market, an issue that U.S. manufacturers constantly cite, that is addressed in the KORUS FTA.

### ***Tariff Elimination on Passenger Cars and Trucks***

As shown in **Table 2**, under the KOREU FTA, if enacted, the EU and South Korea would eliminate all of their tariffs on passenger cars and trucks over five years, including tariffs on

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<sup>18</sup> For more details about the South Korean automotive market see CRS Report R41389, *Pending U.S. and EU Free Trade Agreements with South Korea: Possible Implications for Automobile and Other Manufacturing Industries*, by Michaela D. Platzer.

electric vehicles. Their respective tariffs on auto parts—8% for South Korea and 3% to 4.5% for the EU—would be immediately removed.

The 2007 KORUS FTA would have eliminated their respective passenger car tariffs more quickly than under the KOREU FTA upon implementation. But the 2010 supplemental agreement changed the original terms of the KORUS FTA.<sup>19</sup> It now puts the U.S. and EU on roughly the same tariff elimination schedule, rather than abolishing them immediately. For instance, South Korea would eliminate its 8% tariff on U.S. passenger cars (including electric cars and plug-in hybrids) within five years following implementation. One exception is the U.S. truck tariff of 25% which would remain for the first eight years following implementation and would then be phased out completely in year ten.

Another difference is the 2010 KORUS FTA agreement added a special motor vehicle safeguard whereas the KOREU FTA offers protection in case of a sudden surge in imports via a general safeguard clause. The two agreements also diverge on rules of origin, which are used to verify that products are eligible for duty-free status under preferential trading programs. The KORUS FTA requires that 35% of the content in an automobile originates in either the United States or South Korea, while the KOREU FTA requires that 55% of the content be from either the EU or South Korea.

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<sup>19</sup> White House, *Increasing U.S. Auto Exports and Growing U.S. Auto Jobs Through the U.S.-Korea Trade Agreement*, December 3, 2010, [http://www.whitehouse.gov/sites/default/files/fact\\_sheet\\_increasing\\_us\\_auto\\_exports\\_us\\_korea\\_free\\_trade\\_agreement.pdf](http://www.whitehouse.gov/sites/default/files/fact_sheet_increasing_us_auto_exports_us_korea_free_trade_agreement.pdf).

**Table 2. Comparison of Automobile Tariff Reductions**

Proposed Tariff Reduction Commitments and Time Frame for Tariff Elimination under the Proposed KORUS FTA and KOREU FTA

	South Korea		European Union		United States	
	Current Base Tariff Rate	Time Frame	Current Base Tariff Rate	Time Frame	Current Base Tariff Rate	Time Frame
Passenger Cars	8%	KORUS FTA: Reduce tariff from 8% to 4% immediately and fully eliminate the tariff in year 5.  KOREU FTA: Eliminated over 3 or 5 years depending on engine size.	10%	KOREU FTA: Eliminated over 3 or 5 years depending on engine size. <sup>a</sup>	2.5%	KORUS FTA: Eliminated in year 5 (no linear phase-out).
Electric Vehicles/Plug-in Hybrid Vehicles <sup>b</sup>	8%	KORUS FTA: Reduce tariff to 4% immediately and fully eliminate by year 5.  KOREU FTA: Eliminated over 5 years.	10%	KOREU FTA: Eliminated over 5 years.	2.5%	KORUS FTA: Eliminated over 5 years.
Trucks <sup>c</sup>	10%	KORUS FTA: Eliminated immediately.  KOREU FTA: Eliminated immediately or 3 to 5 years depending on truck size.	22%	KOREU FTA: Eliminated over 3 or 5 years depending on truck size.	25%	KORUS FTA: Remains in place until year 8 and phased out by year 10.

**Source:** CRS, compiled from South Korean, EU, and U.S. Tariff Schedules.

- a. The European Union 10% tariff would be phased out over three years for some passenger vehicles that fall into certain HTS codes like passenger vehicles with engines over 3,000 cc (HTS 8703.24) or five years for smaller cars: cars with engines over 1,000 cc, but not over 1,500 cc (HTS 8703.22). South Korea would also eliminate its tariffs over three to five years, depending on engine size.
- b. Not all hybrid vehicles are covered by this category. Vehicles in this tariff classification are those in which the gas- or diesel-powered engine “does not give the vehicle’s power system its essential character,” which in the case of South Korea include electric vehicles (HSK 8703.90.70) and Other Vehicles (HSK 8703.90.90).
- c. Tariffs on trucks apply to “motor vehicles for the transport of goods,” which basically cover pickup trucks, panel vans, and commercial vehicles. Trucks are categorized by gross vehicles weight (GVW) and by engine type (gas or diesel) but not by engine size. Many light trucks (i.e., SUVs and minivans) are counted as passenger cars.

### ***Duty Drawback***

One of the more controversial provisions of the KOREU FTA is a duty drawback mechanism. Duty drawback allows an exporter to receive a rebate of any customs duties paid on imports that were integrated into the exported product. The KOREU FTA marks the first time the EU included such a provision in a bilateral or multilateral trading agreement.<sup>20</sup>

Duty drawback may be particularly important for automotive exports. Under this procedure, a South Korean car manufacturer could buy auto parts from manufacturers in low-cost countries such as China, import them into South Korea, and claim the duties back when the assembled vehicles are shipped to the European Union. As an example, Chinese radios could enter the EU duty-free as part of South Korean cars, whereas EU companies pay a 14% tariff when importing the same radios directly from China.

This duty drawback provision raises the question of whether the KOREU FTA will allow South Korean producers to relocate parts of their production chain to lower cost countries. European auto manufacturers have warned that the text could open the EU car market to autos with a significant percentage of Chinese components. The KOREU FTA includes a provision to permanently cap refundable tariffs at 5% should there be a “notable increase” in foreign sourcing by South Korean manufacturers starting five years after the agreement goes into effect, but the European Automobile Manufacturers’ Association has nonetheless strongly opposed the inclusion of the duty drawback provision in the KOREU FTA. No explicit reference to duty drawback is included in the KORUS FTA and therefore the practice with no accompanying safeguards would be allowed.

### ***Safety and Environmental Automotive Standards***

South Korea is a relatively small market for autos, with domestic sales of 1.2 million passenger cars in 2010.<sup>21</sup> Foreign manufacturers wishing to sell in this market must meet South Korea’s safety and environmental standards. This means foreign, including European and U.S., automakers must customize their vehicles for the South Korean market, which, these automakers claim, raises their costs and discourages imports. (Fewer than 61,000 foreign automobiles were sold in South Korea in 2009). U.S. car manufacturers, particularly Ford, consider South Korea’s unique automobile standards a significant barrier to imports of U.S.-made cars to South Korea. Standards-related issues have been an important factor in holding up further consideration of the agreement in Congress.

EU negotiators also made automotive standards a priority in the negotiations on the KOREU FTA. NTB reforms on automotive trade include a regulatory convergence approach based on the United Nations Economic Commission for Europe (UNECE) standards,<sup>22</sup> which commits South

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<sup>20</sup> The mechanics of the KOREU FTA duty drawback provision are covered in Protocol 1: Rules of Origin, Title IV, Article 14: Drawback of, or Exemption From, Customs Duties in the KOREU FTA, which can be found on the European Commission’s website, EU-Korea Free Trade Agreement online, <http://trade.ec.europa.eu/doclib/press/index.cfm?id=443&serie=273&langId=en>.

<sup>21</sup> Korea Automobile Manufacturers Association, *Reports & Statistics*, [http://www.kama.or.kr/eng/R&s/Rsoften\\_e?key=Production](http://www.kama.or.kr/eng/R&s/Rsoften_e?key=Production).

<sup>22</sup> The World Forum for the Harmonization of Vehicle Regulations is a working party (WP.29) of the United Nations Economic Commission for Europe. Its aims to develop harmonized motor vehicle regulations worldwide covering vehicle safety, environmental standards, energy efficiency and anti-theft performance. Neither the United States nor (continued...)

Korea to recognize as equivalents international automotive standards set upon implementation of the KOREU FTA.<sup>23</sup> Another 29 safety standards related to such things as seat belts, passenger seats, headlamps, and rearview mirrors will be brought into line with UNECE standards over a five-year transitional period. All other standards not subject to harmonization or equivalence should be applied in a manner which does not limit market access. Any new standards would be based on UNECE standards, and going forward the KOREU FTA states new features and technologies should not hinder trade.<sup>24</sup>

The KORUS FTA takes a different approach and includes a “low volume seller exemption” which would allow each U.S. automaker to sell up to 25,000 vehicles per year in South Korea built to U.S. safety standards without any additional modification.<sup>25</sup> This is four times the level permitted in the 2007 KORUS FTA which would have limited each U.S. automaker to 6,500 vehicles per year. Raising the level means U.S. carmakers will be able to build more cars to U.S. safety standards and export these automobiles to the smaller South Korea market without incurring any additional costs that alterations and adjustments to South Korean standards would require.

The KOREU FTA, like the KORUS FTA, includes provisions on auto emissions standards and both would establish a working group on motor vehicles and parts to serve as an early warning system for potential trade barriers related to testing and certification standards and the implementation of future standards on requirements related to autos, particularly automotive environmental standards.

## **Other Manufactured Goods**

Of particular interest to EU manufacturers (and to U.S. manufacturers) is the KOREU FTA's coverage of the following industries.

- **Pharmaceuticals and medical devices:** Many of South Korea's tariffs on imports of pharmaceutical products of 8% are to be phased out immediately upon implementation of the KOREU FTA; others will be eliminated within three years. Tariffs on medical device exports would also be removed—immediately for many products, phased in over three years for others, and over a longer period of time for a few selected products. The two pending FTAs tackle NTBs, as they are among the most important barriers to trade in pharmaceutical products and medical devices. The KOREU FTA also specifically provides that the South Korean authorities will introduce new rules to align their practices with international standards and a more secure regulatory environment will be introduced through a better recognition of the value of innovative products. In

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(...continued)

Canada recognizes UNECE motor vehicle standards.

<sup>23</sup> The automotive standards are listed in Appendix 2-C-3 and cover such things as steering control, seating systems, head restraints, sun visor impact, and lighting and signaling systems, see [http://trade.ec.europa.eu/doclib/docs/2009/october/tradoc\\_145157.pdf](http://trade.ec.europa.eu/doclib/docs/2009/october/tradoc_145157.pdf).

<sup>24</sup> European Commission, DG Trade, *EU-Korea FTA: A Quick Reading Guide*, October 20, 2009, p. 3. [http://trade.ec.europa.eu/doclib/docs/2009/october/tradoc\\_145203.pdf](http://trade.ec.europa.eu/doclib/docs/2009/october/tradoc_145203.pdf).

<sup>25</sup> White House, *Increasing U.S. Auto Exports and Growing U.S. Auto Jobs Through the U.S.-Korea Trade Agreement*, December 5, 2010, [http://www.whitehouse.gov/sites/default/files/fact\\_sheet\\_increasing\\_us\\_auto\\_exports\\_us\\_korea\\_free\\_trade\\_agreement\\_v2\\_0.pdf](http://www.whitehouse.gov/sites/default/files/fact_sheet_increasing_us_auto_exports_us_korea_free_trade_agreement_v2_0.pdf).



addition, the KOREU FTA also introduces detailed binding rules on transparency regarding decisions on reimbursement, and stipulates the possibility that pricing decisions could be reviewed by a court. The KOREU FTA provisions on pharmaceuticals also require that decisions on reimbursement and pricing be objective and clear. The pending KORUS FTA also includes NTB provisions which, among other things, aim to improve transparency in the reimbursement process; put less complex regulatory policies in place; and ensure adequate enforcement of pharmaceutical patent rights to specifically protect proprietary data that manufacturers must submit for market approval. To further regulatory cooperation in the pharmaceutical and medical device sector, the KOREU FTA would establish a Working Group on Pharmaceutical Products and Medical Devices as would the KORUS FTA.

- **Consumer electronics:** Included in the KOREU FTA is a special annex on non-tariff barriers related to consumer electronics with an objective of addressing technical barriers, especially a lack of recognition of international standards. The KOREU FTA would permit EU exporters to conduct safety testing in the EU, effectively reducing their costs and cutting back on bureaucratic hurdles. In contrast, the KORUS FTA does not include separate provisions on standards, testing, and certification for consumer electronics exports from the United States to South Korea.
- **Textiles and apparel:** Implementation of the KOREU FTA would result in the abolition of most tariffs on textiles and apparel, 92% of which will be eliminated immediately, with the others to be eliminated over five years. This is similar to the KORUS FTA. The KOREU FTA will maintain the European Union's standard rules of origin with only a small number of exceptions. The KORUS FTA adopts a "yarn forward" rule, which means generally apparel using yarn and fabric from the United States and South Korea would qualify for preferential treatment. A special textile safeguard is included in the KORUS FTA, which would allow the United States to impose tariffs on certain goods should injury occur due to import surges.

### **Cross-Cutting Manufactured Goods Provisions**

The KOREU and KORUS FTA contains provisions that apply primarily to trade in other manufactured goods. EU manufacturers currently pay tariffs on the overwhelming majority of all industrial products they export to South Korea, which applied an average most-favored-nation (MFN) tariff rate of 6.6% on non-agricultural goods in 2008.<sup>26</sup> Tariffs are higher for appliances, pharmaceuticals, and textiles. Under the terms of the KOREU FTA, the EU agreed to eliminate all of its import tariffs on industrial goods within five years and South Korea would remove all of its tariffs within seven years. This would be faster than under the KORUS FTA, where the United States would eliminate all of its industrial tariffs over 10 years.<sup>27</sup>

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<sup>26</sup> World Trade Organization, *World Tariff Profiles 2009*, Republic of Korea, p. 102. [http://www.intracen.org/marketanalysis/Docs/Tariff\\_Profiles/Tariff\\_Profiles\\_09\\_ENG\\_LR.pdf](http://www.intracen.org/marketanalysis/Docs/Tariff_Profiles/Tariff_Profiles_09_ENG_LR.pdf).

<sup>27</sup> Lee Jong-Kyu, *Korea-EU FTA: Major Features and Implications*, Samsung Economic Research Institute, August 2009, p. 8.

To further facilitate bilateral trade in manufactured goods, the KOREU and KORUS FTAs include provisions on cross-cutting non-tariff barriers in major industrial sectors. These provisions include

- **Technical barriers to trade:** to ensure standards and regulations are not applied in manner that unnecessarily inhibits trade in their development and applications;
- **Customs administration and trade facilitation:** to ensure compliance with each other's customs laws and regulations;
- **Rules of origin:** to define goods that originate in the FTA region and therefore are eligible for preferential treatment (these are in addition to the special rules of origin for autos as discussed earlier);
- **Competition laws and regulations:** to promote cooperation in enforcing antitrust laws through the exchange of information and consultation; and,
- **Regulatory transparency:** by publishing relevant regulations and administrative decisions as well as proposed regulations; to allow persons from the other party to make comments and to ask questions regarding proposed regulations; to notify such persons of administrative proceedings and to allow them to make presentations before final administrative action is taken; and to allow such persons to request review and appeal of administrative decisions.

In addition, protocols are attached to the KOREU FTA agreement that affect manufactured goods trade. One protocol is on **rules of origin**, that is the criteria, such as allowable foreign (non-KOREU FTA) content, for determining a product's eligibility for preferential treatment under the FTA. The protocol also contains the **duty drawback** provision discussed earlier. A second protocol calls for the two Parties to work together in facilitating **customs issues**.

## **Agriculture**

Under the KOREU FTA, the EU's agricultural sector is expected to realize export gains as South Korea implements its commitments to open up its market. This trade agreement acknowledges South Korea's sensitivity on some agricultural products—reflected in provisions that require some opening—but indefinitely leave in place a few quotas and some high tariffs. Rice and rice products are excluded from coverage, as they also are in the KORUS FTA. Since the EU imports little in agricultural products from South Korea, those provisions are not discussed below.

### **Market Access for Agricultural Products**

In 2009, EU agricultural exports to South Korea (\$1.4 billion) accounted for almost 5% of total EU merchandise exports to that country. The leading five agricultural/food products shipped—pork, whiskies, corn, wine, and chocolate—accounted for 42% of the value of the EU's agricultural exports to the Korean market. In 2009, the EU-27 ranked fourth as the source of Korea's agricultural imports, while the United States placed first.

The KOREU FTA would reduce South Korea's high tariffs and restrictive quotas on most agricultural imports from the EU over a 20 year period. More than two thirds of these products (in value terms) that now enter the Korean market would benefit from free access by year five following its implementation as tariffs are eliminated and quotas increase. However, EU exporters

would receive immediate duty-free status for almost 30% (\$430 million) of the agricultural exports they currently ship to South Korea. For comparison, under the KORUS FTA, U.S. exporters would immediately benefit from duty-free access for 62% (almost \$2.7 billion) of their agricultural products shipped to Korea.<sup>28</sup>

The KOREU FTA includes tariff reduction schedules and quota expansion provisions for agricultural products that are nearly similar to those found in the KORUS FTA. However, both agreements differ slightly in how South Korea would be allowed to protect some of its more sensitive products. Because the EU is a smaller supplier of several such products compared to the United States, the size of many of the EU's preferential quotas in the Korean market may reflect this fact. For example, in year five, the EU's quota for natural honey would be 60 metric tons (MT), compared to the 225 MT quota granted to the United States. Further, South Korea's quotas for imports of three dairy products (non-fat dry milk, whole dry milk, and evaporated milk), natural honey, and seasonal oranges from the EU-27 would be indefinitely capped at the end of their respective transition periods. However, the size of the preferential quotas granted to the United States for these three same product categories would continue to increase 3% annually in perpetuity. Similarly, South Korea secured protection against import surges of nine agricultural products from the EU (compared to 30 products under the KORUS FTA). A "safeguard" would be automatically triggered when the quantity of a commodity entering the South Korean market exceeds a specified amount. When triggered, tariffs would temporarily revert to a higher level to give producers additional time to adjust to increased import competition.

Though EU agricultural exports to South Korea are a small share of its total, observers note that the elimination of tariffs would particularly facilitate additional exports of pork products, wine, spirits, and processed foods. EU agricultural exporters would also benefit from the substantial savings associated with tariff reductions. Most acknowledge, though, that the KORUS FTA would have a more significant impact on agricultural exports to South Korea than is expected under the KOREU FTA.<sup>29</sup>

### **Sanitary and Phytosanitary Commitments**

The KOREU FTA's sanitary and phytosanitary (SPS) chapter details the commitments and the process both countries would follow to address human, animal, and plant health issues that may arise in bilateral trade of agricultural products. It identifies those issue areas that would receive special attention (i.e., animal welfare standards, designation of pest- or disease-free areas and areas of low pest or disease prevalence). The KOREU FTA would establish a SPS committee to facilitate consultations on, and resolve, bilateral SPS problems as they arise, as would the KORUS FTA. While the KOREU FTA emphasizes this committee's responsibilities to implement commitments on the issue areas identified, the focus of the committee to be created under the KORUS FTA emphasizes the use of science and risk-based assessment to resolve SPS matters through bilateral technical cooperation and consultation. Both agreements prescribe that dispute settlement provisions cannot be used as recourse to address any SPS issue that might arise in bilateral trade.

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<sup>28</sup> These figures are derived by CRS by applying Korea's tariff reduction schedule commitments made in each trade agreement against EU and U.S. agricultural exports in calendar year 2009.

<sup>29</sup> European Parliament, "An Assessment of the EU-Korea FTA," July 2010, pp. 15, 23.

## **Geographical Indications for Agricultural Products**

The KOREU FTA has more expansive provisions on geographic indications (GIs) than does the KORUS FTA. GIs (similar to a trademark) refer to marks that “identify a good as originating in the territory of a country, or a region or locality in that territory, where a given quality, reputation or other characteristic of the good is essentially attributable to its geographical origin.”<sup>30</sup> The use of GIs applies primarily to wines, spirits, and agricultural products. For example, “Rocquefort” cheese from France is an EU-designated GI.

Because GIs are commercially valuable in international trade, the EU in negotiating its bilateral trade agreements has sought to secure additional protection for its GI-designated agricultural and beverage products in FTA partner country markets beyond what multilateral trading rules currently provide. This means that GI-designated products are eligible for relief from acts of infringement and/or unfair competition under a country’s trademark laws and regulations. Reflecting this objective, the EU in its FTA with South Korea secured protection for 165 GI-designated products (e.g., wines, spirits, cheeses, hams, and beers). South Korea secured GI recognition in the EU market for 64 of its GI-designated products (teas, spices, vegetables, rices, fruits, meats, among others). The U.S. dairy sector has expressed concern that the GI-designation of various EU cheeses in the South Korean market could undercut the sale of U.S. generically-labeled cheeses in that market with identical names. Accordingly, members of Congress have urged the USTR to work with their counterparts to ensure that South Korean regulations drafted to implement the KOREU FTA do not impair the dairy market access concessions that the United States would receive under the KORUS FTA.

## **Services Trade**

The EU made increased market access to the South Korean market for services a high priority, given the relative competitiveness of EU-based services providers and the openness of EU markets going into the negotiations compared to South Korean providers and markets. As WTO members, the EU-27 and South Korea adhere to and have made commitments under the WTO’s General Agreement on Trade in Services (GATS).<sup>31</sup> However, competitive services providers, especially from the EU and the United States, view the GATS, that resulted from the Uruguay Round negotiations, as just a first step in establishing a multilateral framework on trade in services. As a result, its trade liberalizing commitments are far below what many WTO members consider necessary to effectively reduce barriers to trade in services. The KOREU FTA would expand on the commitments that the EU members and South Korea have made under the GATS.

KOREU FTA addresses the overall rules for EU-South Korea trade in services, such as allowing for the establishment of a commercial presence by a service provider from one Party to the agreement through investment in the other Party, reaffirming rules established in the multilateral General Agreement on Trade in Services (GATS). The KOREU FTA establishes the basic principles by which the two Parties would conduct bilateral trade in services covered by the agreement. These principles include non-discriminatory treatment—both most-favored-nation treatment and national treatment and market access which proscribes government restrictions on

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<sup>30</sup> Uruguay Round Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), Article 22.1.

<sup>31</sup> The GATS is the WTO multilateral trade agreement that establishes rules of the road for trade in services as the General Agreement on Tariffs and Trade does for trade in goods. Under the GATS rules, each WTO member has made sector-specific commitments to liberalize trade in services.

trade in covered services but allows for exceptions for government restrictions for prudential objectives. Among other things, the chapter also calls for transparency in establishing regulations on services.

The KOREU FTA uses the “positive list approach” rather than the “negative list approach,” in laying out the schedule of these commitments. The positive list requires each Party to specifically identify the types of services for which it will provide national treatment and market access to providers from the other Party.<sup>32</sup> By contrast, the KORUS FTA uses the negative list.

Notwithstanding the “positive list,” the EU-Korea FTA covers a broad range of services, including transportation services, telecommunications, finance, legal services, environmental services and construction, and largely mirrors coverage found in the KORUS FTA.<sup>33</sup> South Korea obtained increased access to EU markets for architecture, engineering, urban planning, landscaping, printing and publishing, telecommunication, construction, finance, and transportation services. However, as requested by the EU, the KOREU FTA would not open markets for medical, education, and audiovisual services.<sup>34</sup>

Because South Korea’s services market is much more restricted than the EU’s, the EU had particular interest in obtaining increased market access in South Korea for its legal, financial, retail, transportation, and telecommunications services. In general, South Korea agreed to provide similar access for its markets for EU providers as would be given to U.S. providers under the proposed KORUS FTA. According to the European Commission, the KOREU FTA would provide the most comprehensive treatment of services trade of any EU FTA.<sup>35</sup>

For example, in the area of legal services, an EU priority during the negotiations was to secure South Korea’s commitment to allow EU firms to increase their onsite presence. In that regard, by the date the agreement enters into force, EU-based law firms would be permitted to open representative offices in South Korea to advise foreign investors and local clients on non-Korean law. No later than two years after that effective date, EU law firms’ representative offices would be able to enter into cooperative agreements with Korean law firms, and no later than five years after that date, they would be permitted to form joint ventures with Korean firms. The KORUS FTA contains similar provisions for U.S. law firms.

In the area of telecommunication services, under the KOREU FTA, South Korea would allow EU telecommunications providers to own 100% of the voting shares of Korean-based providers, except for the KT Corporation and SL Telecom Co, for which the share of ownership would be limited to 49% or less. Under the KORUS FTA, U.S. telecommunications firms would have similar access to ownership. In addition, under the KOREU FTA, South Korea would allow EU satellite telephone and television providers to operate directly into South Korea without the need

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<sup>32</sup> The “negative list” approach requires each Party to list only those types of services for which it is not prepared to provide national treatment and market access. In addition, under the negative list approach new types of services that are developed after the trade agreement enters into force, are considered part of the trade liberalizing schedule of commitments unless otherwise identified. On balance, the negative list is considered to be the more trade liberalizing approach. It is also the approach that the United States has employed in its FTAs, including the proposed KORUS FTA. WTO members employ the positive list in the GATS.

<sup>33</sup> Lee, Jong-Kyu. *KOREA-EU FTA: Major Features and Implications*. Samsung Economic Research Institute, August 2009, p. 10.

<sup>34</sup> *Ibid.*

<sup>35</sup> European Commission, DG Trade, *EU-Korea FTA: A Quick Reading Guide*, October 20, 2009, p.7.

to have a business tie with a domestic company. The EU views this as an important benefit to EU providers.<sup>36</sup> The KORUS FTA does not appear to mention such operations; so it is not clear if U.S. satellite broadcasters would have similar access.

In general, the EU and South Korea agreed to provide access to their respective financial markets as the United States and South Korea agreed to under the KORUS FTA. Because of the positive list approach, EU commitments in services are member-specific, so not all of the 27 members may have committed to any specific trade liberalization measure. In insurance, 21 of the EU 27 countries and South Korea agreed to open up their respective markets for direct insurance in maritime shipping, commercial aviation, and space launching and in insurance for the international transport of goods. South Korea and some EU members would also open their markets for risk management services. In banking and other financial services, South Korea and 20 of the 27 EU members would allow financial institutions from each others' territories to provide and transfer financial information and data across their borders and to provide advisory and other auxiliary services. While the KOREU FTA appears to be cautious regarding financial services liberalization in some respects, it appears to be forward looking in other respects. For example, its provisions would apply to all financial services including new financial services.

The KORUS FTA handles financial services somewhat differently. It distinguishes two broad categories of delivery of services. One category is services sold by a service provider located in one FTA partner country to residents in the other partner country through an affiliate located in the territory of the latter partner country (commercial presence). The second category is services sold by a provider located in one partner country to a national of the other partner country no matter the location of that national (cross-border trade).

In the case of providers with a commercial presence, the KORUS FTA would apply to all financial services. As with the KOREU FTA, it would also automatically cover any new financial service. In the case of cross-border trade, the KORUS FTA coverage would be limited to those banking and insurance services listed in the agreement.<sup>37</sup> It is not clear whether the difference in approaches between these two FTAs would yield different levels of trade liberalization.

## **Other Provisions**

### **Trade Remedies**

The trade remedy provisions in the KOREU FTA (anti-dumping, countervailing duty, and safeguard measures) closely resemble those in the KORUS FTA. Among other things, they include

- special bilateral safeguard provisions allowing either Party to either suspend phase-out of tariff rates or increase customs duties on an import of a product

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<sup>36</sup> European Parliament, Directorate-General for External Policies, Policy Department, *An Assessment of the EU-Korea FTA*, July 2010, p. 75.

<sup>37</sup> Regarding insurance, the FTA's coverage would be limited to cross-border trade in marine, aviation, and transit insurance; reinsurance; services auxiliary to insurance, such as consultancy, risk assessment, and actuarial and claim settlement services; and insurance intermediation services such as brokerage and agency services. Regarding banking and securities, the agreement's coverage in cross-border trade would be limited to providing financial information and data processing, advisory, and other auxiliary financial services.

- from the other Party, if surges in imports of that product cause or threaten to cause serious injury to the domestic industry;
- special safeguard measures to counter the adverse effects of imports surges of specified agricultural products;
  - special notification to one Party of a global safeguard measure imposed by the other Party, if the former would be one of the top five suppliers of the product in question; and
  - a commitment by both sides to abide by WTO agreements on antidumping and countervailing duty measures when imposing those measures.

## **Government Procurement**

The Government Procurement Agreement (GPA) is a WTO plurilateral pact that applies to only those WTO members that are signatories. Under the GPA, government contracts for goods and services to be used for public purposes are opened up to bids from providers from other signatory countries. The GPA applies to contracts valued above a specified threshold and to contracts let by those agencies that each signatory country lists in its schedule of commitments. The EU, South Korea, and the United States are GPA signatories. Under the KOREU FTA, both sides reaffirm their commitments to open up government procurement contracts to bidding by foreign providers under the GPA. Under the KOREU FTA (and the KORUS FTA) South Korea would apply the trade liberalization provisions to a larger number of public agencies than required under the GPA. Under the KORUS FTA, the United States and South Korea would lower the thresholds beyond those established under the GPA for eligibility of contracts for supplies and services and for contracts for construction services, thus potentially opening up more government procurement opportunities to bilateral trade. The EU-Korea FTA would adhere to the GPA thresholds. The KOREU FTA includes a special section that would open up build-on-transfer (BOT) and public works contracts valued above 15 million SDRs (or about \$22.5 million).<sup>38</sup> The EU considers this provision to be an important contribution of the agreement because these contracts are not covered by the WTO GPA.<sup>39</sup> The KORUS FTA has no such *special* provision, although these contracts appear to be included in the coverage of the agreement.

## **Intellectual Property Rights**

The KOREU FTA would reaffirm each of the EU and South Korean commitments to uphold the provisions of the WTO Trade-Related Intellectual Property (TRIPS) agreement as well as other international conventions on the protection of owners of intellectual property (IP)—copyrights, trademarks, and patents. While at one time an issue, South Korea protection of IP has improved to the point it is not an issue, at least in U.S.-South Korean trade relations. The agreement also contains provisions to assist owners to obtain payment for the use of their IP and expands on

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<sup>38</sup> In the agreement, a BOT contract is defined as “any contractual arrangement the primary purpose of which is to provide for the construction or rehabilitation of physical infrastructure, plant, buildings, facilities, or other government-owned works and under which, as consideration for a supplier’s execution of a contractual arrangement, a procuring entity grants to the supplier, for a specified period of time, temporary ownership or a right to control and operate, and demand payment for the use of, such works for the duration of the contract.”

<sup>39</sup> Europa, *EU-Korea Free Trade Agreement: 10 Key Benefits for the European Union*. Memo/10/423, <http://www.europa.eu>.

protection of the rights of designers. The agreement would extend authors' rights to 70 years after the death of the author, the same as under the KORUS FTA. As mentioned in the discussion on agriculture, the KOREU FTA commits both sides to preserve the integrity of certain geographical indicators (GIs), an issue important to EU producers of food products for which they want to emphasize the origin of the region in which those products are produced.

### **Trade and Sustainable Development—Labor and Environmental Standards**

The KOREU FTA combines provisions on workers' rights and on environmental standards into one chapter devoted to trade and sustainable development, unlike the KORUS FTA, which handles them separately. Similar to provisions in the KORUS FTA, the KOREU FTA would commit both sides to uphold International Labor Organization (ILO) core labor standards as well as ratify all ILO conventions that go beyond the core labor standards.<sup>40</sup>

Under the KOREU FTA, both sides also agree to uphold and effectively implement all multilateral environment agreements to which they are a party. In addition, the EU and South Korea would commit to not lowering enforcement of labor standards or environmental standards in a way that would affect trade or investment between them. The two sides would also set up advisory groups to monitor the implementation of workers rights and environmental provisions and to set up a panel of independent experts to resolve issues that arise during implementation. In this respect, the treatment of labor rights and environmental issues under the KOREU FTA is similar to that under the KORUS FTA. However, the proposed KORUS FTA provides for disputes under the labor and environmental chapter to be resolved through the agreement's dispute settlement mechanism, and thus the possibility of sanctions, if consultations do not resolve the dispute. In contrast, the KOREU FTA states that disputes can only be resolved through consultations and does not provide for any sanctions.

## **Potential Economic Impact of the KOREU FTA**

Most of the studies done on the impact of the KOREU FTA estimate that the agreement will have a small but positive affect on the economies of the EU and South Korea as a whole and that the larger *relative* impact would be on the South Korean economy. This conclusion logically follows from the fact that the South Korean economy is much smaller than the EU, more dependent on the EU market than is the opposite case, and has higher trade barriers than the EU; therefore, the effects of trade liberalization under the KOREU FTA would be greater in relative terms for South Korea. However, in both cases, the impact of the agreement on the overall economy on both sides would be small, reflecting the larger role played by other countries in their trade and also the larger impact that other economic activities—domestic consumption, government spending, and business investment—have in their economies.

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<sup>40</sup> To many outside observers, South Korea's labor rights regime is generally considered to be strong for regular workers. South Korea ranks in the top third of the OECD's thirty members in terms of employment protection for regular workers. Indeed, for years, a major complaint by multinational corporations is that restrictions in the South Korean labor market, such as mandatory severance pay, significantly raise the cost of investing and doing business in Korea.



Most studies indicate that South Korea's GDP would increase 1%-2% after the KOREU FTA is implemented, while the EU GDP would increase less than 0.05%.<sup>41</sup> Studies regarding the impact of the KORUS FTA on the United States and South Korea yielded comparable magnitudes, an expected result given the similarities in the size and comparable levels of development of the EU and the United States and the similarities in the KOREU FTA and the KORUS FTA.<sup>42</sup>

As with most other FTAs, the greatest economic impact of the KOREU FTA would be on specific sectors in each economy. Those having a comparative advantage vis-a-vis those in their other country are most likely to experience the greatest benefits while import-sensitive sectors would experience the least gains, if not losses, when the agreement is implemented. EU services providers would be expected to experience gains from the agreement, especially in the areas of retail and wholesale trade; transportation services; financial services; and business services.<sup>43</sup> This conclusion follows from the fact that EU service providers are among the world's most competitive and EU markets the most open, while the South Korean services market is relatively closed. In terms of trade in goods, EU exporters of pharmaceuticals, auto parts, industrial machinery, electronics parts, and some agricultural goods and processed foods would be expected to gain from the KOREU FTA's implementation. At the same time, South Korean producers of cars, ships, wireless telecommunications devices, chemical products, and imaging equipment would be expected to increase their exports to the EU market.<sup>44</sup>

## Next Steps—Ratification

The EU is now in the midst of the approval process for the KOREU FTA. Trade agreements must first be approved by the Council of the European Union (the Council), a body consisting of ministers from each of the 27 member states with the power to approve or reject all EU legislation. While technically a qualified majority of the ministers is required to approve a trade agreement, in practice the Council has required a consensus, meaning that any single member-state can veto a trade agreement. After the Council gives its consent, the agreement is sent to the European Parliament (EP), whose members are directly elected by citizens of the member states. A trade agreement needs to be approved by a simple majority of the 736 European parliamentarians.

Both the Council and the EP vote on the trade agreement as initialed and presented by the European Commission, the executive body of the EU, which negotiates the agreement on behalf of the member states. The agreement cannot be amended. If and when the Council and the EP have approved a trade agreement, the Council decides on a date for "provisional application." Then, most elements of the trade agreement would enter into force, but elements in which only

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<sup>41</sup> European Parliament, Directorate-General for External Policies, Policy Department, *An Assessment of the EU-Korea FTA*, July 2010, p. 23.

<sup>42</sup> A study by the U.S. International Trade Commission estimates that U.S. GDP would increase approximately 0.1% and a study by the Korea Institute for International Economic Policy estimates that South Korean GDP would increase 0.42% to 0.59% if and when the KORUS FTA is fully implemented. These estimates are discussed in CRS Report RL34330, *The Proposed U.S.-South Korea Free Trade Agreement (KORUS FTA): Provisions and Implications*, coordinated by William H. Cooper.

<sup>43</sup> European Parliament, Directorate-General for External Policies, Policy Department, *An Assessment of the EU-Korea FTA*, July 2010, pp. 23-24.

<sup>44</sup> *Ibid.*

the individual member states have sole or mixed competence would enter into force after subsequent national ratifications have been completed.<sup>45</sup>

On September 16, 2010, the Council approved the KOREU FTA after debate within the Council. Italy initially opposed the agreement and raised concerns that increased competition from South Korean car manufacturers would adversely affect the Italian auto industry. Among other things, Italy objected to the duty drawback provision of the agreement.<sup>46</sup> Italy lifted its objection reportedly after the other trade ministers agreed to postpone the agreement's provisional application until July 1, 2011. EU and South Korean leaders signed the agreement at the EU-South Korea Summit held on October 6, 2010.<sup>47</sup>

In the meantime, both the Council and the EP are considering a special safeguard mechanism in the KOREU FTA. The safeguard would allow EU industries to petition for relief in the form of increased tariffs or suspension of tariff reductions, if, as a result of this trade agreement, imports from South Korea surge at a rate that causes serious injury to the EU industry. Unlike a trade agreement, legislation enacting the safeguard can be amended and the final version is the product of negotiation between the Council and the European Parliament. Like the FTA, this measure must be approved by both bodies for this safeguard to go into effect. One controversial issue is that the current version of the safeguard proposal would permit safeguard investigations measures to be initiated regionally, if the effects of the import surges are concentrated only in certain regions. It is uncertain when an EP vote on the KOREU FTA will take place.

In South Korea, the KOREU FTA must be approved by a majority vote in the unicameral National Assembly to take effect. President Lee's government submitted a ratification bill to the Assembly on October 25, 2010. Unlike in the United States, trade agreements in Korea are not subject to any expedited congressional procedure time lines. The Assembly is controlled by President Lee Myung-bak's Grand National Party; thus, the agreement generally is expected to be approved.

## **Potential Implications of the KOREU FTA for the United States**

The potential implications for the United States if the KOREU FTA enters into force are complicated, making an accurate assessment difficult. Nevertheless, some observations can be made. For example, most assessments of the potential economic effects of the agreement conclude that South Korea's GDP, and to a lesser degree the EU's GDP, would increase with the removal of trade barriers and the improved use of resources. The additional economic growth could translate into increased demand for imports, including those from the United States, whether or not the KORUS FTA has yet entered into force.

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<sup>45</sup> Such measures in the KOREU FTA would be criminal penalties for non-compliance with IPR laws, transport provision, and a co-production issue regarding the Protocol on Cultural Cooperation. European Parliament, Directorate-General for External Policies, Policy Department, *An Assessment of the EU-Korea FTA*, July 2010, pp. 33-34.

<sup>46</sup> *Daily Report for Executives*, September 9, 2010.

<sup>47</sup> *Wall Street Journal*, wsj.com accessed on September 16, 2010.

However, attention has begun to turn to the potential impact of the KOREU FTA on specific U.S. industries and sectors, and in particular on what happens to their sales to, and engagement in, the South Korean market if the KOREU FTA enters into force before the KORUS FTA does, assuming that the KORUS FTA does at all. If this scenario unfolds, EU manufacturers of products and some agricultural producers that compete head-to-head with their U.S. competitors could benefit from the price advantage achieved as South Korean tariffs and non-tariff barriers on their products are phased out or eliminated, while Korean tariffs on U.S. products begin to be reduced later or stay the same. Goods that might be affected this way include pharmaceuticals and medical devices, scientific equipment, industrial machinery, and some agricultural products. However, this advantage would likely not be present if the KORUS FTA enters into force about the same time as, or very soon after, the KOREU FTA does.

Some members of the U.S. business community argue that it is important for the KORUS FTA to take effect before the KOREU FTA does in order to secure “first-mover” benefits (i.e., the elimination of and/or lower South Korean tariffs for U.S. products). If not, EU exporters would be positioned to benefit first, an advantage that could continue even if the KORUS FTA is later approved, as EU firms have already entrenched stronger positions in the South Korean market. What might mitigate such an advantage, though, if the EU moves first, would be those U.S. exporters who are already well established in the South Korean market based on other factors besides price, and a U.S. dollar that is lower in value to the euro compared to recent history—offsetting the tariff advantage benefiting EU exporters.

To illustrate, on the manufacturing side, EU carmakers might be able to reduce the price of their higher-priced luxury vehicle such as the BMW 528 or Mercedes 3000, giving them another advantage, while U.S. automakers of luxury vehicles will continue to pay the 8% auto tariff. U.S. manufacturers have a small share of imported passenger vehicles sales (10%) in South Korea, compared to sales of imported cars from the EU (62%). Passage of the KOREU FTA could further enhance the strong position of European automakers in the South Korean market.

The case of frozen french fry potatoes is a second example. South Korea’s MFN tariff on frozen potato products (french fries) is 18%. Under both the KOREU and KORUS FTAs, Korea would immediately reduce this tariff to zero. In calendar 2009, the United States accounted for 81% (\$36 million) of Korea’s frozen potato imports; the EU’s share was 2% (about \$900,000). If the KOREU FTA were to take effect before the KORUS FTA, the elimination of the 18% tariff, combined with lower transportation costs from Europe than from U.S. Pacific ports, could give EU exporters a competitive price advantage over U.S. firms and enable them to quickly increase their market share. Further, the EU, with the largest frozen potato processing capacity in the world, could be able to easily meet the additional demand created by this market opening.

Services is another area in which U.S. and EU providers compete for access to the South Korean market, especially in such areas as business services, professional services, financial services, and express delivery. Presumably, EU providers might obtain an advantage over their U.S. competitors if the KOREU FTA enters into force, but that advantage would likely be diminished if the KORUS FTA takes effect. The cross-border services and the financial services chapters in the KORUS FTA contain MFN provisions which state in essence that any preferences that South Korea gives to a non-Party (such as the EU) in another FTA, it must also give to the United States. The services chapter in the KOREU FTA also contains an MFN provision, but it is more restricted and would not necessarily require South Korea to accord to EU the preferences it would give to the United States under the KORUS FTA.

In sum, the KOREU FTA, if and when it is implemented will likely strengthen the fledgling EU-South Korean economic relationship and give the EU a significant economic presence in East Asia. EU firms are important competitors with U.S. firms in a number of areas, including services; therefore, the KOREU FTA will likely have important implications for the United States and could play a role in the shape and timing of the expected congressional debate on the KORUS FTA in the 112<sup>th</sup> Congress.

## Appendix. Selected Economic Indicators, Tariff, and Trade Tables

**Table A-1. Selected Economic and Tariff Indicators for European Union, United States, and South Korea, 2009**

	European Union	United States	South Korea
Population in millions (July 2010 estimate)	492	310	49
GDP - Purchasing Power Parity in trillions of U.S. \$ (2009)	\$14.43	\$14.14	\$1.36
GDP - Real Growth Rate in percent (2009 est.)	-4.1%	-2.6%	0.2%
GDP - Per Capita (PPP) in U.S. \$ (2009 est.)	\$32,500	\$46,000	\$28,100
<b>MFN Average Applied Tariffs, 2009<sup>a</sup></b> (percent)			
All Goods	5.3%	3.5%	12.1%
Agricultural Goods	13.5%	4.7%	48.6%
Non-Agricultural Goods	4.0%	3.3%	6.6%

**Source:** CIA, *The World Factbook*, as updated November 9, 2010; WTO, *Country Profiles*, October 2010.

a. Simple average of import duties

**Table A-2. EU and U.S. Trade with South Korea, 2009**

	European Union	United States
<b>TOTAL MERCHANDISE TRADE</b>	<i>billion US \$</i>	
Exports to South Korea	\$29.9	\$28.6
Imports from South Korea	\$44.9	\$39.2
Trade Balance	-\$15.0	-\$10.6
<b>TRADE BY SELECTED SECTORS</b>	<i>million US \$</i>	
<b>Automobiles</b>		
Exports to South Korea	2,037	388
Imports from South Korea	7,185	4,665
<b>Agriculture</b>		
Exports to South Korea	1,405	3,961
Imports from South Korea	85	324
<b>Machinery; Reactors, Boilers</b>		
Exports to South Korea	6,740	4,417
Imports from South Korea	5,193	8,546
<b>Pharmaceuticals</b>		
Exports to South Korea	1,321	501
Imports from South Korea	38	96
<b>Medical Devices</b>		
Exports to South Korea	839	859
Imports from South Korea	634	328
<b>Textiles &amp; Apparel</b>		
Exports to South Korea	611	210
Imports from South Korea	800	934

Sources: Global Trade Atlas; World Trade Organization.

**Table A-3. EU FTAs Since 2006**

Partner	Status
ASEAN <sup>a</sup>	Negotiations begun in June 2007 but suspended.
Bosnia-Herzegovina	Agreement in force
Canada	Negotiations ongoing
CARIFORUM States <sup>b</sup>	Agreement pending ratification
Central America (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and Panama)	Negotiations concluded
Colombia and Peru	Negotiations ongoing
GCC (Gulf Cooperation Council) <sup>c</sup>	Negotiations suspended
India	Negotiations ongoing
Malaysia	Negotiations ongoing
MERCOSUR <sup>d</sup>	Negotiations ongoing
Montenegro	Agreement in force
South Korea	Agreement signed
Serbia	Agreement in force
Singapore	Negotiations ongoing
Ukraine	Negotiations ongoing
Vietnam	Negotiations ongoing
South Africa	Negotiations ongoing

**Note:** The EU has established a network of various preferential trade arrangements besides FTAs. For more information see CRS Report R41143, *Europe's Preferential Trade Agreements: Status, Content, and Implications*, by Raymond J. Ahearn.

- a. The Association of Southeast Asian Nations' ten members are: Brunei Darussalam; Cambodia; Indonesia; Laos, Malaysia; Myanmar; The Philippines; Singapore; Thailand; and Vietnam.
- b. The CARIFORUM states are: Antigua and Barbuda; Bahamas; Barbados; Belize; Dominica; the Dominican Republic; Grenada; Guyana; Haiti; Jamaica; Saint Lucia; Saint Vincent and the Grenadines; Saint Christopher and Nevis; Suriname; and Trinidad and Tobago.
- c. The Gulf Cooperation Council consists of Saudi Arabia, Kuwait, Bahrain, Qatar, the United Arab Emirates, and Oman.
- d. Mercosur is the Common Market of the South established by Brazil, Argentina, Uruguay, and Paraguay.

**Table A-4. South Korea's FTAs**

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<b>FTAs in effect</b>	
Korea-Chile FTA	Korea-ASEAN FTA <sup>a</sup>
Korea-Singapore FTA	Korea-India Comprehensive Economic Partnership Agreement (CEPA)
Korea-EFTA FTA <sup>b</sup>	
<b>Concluded FTAs</b>	
Korea-U.S. FTA	Korea-Peru FTA
Korea-EU FTA	
<b>FTAs under negotiation</b>	
Korea-Canada FTA	Korea-New Zealand FTA
Korea-Mexico FTA	Korea-Colombia FTA
Korea-GCC <sup>c</sup> FTA	Korea-Turkey FTA
Korea-Australia FTA	
<b>FTAs under consideration</b>	
Korea-Japan FTA	Korea-Russia Bilateral Economic Partnership Agreement (BEPA)
Korea-China FTA	Korea-Israel FTA
Korea-China-Japan FTA	Korea-SACU FTA <sup>d</sup>
Korea-MERCOSUR FTA <sup>e</sup>	

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**Source:** South Korea Ministry of Foreign Affairs and Trade.

- a. The Association of Southeast Asian Nations' ten members are: Brunei Darussalam; Cambodia; Indonesia; Laos; Malaysia; Myanmar; The Philippines; Singapore; Thailand; and Vietnam.
- b. EFTA is comprised of Iceland, Norway, Switzerland, and Liechtenstein.
- c. The Gulf Cooperation Council consists of Saudi Arabia, Kuwait, Bahrain, Qatar, the United Arab Emirates, and Oman.
- d. The five members of the Southern African Customs Union are: Botswana; Lesotho; Namibia; South Africa; and Swaziland.
- e. Mercosur is the Common Market of the South established by Brazil, Argentina, Uruguay, and Paraguay.

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