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## TRADE SUMMARY

In 2003, the U.S. trade deficit with Korea totaled \$12.9 billion, roughly equal to the deficit in 2002. During 2003, two-way goods trade between the United States and Korea increased to \$61.1 billion, a slight increase over 2002. U.S. exports to Korea totaled \$24.1 billion, a 7 percent increase over 2002. U.S. imports from Korea also increased in 2003 to \$37 billion, up 3.9 percent from 2002. In 2003, Korea was the United States' 7<sup>th</sup> largest export market.

U.S. exports of private commercial services (i.e., excluding military and government) to Korea were \$7.8 billion in 2002 (latest data available), and U.S. imports from Korea were \$4.3 billion. Sales of services in Korea by majority U.S.-owned affiliates were \$2.6 billion in 2001 (latest data available), while sales of services in the United States by majority Korea-owned firms were \$395 million.

The stock of U.S. foreign direct investment in Korea in 2002 was \$12.2 billion, an increase of 15.8 percent from 2001. U.S. foreign direct investment is concentrated largely in manufacturing, banking, and wholesale sectors.

## IMPORT POLICIES

### Tariffs and Taxes

Korea bound 91.7 percent of its tariff line items in the Uruguay Round negotiations. However, Korea's 50 percent average out-of-quota tariff rate for agricultural products in 2003 poses a significant barrier to trade and contrasts sharply with the relatively low average tariff for industrial products of 7.5 percent. Korea's tariffs on all agricultural products, except rice, are bound at an average of 66 percent. In the case of rice, Korea committed under Annex 5 of the WTO Agriculture Agreement to provide increasing market access for rice at a tariff rate of 5 percent, but the allowed quota for imports remains very small. Tariffs on forestry and fishery products remain unbound. Between 1995 and 2004, Korea agreed to lower duties on more than 30 agricultural products of primary interest to U.S. exporters. These products include bulk, intermediate- and high-value items, such as mixed feeds, feed corn, wheat, vegetable oils and meals, fruits and nuts.

As part of its Uruguay Round commitments, Korea also established tariff-rate quotas (TRQs) intended to either provide minimum access to a previously closed market or maintain pre-Uruguay Round access (See also "Quantitative Restrictions, TRQs and Import Licensing"). In-quota tariff rates are zero or very low, but over-quota tariff rates on some products are prohibitive. Specifically, in 2003, natural and artificial honey are subject to an over-quota tariff rate of 245.7 percent; skim and whole milk powder, 180.4 percent; barley, 327.6 percent; malting barley, 518.7 percent; potatoes and potato preparations, more than 307.4 percent; and popcorn, 637 percent.

Duties are still very high on many high-value agricultural and fishery products. Korea imposes tariff rates above 40 percent on many products of interest to U.S. suppliers, including table grapes, beef, canned peaches and fruit cocktail, apples, pears and a variety of citrus fruits. Products subject to 30 percent or higher tariff rates include certain meats, most fruits and nuts, many fresh vegetables, starches, peanuts and peanut butter, various vegetable oils, juices, jams, beer and some dairy products.

By 2004, Korea will reduce bound tariffs to zero on most or all products in the following sectors: paper, toys, steel, furniture, semiconductors and farm equipment. Korea is harmonizing its chemical tariffs to final rates of 0 percent, 5.5 percent or 6.5 percent, depending on the product. In addition, tariffs on scientific equipment are being reduced 65 percent from pre-Uruguay Round levels. On textile and apparel products, Korea has harmonized and bound most of its tariffs at the following levels: 13 percent

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to 16 percent for man-made fibers and yarns, 30 percent for fabrics and made-up goods and 35 percent for apparel. The U.S. will continue to press for reduced applied tariffs on agricultural and food products.

Korea uses "adjustment tariffs" and compounding of taxes to boost the applied tariff rate in order to protect domestic producers, practices about which the U.S. Government has expressed concern to the Korean government. In 1997, Korea agreed as a condition of its IMF stabilization package to reduce the number of products subject to tariff adjustments. In 2003, Korea renewed adjustment tariffs on 23 items that received adjustment tariffs in 2002 (reducing the tariff rates for 10 of these 23 items). Most of the 23 adjustment tariffs are imposed on agricultural products and seafood, including frozen croaker and skate.

The combination of relatively high tariffs and value-added taxes continues to render a variety of imported products uncompetitive in Korea. One such product is motor vehicles, which are subject to a tariff rate of 8 percent B more than three times the U.S. tariff B as well as multiple taxes compounded on the tariff, which raises the effective tariff rate to above 12 percent. Three of these taxes are based on engine size and thus have a disproportionate impact on imported vehicles. Although Korea eliminated or reduced some motor vehicle taxes based on commitments it made to the United States under the 1998 Memorandum of Understanding Regarding Foreign Motor Vehicles in the Republic of Korea, the combination of the tariff and remaining taxes levied on imported cars continues to severely impede their price competitiveness. The United States continues to urge Korea to lower automotive tariffs and to undertake reforms of its overall automotive tax system in an open and transparent manner that fully involves all stakeholders throughout the process (*See also "Motor Vehicles"*).

### NON-TARIFF MEASURES

#### Internal Supports

As part of its commitments under the WTO Agreement on Agriculture, Korea agreed to reduce its domestic support (Aggregate Measurement of Support, or AMS) for agricultural products by 13 percent by 2004. The Korean government substantially increased the level of domestic support it provided to its cattle industry during 1997 and 1998, thereby raising the overall level of support for agriculture. The issue of whether Korea had adequately confined domestic support in line with its WTO reduction commitments on domestic subsidies was raised, along with other related issues, by the United States and Australia in WTO dispute settlement proceedings in 1999. While the panel ruled against Korea on this issue, the outcome of the dispute was inconclusive as the WTO Appellate Body was unable to make a specific finding on the consistency of Korea's subsidy level with the applicable obligations under the WTO Agreement on Agriculture. Nonetheless, the Appellate Body did conclude that Korea had not been computing the current level of domestic support in a manner compatible with the requirements of the Agreement. The United States will continue to monitor Korea's notification of its AMS to the Committee on Agriculture to ensure that the calculation is now in conformity with Korea's commitments.

#### Quantitative Restrictions, TRQs and Import Licensing

##### Quantitative Restrictions

Korea has purchased U.S. rice under the minimum market access (MMA) quota for rice. However, surging world rice prices in 2003 prompted Korea to implement a "price ceiling" mechanism for rice import tenders. Under the "price ceiling" system, the Agricultural and Fisheries Marketing Corporation (AFMC), the state trading enterprise for purchasing rice, set an internal price ceiling and rejected bidders that offered prices that were higher than the AFMC's internal target price. As a result, completion of several tenders and subsequent deliveries of MMA rice were delayed. Although Korea will eventually import the full amount required under the MMA quota obligation, some of the deliveries to fulfill the

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2003 quota will occur in 2004. The exception to tariffication of rice that Korea received during the Uruguay Round expires at the end of 2004. On January 20, 2004, Korea notified the WTO that it would like to continue special treatment of rice. In order for Korea's key trading partners to support continuing special treatment, Korea must offer acceptable concessions that must be negotiated by the end of 2004. (*See also Rice below.*)

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

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

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

### **Rice**

The Korean government continues to exercise full control over the purchase, distribution and end-use of imported rice. Korean law allows imported rice to be used only for industrial or processing purposes. The state trading enterprises that administer the WTO-mandated minimum access program typically purchase only low-quality rice on instruction from the purchasing ministry, the Ministry of Agriculture and Forestry. In 2001, Korea imported high-quality U.S. rice for the first time under its minimum market access (MMA) quota, after adjusting its tender specifications to target higher quality rice. The United States sold 30,000 metric tons out of the 142,520 MT tariff rate quota (TRQ) available in CY2001, 40,000 MT out of the 171,023 MT TRQ available in CY 2002, and 55,000 MT out of the 199,528 MT TRQ available in CY 2003.

The U.S. Government welcomed the purchase of higher quality rice while raising concerns that the imported U.S. rice remains relegated to storage facilities, as does most other rice imported under the MMA quota programs. Specifically, the access afforded to U.S. rice is not on par with domestic rice due to marketing restrictions placed on rice imported under the TRQ. Korea has repeatedly stated that it will not allow imported table rice to be marketed directly to Korean consumers, raising questions about the consistency of Korea's actions with its WTO obligations. Since Korea has notified its intent to continue special treatment of rice, access to the domestic market may be a condition for key trading partners to not oppose the continuance.

### **Import Clearance Procedures**

U.S. suppliers of food and agricultural products, including products for which market access was liberalized under bilateral or multilateral trade agreements, continue to encounter market access barriers in Korean ports despite the steps the Korean government has taken in this area over the past few years. After WTO dispute settlement consultations with the United States between 1995 and 1999, the Korean government revised its import clearance procedures by: (1) expediting clearance for fresh fruits and vegetables; (2) instituting a new sampling, testing and inspection regime; (3) eliminating some non-science-based phytosanitary requirements; (4) revising the Korean Food and Food Additives Codes, for

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example, to bring Korean pesticide residue level standards for citrus into conformity with CODEX Alimentarius standards; and (5) requiring food ingredient listings by percentage for major, rather than for all, ingredients.

In 2003, however, a new import inspection program implemented by the Ministry of Health & Welfare (MHW) and the Korea Food & Drug Administration (KFDA) eroded Korea's earlier efforts to harmonize its import clearance programs with international norms. On January 27, 2003, a draft version of Korea's revised Ministerial Ordinance of the Food Sanitation Act was notified to the WTO in G/SPS/N/KOR/123. The United States and other countries questioned elements of the new import inspection regime in meetings (October 2003) of the WTO Sanitary and Phytosanitary (SPS) Committee as being inconsistent with WTO national treatment provision.

Of particular concern, the new import inspection program mandates annual maximum residue limit (MRL) testing of agricultural products on a packing-house basis and the associated testing fee of approximately \$1,960 for foreign products. However, Korean domestic agricultural products are only subject to random tests paid for by the Korean government. KFDA, the implementing agency of the new import inspection program, subsequently proposed to lower the MRL testing fees from approximately \$1,960 to \$242. Despite these concerns voiced by the U.S. Government and other Korean trading partners in bilateral and multilateral fora, the new requirements went into effect on August 18, 2003 with no changes. The United States will continue to encourage Korea to bring these requirements in line with Korea's WTO obligations.

Import clearance of agricultural products at Korean ports remains generally slow and procedures continue to be somewhat arbitrary, despite the steps the Korean government has taken in this area over the past couple of years. Surveys of U.S. trading partners in Asia indicate that import clearance for most agricultural products requires less than three to four days. In Korea, import clearance for new products still typically takes 10 days to 18 days, and six months to one year if a food additive is not specifically recognized in Korea's Food Additive Code for use in that product. (Any unauthorized additive must go through a formal approval process before it can be approved for use in a particular food).

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

Korea has continued to revise its food-related standards and specifications every year to harmonize with international standards. KFDA's extensive documentation requirements for mandatory pre-market approval of each food additive not recognized in Korea's positive food additive list and functional foods which are widely accepted by consumers in foreign countries, and its determination that a product is new if formula ratios are changed or if substitute ingredients are used, set its procedures apart from those of other OECD food safety agencies. More work is needed to bring Korea's food code standards up to international standards, especially those related to food additives (for example, Korea has not effectively adopted the "generally recognized as safe" standard).

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Concerning the Biosafety Protocol, a lack of clear guidance to industry on document requirements and import procedures when the Biosafety Protocol is enforced may cause great confusion and thus result in trade disruption.

The United States will continue to urge the Korean government to improve its import clearance procedures until clearance times in Korean ports are comparable to those in other Asian ports and Korean procedures are based on science and consistent with international trade rules and norms (*See also "Standards and Conformity Assessment Procedures" section*).

### **Customs Procedures**

The Korea Customs Service (KCS) frequently classifies "blended products" under the Harmonized System (HS) heading for the major ingredient of that product rather than the HS heading for the blended product, which usually has a lower tariff rate. Changes in classification often are based on arbitrary standards (for example, for dehydrated potato flakes to be classified as blended products, they must include at least 10 percent non-potato ingredients) and are at odds with practices observed by other OECD members. "Blended products" disadvantaged by this practice include potato flakes, soybean flakes, flavored popcorn and peanut butter chips. KCS also classifies beef bones with meat attached as pure muscle meat, subject to a tariff of 40.5 percent, rather than offal which would be subject to a 18.2 percent tariff rate.

KCS's misclassification of potato preparations under the HS heading 1105 has restricted U.S. exports of these products to Korea. Korea should import dehydrated potato products under the unrestricted HS 2005 heading, with an applied tariff rate of 20 percent and a bound rate of no more than 31.5 percent in 2004.

The Korean Customs Service (KCS) has issued tariff code classifications of commodities that diverge from classifications observed by other countries (such as the United States and EU). For example, Citrus Pulp Pellets are classified in under HS 2308 by the United States and the EU. However, due to the percentage of molasses content, Korea has classified them under HS 2309, and therefore subject to a quota. In addition, KCS routinely rejects customs clearance applications on administrative grounds (wrong print, font size, erasure marks on application, etc.), thereby delaying the official start of the customs clearance process. Finally, Korean regulations often require local trade associations to certify or approve import documentation. In addition to requiring the importer to pay a processing fee, which is used to help fund the association, this rule requires importers to submit proprietary business information, to which their local competitors often appear to have access.

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

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

The U.S. government is seriously concerned that a pattern of exclusionary practices is starting to emerge in the setting of standards for new technologies in the field of next generation mobile communications. The Korean government appears to be encouraging the development and selection of homegrown "Korea-only" technology standards, in some cases mandating a single domestic standard for emerging technologies, rather than allowing companies to freely choose the technology that best suits their needs. Such an approach can sharply limit opportunities for providers of proven foreign technologies. (*See also Telecommunications section.*)

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Korea maintains standards and conformity assessment procedures, such as sampling, inspection, testing and certification that appear to be overly burdensome and appear to have a disproportionate impact on imports.

Since April 20, 1999, the Korea Food & Drug Administration (KFDA) has been operating a voluntary safety assessment program of biotechnology crops for human consumption. In accordance with the revision of the Food Sanitation Act issued in August 2002, safety assessments of biotechnology crops became mandatory on February 26, 2004. The U.S. Government and U.S. industry expressed concerns that the requirement to have completed the mandatory safety assessment prior to February 26, 2004, could result in trade disruptions if resource constraints made it impossible for KFDA to process all applications prior to the deadline. Recognizing the potential problem, KFDA revised its safety assessment guidelines to provide an additional year for assessments of all biotech crops except soybeans, corn, and potatoes. Safety assessments for soybeans, corn, and potatoes must still have been completed by February 26, 2004. Assessments for all other biotech crops may be completed by February 26, 2005. To date, twenty biotechnology crops and seven biotechnology additives have undergone and received positive KFDA safety assessments.

Korea's approach to implementation of the Cartagena Protocol on Biosafety to the Convention on Biological Diversity (the Biosafety Protocol) and plans for mandatory environmental risk assessments are also areas of concern to the United States. A lack of clarity and transparency in the proposed regulations and a lack of coordination among ministries involved in enforcement of the Biosafety Protocol are expected to cause confusion, trade disruptions, and duplication of requirements for industry at port of entry. Environmental risk assessments for biotechnology crops will become mandatory when the Ministry of Commerce, Industry and Energy's LMO Act goes into effect (expected sometime in late 2004). So far, 11 applications have been submitted for voluntary environmental assessments (6 corn, 1 soybean, 4 cotton). No environmental assessments have been completed to date. Like food safety assessments of biotechnology crops for human consumption, the U.S. Government has continued to urge Korea to adopt a sufficient grace period with adequate lead-time and minimally restrictive implementation requirements to avoid major disruptions of trade and to notify the appropriate WTO Committee of new revised requirements.

In 2002, KFDA port inspectors detained many shipments of U.S. processed organic food because the inspectors lacked clear guidelines from KFDA headquarters on the required documentation for clearance of imported processed organic food. After intervention by the U.S. government, KFDA headquarters agreed to recognize an original transaction certificate issued by U.S. government-accredited organic certifying agents for U.S. processed organic food. However, detention of U.S. processed organic food accompanied by the original transaction certificate issued by U.S. government certifying agents continued in 2003 because some regional KFDA inspectors still demanded unnecessary documentation.

Every year KFDA revises the Food Code, Food Additive Code, and Labeling Standards in an attempt to better harmonize them with international standards. However, additional work is needed. For example, KFDA narrowly defines product categories eligible to use specific food additives. If a particular product does not fit in the defined product category, it then is classified within the "other products" category. The microbial standards and approved food additives for the "other products" category often do not encompass products which failed to meet the KFDA's definition for specific food classifications. KFDA also has not effectively adopted the "generally recognized as safe" standards. Instead, Korea's standards are much more restrictive than internationally recognized standards. Consequently, imports of "generally recognized as safe" food are frequently detained (*See also "Import Clearance Procedures" sections*).

On June 28, 2003, KFDA announced new "Proposed Standards and Specifications for Health Functional Foods". The objective of the so-called "Functional Food Code" is to regulate health foods and nutritional

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supplements by listing products that can be classified as functional foods and setting standards and specifications for them. Products classified as functional foods can carry "efficacy claims" on their labels. In the proposed Functional Food Code, however, the limited number of functional food categories as well as non-science-based upper limits on vitamin and mineral content restrict entry of U.S. health foods and supplements into the Korean market. The U.S. Government and U.S. industry submitted comments detailing concerns about the potential for Korea's proposals to restrict trade in health foods and nutritional supplements that are traded in foreign countries. KFDA amended its final version of the functional food regulations which were implemented January 31, 2004 to address U.S. concerns regarding KFDA's proposed upper limits on vitamins and minerals. However, KFDA has not addressed U.S. concerns regarding the limited number of functional food categories which currently do not provide for sport nutrition products or herbal products; categories which are widely accepted by consumers in other countries.

A number of Korea's sanitary and phytosanitary certification requirements still continue to limit market access for a variety of products. However, progress was made in market access for cherries. In April 2003, after lengthy consultations, MAF issued a final rule allowing access of all varieties of cherries to Korea under certain conditions. However, market access for in-shell walnuts is still hampered due to a requirement for pre-export clearance by MAF inspectors.

In an effort to prevent imports of products containing BSE-tainted ingredients, in the spring of 2001 Korea enacted requirements that the U.S. Government certify ruminant and ruminant product exports as BSE-free. These requirements proved overly restrictive. However, the issue was resolved for pharmaceutical products, when the Korean government, after extensive legal review, decided to accept BSE-free certifications by governments, relevant legal entities (associations, etc.), or manufacturers (if notarized). For non-pharmaceutical products, Korea still requires government certification if the product is from a BSE-free country. A BSE-infected cow was discovered in the United States in December 2003. With some limited exceptions, all exports of ruminant origin products from the United States to Korea were suspended pending further investigation. Imports of ruminant products recognized as being free from the BSE prions, such as muscle meat and gelatin, are banned. Korea's import ban on non-ruminant products such as poultry meal from countries where there has been a BSE case is overly restrictive.

Korean government agencies also require prior approval for pharmaceuticals, chemicals, computers, telecommunications equipment, all food additives, and other products. While many other countries require prior approval for some products, the range of affected products is exceptionally broad in Korea, and companies must submit documentation that is extraordinarily detailed. In the past, information provided by importers as part of the prior approval/certification processes often was not adequately protected. Regarding pharmaceuticals, in June 2002, the KFDA implemented Drug Master File (DMF) requirements that oblige manufacturers to submit significant quantities of proprietary manufacturing data to the KFDA as part of the drug approval process. The Korean government says the requirements are designed to assure product quality. U.S. industry, however, has expressed concern that because the requirements apply only to new drugs they apply almost exclusively to foreign manufacturers of innovative pharmaceuticals, and not to local generic companies. Industry has raised concerns that the requirements may delay market access and could jeopardize intellectual property protection. A KFDA task force is studying the concerns expressed by industry and other stakeholders.

KFDA approval for local sale of drugs developed outside Korea remains slow. The frequent need for companies to duplicate clinical trials in Korea that have already been completed elsewhere is of particular concern because such trials are costly and delay market access for U.S. products. Duplicate trials were expected to decrease following Korea's 1999 announcement that it would implement International Conference on Harmonization (ICH) guidelines. While the KFDA has made progress in accepting the concepts in the ICH E5 guidelines, the KFDA typically declines to consider Koreans to be members of

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the general Asian population for drug testing and presumes that drugs are more narrowly sensitive unless proven otherwise. In November 2002, Korea published revised guidelines that could improve market access for U.S. companies. The U.S. Government will continue to work with Korea on the implementation of these guidelines and the streamlining of the KFDA clinical trial application process.

Finally, the Korean government continues to require that each shipment of a drug imported into Korea for commercial purposes be tested once registered. This is expensive, inefficient and scientifically unsound. The United States will continue to emphasize the need for the Korean government to implement appropriate international guidelines on the acceptance of foreign clinical test data, to make the approval process for new drugs more science-based, and to shorten the overall drug approval process in Korea. (See also *"Intellectual Property Rights Protection"* and *"Pharmaceuticals"*.)

### **Automotive Standards Experts Working Group**

The United States and Korea have worked together cooperatively over the past few years to resolve a range of motor vehicle standards issues. Consistent with the 1998 U.S.-Korea Memorandum of Understanding (MOU) Regarding Motor Vehicles, Korea has taken steps to simplify and streamline its safety and environmental standards and certification procedures. In October 2000, Korea joined the Global Agreement, an agreement intended to encourage the international harmonization of motor vehicle standards. The United States and Korea have been working since 2001, when a new working group was formed to improve the dialogue between the two sides on complex standards and certification issues. The meetings of this group to date have proved highly productive, and the U.S. Government believes that this forum offers the potential to build a stronger cooperative relationship on standards and certification issues as the work of this group continues. The U.S. Government has closely consulted with the Korean government on the development of a self-certification system, which Korea implemented in January 2003. Also, along with the member governments working to develop a new global standard on side impact crash tests under the Global Agreement, the Korean government committed in January 2002 to continue to accept both the U.S. and European side impact standards. The U.S. Government continues to monitor a variety of other automotive standards issues which could become serious market access barriers to U.S. automakers, and will continue to work with Korea to expeditiously address these matters.

### **Labeling Requirements**

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

Korea implemented mandatory biotechnology labeling requirements for corn, soybean, and soybean sprouts in March 2001, and for processed foods containing biotechnology enhanced corn and soybeans in July 2001. In March 2002, MAF extended biotechnology labeling requirements further to include fresh potatoes. MAF officials have indicated to the U.S. Government that U.S. fresh potatoes are exempt from biotechnology labeling requirements with no requirement for extra documentation as long as no biotechnology potatoes are produced in the United States.

Korea originally provided only vague and limited information on the mandatory biotechnology labeling requirements prior to September 2002. Moreover, the new requirements appear far more burdensome than necessary to achieve their stated goal of providing Korean consumers clear information, and appear to raise national treatment concerns as well. After lengthy consultations, in September 2002 Korea permitted acceptance of a notarized self-declaration as certification that products meet requirements to be exempt from biotechnology labeling.



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New Korean language labeling requirements for functional foods have raised a new concern. The labeling guideline for functional foods indicates that labels must be printed on packages. Under the new labeling requirements for functional foods, no provision is made to affix labels by means of a sticker. The U.S. Government will continue to monitor the impact of this new labeling requirement.

On January 1, 2001, the Ministry of Environment's (MOE) new packaging and labeling standards for food went into effect. Aimed at protecting the environment by minimizing landfill material, the standards prohibited the use of PVC-shrink-wraps and promotional packaging that included more than 20 percent "dead space" in the container. MOE addressed U.S. Government concerns about the restricted use of PVC-shrink-wrap on some products, including frozen products, on food safety grounds. However, the U.S. Government continues to question Korea's rationale for restricting package size based on gross dead space. The United States has argued that net space displaced by such containers, once collapsed and measured (MOE does not allow this), is minimal and well within the objective of the standard.

In December 2003, major retailers in Korea indicated that they would refuse to accept meat from suppliers after January 1, 2004, if packaging on the meat failed to conform with marking requirements mandated under the Korean Ministry of Environment (MOE) Extended Producer Responsibility (EPR) system. The EPR mark is intended to allow different types of packaging to be channeled for "separate discharge" by providing consumers with information on how packaging should be disposed. The new EPR regulations started going into effect for some products as far back as 1999 although extensions were granted for some products such as food. The U.S. Government will monitor implementation of the MOE packaging requirements.

### Other Issues

Korea banned imports of U.S. beef in December 2003 with the detection of one positive case of Bovine Spongiform Encephalopathy (BSE) in the State of Washington. As of the publication of this report, the U.S. government is taking aggressive action and is working intensively to re-open the market as quickly as possible. In addition, the United States is working in the International Organization for Epizootics to revise international standards on BSE to reflect current scientific knowledge.

### GOVERNMENT PROCUREMENT

Korea joined the WTO Agreement on Government Procurement (GPA) on January 1, 1997, and agreed to cover procurement of goods and services over specific thresholds by numerous Korean central government agencies, provincial and municipal governments and some two dozen government-invested companies. In accordance with its commitments under the GPA, procurement of satellites was included in Korea's coverage as of January 1, 2002.

### EXPORT SUBSIDIES

Korea has historically promoted exports aggressively through a variety of policy tools, including export subsidies. However, it committed several years ago to phase out export subsidy programs that are not permitted under the WTO Agreement on Subsidies and Countervailing Measures. Under its IMF economic stabilization package, Korea eliminated four WTO-prohibited export subsidies earlier than originally planned. Korea is rationalizing its overall subsidy regime, including through the notification of 19 programs to the WTO, as required by reporting obligations, and the elimination or reduction of the benefits available in 68 others. The U.S. Government has strongly urged Korea to ensure that its government support programs comply with its WTO obligations.

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

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

The U.S. Government continued to express strong concerns about instances of possible Korean government subsidization of semiconductor production and export that could adversely affect U.S. trade interests. In particular, the U.S. Government raised concerns about continued support extended to Hynix Semiconductor, Inc. (Hynix), Korea's second largest semiconductor manufacturer, by Korean government-owned financial institutions. Because the Korean government continued to provide financial assistance to Hynix, a formal countervailing duty (CVD) investigation was conducted and completed by the U.S. Commerce Department and the International Trade Commission during 2003. As a result of this investigation, Hynix's exports to the United States have subsequently been subject to countervailing duties of 44.29 percent.

The U.S. Government also continued examining concerns raised by members of the U.S. paper industry about alleged targeted Korean government aid to its coated paper sector, including low-cost facility investment loans and loan guarantees, tax benefits for facility expansion, government-sponsored creation of a paper manufacturing complex and government sale of debt obligations. Since a significant percentage of Korean coated paper output is exported to the United States and other markets, U.S. industry is concerned that this support may be distorting international markets for paper goods. The U.S. Government raised the issue both formally and informally several times with Korean government officials. The United States will continue to review detailed and updated information submitted by the U.S. industry concerning Korean government practices that may distort trade or conflict with international subsidy rules. In addition, the U.S. Government will consult closely with the industry with regards to this issue and, if warranted, consider the possibility of further bilateral discussions, multilateral action or remedies available under U.S. law if it is determined such steps are necessary to address U.S. concerns.

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

Korea was elevated from the Special 301 Watch List to the Priority Watch List in January 2004 as the result of an Out-of-Cycle Review (OCR) conducted in late 2003. During the OCR, Korea's progress was assessed based on the following criteria, which were set out in the 2003 Special 301 report:

- 1) granting police authority to the Special Inspection Team (SIT) of the Ministry of Information and Communication (MIC) to conduct raids for software piracy;
- 2) drafting and submitting legislation to the National Assembly that establishes the exclusive right of transmission for sound recordings, including both the full right of making available and the full right of communication to the public, seeking its enactment by the end of 2003;
- 3) providing additional, new data on the Korean government's enforcement efforts that is sufficient to evaluate more fully the range of its enforcement activities, including the imposition of

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deterrent penalties, and sufficient to allow right holders to have the opportunity to take action against infringers who are not convicted;

- 4) drafting and submitting legislation to the National Assembly to grant the Korea Media Rating Board (KMRB) all authority necessary to stop film piracy. The United States has asked Korea to ensure that this legislation and/or the implementing regulations: a) clearly provide the KMRB the authority to reject false applications; b) clearly provide the KMRB the authority to cancel existing ratings which were approved on the basis of a false application; and c) not place undue burdens on legitimate rights holders to prove their rightful ownership; and
- 5) implementing fully and faithfully its agreement on the Wireless Internet Platform for Interoperability (WIPI) intellectual property issue.

While some progress had been made in some of these areas, the review found that growth of online music piracy and continued piracy of U.S. motion pictures has caused serious economic damage to U.S. companies. The U.S. government also remains concerned with respect to Korea's the legal regime for the protection of temporary copies, technological protection measures, Internet Service Providers (ISP) liability, reciprocity provisions regarding database protection, *ex parte* relief, the lack of full retroactive protection for pre-existing copyrighted works and copyright term extension. In addition, new concerns have arisen over continuing book piracy in universities, street vendor sales of illegally copied DVDs, counterfeiting of consumer products, protection of pharmaceutical patents, and lack of coordination between Korean health and IPR authorities on drug product approvals for marketing. These issues will be revisited during the next Special 301 Review, which will be completed in April 2004.

### **IPR Enforcement**

In an important step forward, Korea passed legislation in July 2003 to give police powers to the SIT of the Ministry of Information and Communication. This new authority took effect on October 18, 2003 and allowed the SIT inspectors to conduct raids on commercial firms and other institutions suspected of using illegal software. In June 2003, the Ministry of Justice sent a directive to all regional prosecutor offices to work pro-actively in pursuing IPR infringement violations. As a result, Korean police and prosecutors are conducting raids against software end-users more consistently, with higher damages being discovered than in previous years. Raids are also more frequently initiated based on leads provided by the software industry.

The United States remains concerned, however, about the transparency of the Standing Inspection Team (SIT) enforcement process, including whether the SIT will act on tips provided by industry, and if the right holders will be able to participate in raids to the maximum extent possible and will be notified about all raids initiated by SIT, even when discovered infringements are minor.

In response to requests by the U.S. Government that the Korean government provide detailed information on the results of IPR enforcement efforts in April 2002, Korea agreed to provide additional data to the United States. The Korean government provided regular quarterly reports during 2003 on the inspections of the SIT, on the disposition of cases by prosecutors and also on court verdict reports (i.e. acquittals, convictions, punishments). However, to date, Korea has not provided new data by which the efficacy of Korea's enforcement efforts can be better evaluated, such as the level of fines imposed on convicted infringers.

The Korean government passed amendments to the patent, trademark and utility model laws in January 2001 that increased both fines and terms of imprisonment for IPR violators. However, the United States

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continues to urge Korea to further review the penalties for IPR violations in order to increase their deterrent effect against piracy.

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

Korea has one of the highest levels of broadband Internet penetration in the world. Given this, it needs to show a more effective response to the challenges posed by the changing nature of digital copyright piracy by adopting new legal tools and making substantial improvements in enforcement practices. Important aspects of Korea's copyright law structure have failed to keep pace with the transformation of the market resulting from digitization and high-speed access to the Internet. Overhauling these outmoded laws should be a top priority for Korea.

A critical element missing in Korea's Copyright Act is the failure to give exclusive rights for the on-line dissemination of recorded music. Following a National Assembly member's unsuccessful effort to move forward on legislation, the Ministry of Culture and Tourism has announced plans to introduce legislation to the National Assembly in early 2004 that would provide only narrow "interactive" transmission rights for sound recording producers and performers. Without broadening these rights to take into consideration transmission through webcasting or other noninteractive digital transmissions, both rapidly emerging technologies in Korea, on-line piracy rates may continue to surge and to damage the revenues of both domestic and foreign phonogram industries. Korea should introduce legislation that provides a full set of exclusive rights for sound recording producers.

### **Korea Media Rating Board**

In December 2003, the Korean National Assembly passed legislation that the Korean government has stated grants the Korea Media Rating Board (KMRB) the authority to identify and stop the fraudulent registration of videos, DVDs, and games. Due to the lack of specificity in the legislation, the viability of the system will depend on well-drafted implementing regulations. The KMRB's first draft of these regulations did not contain clear lines of authority for the KMRB and included unnecessary and burdensome documentation requirements. However, the KMRB has committed to redrafting the regulations to address these concerns. The U.S. Government will continue to work with Korea to ensure the regulations will not place any undue burdens on the legitimate rights holders to prove their rightful ownership.

### **Wireless Internet Platform for Interoperability (WIPI)**

The U.S. private sector has alleged that the WIPI telecommunications standard has infringed on U.S. companies' IPR. The U.S. Government will continue to monitor this situation closely.

### **Copyright Act (CA)**

In July 2000 and again in December 2001, the Korean government drafted revisions to the Copyright Act that went to committee in the National Assembly in April 2002. The Copyright Act amendments were passed by the National Assembly in April 2003 and the implementing regulations announced in July 2003. Two important steps were taken to strengthen the Copyright Act. First, the amendments strengthened the effectiveness of technological protection measures (TPMs) by prohibiting the production and trafficking of devices aimed at circumventing TPMs. Secondly, the framework for a "notice and takedown system" was introduced under which an Internet Service Provider (ISP) would be given a legal incentive to respond promptly and positively to requests from rights holders to take down or cut off access to sites where pirate activities are taking place. However, Korea must undertake further steps in

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order to fully comply with the WIPO Copyright Treaty (WCT), which Korea has indicated it intends to join.

With regard to TPMs, Korea's Copyright Act does not clearly protect technologies that manage who can access a work, nor does it prohibit the act of circumvention itself, only the creation or distribution of circumvention tools. A party who strips off protection and leaves the work "in the clear" for others to copy without authorization may escape liability. Until these changes are made, Korea will not have brought its TPM provision into compliance with the global minimum standards embodied in the WCT and WPPT.

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

### **Other Issues**

Concerning library exceptions under the Copyright Act amendments, the U.S. Government believes that a notice period of at least 30 days should be given to the rights holder prior to the unauthorized digitization of their works to minimize any negative effects. Under the current law, library exceptions still apply only to literary works and not to broadcasts, performances and sound recordings. The U.S. government has also urged Korea to delete the reciprocity provisions relating to database protection in the Copyright Act, as it discourages the introduction of databases from other countries without such legislation.

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

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

The modernization of the CPPA to meet current challenges as well as to comply with new global norms continued on an incremental basis in 2003. In December 2002, the National Assembly passed revisions to the CPPA that provided for transmission rights, a critical element of an effective copyright regime in the digital age. The Korean government also accepted the U.S. suggestion that Internet Service Providers should immediately stop the infringing activity upon request of the copyright owner for the purpose of revising or updating programs, or for encryption research. However, the application of the CPPA provisions to access control technologies still needs to be clarified. The CPPA amendments were signed into law on December 30, 2002, and took effect on July 1, 2003, with the implementing regulations becoming effective in August 2003.

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

### **Concerns applicable to both the Copyright Act and the CPPA**

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The United States believes that both the Copyright Act and CPPA need to be strengthened further and has urged Korea to make additional amendments to those laws. Most importantly the reproduction rights accorded works should be clarified and broadened by including: 1) direct or indirect reproduction; 2) temporary or permanent reproduction; 3) reproduction by any means or in any form; and 4) reproduction in whole or in part. The United States has also recommended that the Korean government clarify the availability of injunctive and *ex parte* relief in civil enforcement actions, as required under the TRIPS Agreement.

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

In August 2002, the National Assembly enacted the Publication and Printing Business Promotion Act, which came into effect in February 2003 and allows private sector involvement in enforcement measures against book piracy. The Act gives the Ministry of Culture and Tourism the administrative authority to inspect and dispose of illegal copies of copyrighted books. Whether this new law will provide any practical benefit to U.S. publishers remains to be seen, however. In 2003, the Korean authorities did not carry out effective enforcement efforts against ongoing book piracy which is very common on and near the country's university campuses. The U.S. government will monitor implementation of this law. In February 2004, the Ministry of Education committed to write a letter to all Korean University Presidents, calling on them not to tolerate copyright infringement on their campuses.

Pirated audio-visual materials in DVD format, often sold on the street by illegal vendors, are a serious, emerging problem in Korea. Digital piracy in this sector needs to be addressed by the Korean government with stronger enforcement efforts and deterrent penalties. Despite active enforcement efforts to date, video-DVD piracy in Korea is increasing rapidly because of the growing sophistication of pirate production facilities and more advanced distribution technologies. Intensified and consistent enforcement activities on the part of Korea's law enforcement agencies is needed to cope with the rapidly increasing level of pirated DVDs in the markets and shopping districts of Korea.

### **Patent and Trademark Acts**

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

Despite such progress, U.S. industry still believes that deficiencies remain in the interpretation of claims and in the treatment of dominant and subservient patents. While KIPO has amended Korea's laws to address U.S. concerns regarding restrictions on patent term extension for certain pharmaceutical, agrochemical and animal health products (which are subject to lengthy clinical trials and domestic testing requirements), problems still remain. Of top priority has been the lack of coordination between Korean health and safety and intellectual property officials, which results in the granting of marketing approval for products that may infringe on existing patents. However, in March 2002 Korea agreed to provide full protection against unfair commercial use of test data submitted for marketing approval as required by Article 39.3 of the TRIPS Agreement.

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The Madrid Protocol, an international trademark application system, entered into force in Korea on April 10, 2003. In preparation for membership, the Trademark Act was changed to become compliant with the Madrid Protocol and the Trademark Law Treaty. The Madrid system streamlines and simplifies international application procedures for trademarks and introduces a retroactive damage compensation system for registrants.

The Trademark Act was amended in March 1998 to strengthen provisions that prohibit the registration of trademarks without the authorization of foreign trademark holders by allowing examiners to reject any registrations made in "bad faith." Despite this change, the complex legal procedures that U.S. companies must follow to seek cancellation proceedings acts as a barrier to effective enforcement by discouraging U.S. companies from pursuing legal remedies. In particular these problems still arise with respect to "sleeper" trademark registrations. ("Sleepers" are trademarks filed and registered by Koreans without authorization in the late 1980s and early 1990s, when KIPO was still developing a more effective and accurate trademark examination and screening process) These registrations - although a clear infringement of the rights of legitimate trademark owners - are not challenged and removed.

An Internet Domain Name Dispute Resolution committee was created in 2002 to arbitrate such disputes without going through the courts. The U.S. Government has recommended that Korea include foreign participation on this committee. In October 2003, the Ministry of Information and Communication submitted a bill for an Internet Address Space Management Act to the National Assembly that would enhance the legal foundation of the domain name dispute resolution committee and would prohibit cyber-squatting.

Textile designs were afforded copyright protection (in addition to protection under Korean design law) through the July 2000 revisions to the Copyright Act. However protection of textile designs remains problematic largely because of the lack of enforcement; some Korean companies allegedly pirate U.S.-copyrighted textile designs and export them to third countries where they compete with genuine U.S.-produced goods. The U.S. Government continues to urge Korean authorities to increase efforts to halt the trade in counterfeit goods. In an effort to enhance border enforcement against the exports of counterfeit products, the Korean Customs Service has upgraded its computer system.

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

### SERVICES BARRIERS

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

### Construction

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The construction and engineering markets in Korea were first opened to foreign competition in 1996. Foreign companies may bid on public projects, including the massive capital projects designed to improve basic infrastructure in Korea. Foreign firms still report problems with attempts to renegotiate accepted bid prices, as well as with registration and bonding procedures, which are excessively burdensome.

### **Advertising**

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

Some progress has been shown by KOBACO in recent years in offering more flexible packages and a wider range of commercial time lengths to better meet advertisers' needs. However there are still further changes in airtime sales that should be urgently considered. Firstly, in-program advertising has been proposed several times to KOBACO. The government is reconsidering the issue. Secondly, most television airtime packages are still offered on a monthly basis, limiting the opportunity for advertisers to engage in spot buying of advertising time. This impedes advertisers' ability to run short-term campaigns and tailor their media delivery.

Broadcast advertising censorship presents a continuing source of difficulty for all advertisers and agencies doing business in Korea. The Korea Advertising Review Board (KARB) censorship committee is comprised of representatives of various organizations who change regularly. This handicaps television and radio advertisers since their advertising has to be submitted in its final, fully produced film format for approval by KARB. This approval process contributes significantly to the risk and costs involved in developing new advertising campaigns and introducing new brands into the market. Often the committee requires that substantiating testing be repeated in Korea, disregarding advertising claim substantiation accepted in other countries. In some product categories, such as cosmetics, the Ministry of Health and Welfare requires that advertising copy be additionally approved by the local manufacturers' association in advance of airing or publication. Efficacy claims for pharmaceuticals, over-the-counter medicines and cosmeceuticals are also not permitted. This makes advertising of technologically superior products less effective and ultimately discourages innovation.

### **Screen Quotas**

Korea maintains screen quotas on imported motion pictures, requiring that domestic films be shown in each cinema a minimum number of days per year (currently, 146 days with reductions to 106 days possible if certain criteria are met). The quota discourages trade, cinema construction, and the expansion of theatrical distribution in Korea, and hurts the competitiveness of the Korean film industry. In January 1999 and in December 2000 the National Assembly passed resolutions stating that a relaxation of the screen quota should only be considered if and when Korean films achieve a 40 percent market share. Since 2001, Korean films have maintained a market share close to 50 percent. In 1999, the U.S. and Korean governments suspended negotiations of a Bilateral Investment Treaty pending resolution of the screen quota issue. In 2003, the Roh Moo-hyun Administration indicated renewed interest in resolving this issue, but there has not yet been any movement by Korea on this issue.

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

Korea restricts foreign activities in the free television sector by limiting the percentage of monthly broadcasting time (not to exceed 20 percent) that may be devoted to imported programs. Annual quotas



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also limit broadcasts of foreign programming to a maximum of 75 percent for motion pictures, 55 percent for animation, and 40 percent for popular music. Foreign investment is not permitted for terrestrial television operations.

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

Korea restricts foreign participation in the cable television sector by limiting per channel airtime for most foreign programming to 50 percent. Annual quotas for broadcast motion pictures are set at 70 percent and for animation at 60 percent. These restrictions limit foreign access and the development of Korea's film and animation industries. The Korean government also restricts foreign ownership of cable television-related system operators and program providers to 33 percent, although pending legislation, if passed, would raise the ceiling to 49 percent. Network operators are limited to 49 percent. For satellite broadcasts, foreign participation is limited to 33 percent.

### **Satellite Re-Transmission**

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

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

Presently, there are restrictions on voice-overs (dubbing) and local advertising for foreign re-transmission channels. These restrictions are written into the Korean Broadcasting Commission's guidelines for implementation of the Broadcasting Act, and as such, could easily be revised. Allowing voice-overs in the Korean language would not only make the broadcasts truly accessible to Korean consumers, but also would benefit the Korean economy by creating more studio-production jobs and foreign investment. The prohibition on local advertising for foreign re-transmission channels restricts the long-term viability of foreign re-transmission channels in the Korean market. Foreign re-transmission channels should be allowed to broadcast their content and add/insert local advertising in order to ensure their financial stability as well as to show relevant advertising to their Korean viewers.

### **Accounting**

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

### **Engineering**

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

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

## Legal Services

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

## Financial Services

As a condition of its post-Asian financial crisis IMF economic stabilization package, Korea agreed to bind its OECD commitments on financial services market access in the WTO. Korea's revised schedule of WTO financial services commitments entered into force in September 1999. The U.S. Government will continue to work with Korea to ensure that it meets its WTO and OECD financial services commitments and to establish more liberal treatment of foreign financial services providers.

Foreign-based, non-financial businesses in Korea face burdensome and costly procedural requirements for financial transactions that are inappropriate to Korea's level of development and financial sophistication. For instance, virtually all intra-company transfers are subject to certification. This is a cumbersome, costly, and unnecessary requirement, particularly for transactions between subsidiaries. Even after most foreign exchange transactions were liberalized in 2001, foreign bank and financial subsidiaries must receive Bank of Korea (BOK) permission on their capital account transactions.

## Insurance

Korea is the second largest insurance market in Asia after Japan, with \$51 billion in premiums paid in the fiscal year ending March 31, 2003. The environment for foreign insurance companies has improved considerably since Korea implemented a series of regulatory changes following its 1996 OECD accession. Korea incorporated many of these changes, including expanded market access and national treatment commitments, into the 1997 WTO Financial Services Agreement.

The 1997-98 financial crisis led to an ambitious restructuring of the Korean insurance industry. In 1998, the newly established Financial Supervisory Commission (FSC), the Korean government's financial watchdog and center for financial reform, revoked the licenses of some insurance companies and forced the merger of others on the grounds of insolvency. In addition, 16 life and non-life insurance companies entered FSC-supervised workout programs. (A workout program is a voluntary, out-of-court debt-restructuring framework, which may or may not involve government oversight.)

After failing several times to sell Korea Life Insurance (KLI) to foreign buyers since 1999, the Korean government sold the company to the Hanhwa group in December 2002. KLI has roughly a 16 percent share of the Korean insurance market. The Korean government is gradually liberalizing foreign entry into the life and non-life insurance markets and has lifted some restrictions on partnering with Korean

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financial companies and on hiring Korean insurance professionals. In April 1998, Korea liberalized insurance appraisals and activities ancillary to the management of insurance and pension funds. Korea's brokerage market was opened to foreign firms in April 1998. Several foreign reinsurance firms have since entered the market. In April 2003, the National Assembly passed a new insurance act removing most limitations on business area and working capital. Despite these efforts, there remains a considerable gap between the practices found in developed insurance markets and those in Korea.

### Banking

In the six years since the Asian financial crisis (through September 2003), the Korean government has injected over 86.7 trillion won (\$72.3 billion) in public funds into the commercial banking system, effectively nationalizing it.

The IMF and the U.S. Government have repeatedly urged Korea to privatize state-owned banks to allow market forces to more efficiently allocate financial resources and increase investor confidence in the Korean economy. Over the past several years, this has begun to happen. In January 2000, the Korean government sold its 51 percent stake in Korea First Bank to Newbridge Capital, a U.S. company. Later in 2000, Carlyle Asia, a U.S. private equity firm, purchased a 37 percent share of KorAm Bank. In October 2003, Carlyle Group, announced its intention to sell its stake in KorAm Bank and the acquisition of KorAm Bank to Citigroup Inc. was approved by the Korean Financial Supervisory Service in late February 2004. In January 2002, the Korean government announced a comprehensive plan to sell off its stake in Woori Financial Holding Company, Chohung Bank, Seoul Bank, and Cheju Bank and to liquidate its minority stakes in Korea Exchange Bank, and Kookmin Bank. In June 2002, the Korean Deposit Insurance Corporation (KDIC) listed Woori Financial Holding Company on the Korea Stock Exchange, selling an 11.8 percent stake of the company. One month later, the Korean government sold off a 51 percent stake of Cheju Bank to the Shinhan Financial Group. Chohung Bank was taken over by the locally based Shinhan Bank in August 2003 and the Korean government also sold Seoul Bank to Hana Bank in 2003. In August 2003, Lone Star, a U.S. private equity fund, acquired a 51 percent stake in Korea Exchange Bank for \$1.2 billion - the largest foreign investment in the banking sector at that time.

At the beginning of 2002, Korea modified its regulations to allow foreign bank branches to borrow from their head offices and to include the net borrowing as Class B capital. However, the Korean government did not allow the foreign branches to use head office capital to meet regulatory lending limit requirements and continues to restrict the operations of foreign bank branches based on branch capital requirements. These restrictions limit: (1) loans to individual customers; (2) foreign exchange trading; and (3) foreign-bank capital adequacy and liquidity requirements. Foreign banks are subject to the same lending ratios as Korean banks, which require them to allocate a certain share of their loan portfolios to Korean companies other than to the top four chaebol conglomerates and to small and medium enterprises. Foreign banks are permitted to establish subsidiaries or direct branches. Since 1998, the Korean government opened capital markets to foreigners, permitting foreign financial institutions to engage in non-hostile mergers and acquisitions of domestic financial institutions.

All banks in Korea continue to suffer from a non-transparent regulatory system and must seek approval before introducing new products and services - an area where foreign banks are most competitive.

The April 1999 Foreign Exchange law introduced the first phase of foreign exchange and import-export transaction liberalization. The second phase of foreign exchange liberalization became effective on January 1, 2001 and deregulated foreign exchange and capital account transactions for individuals, but a few restrictions on foreign exchange transactions by corporations and financial institutions still remain.

### Securities

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On June 24, 2000, the Korean government removed limits on local currency issues of stocks and bonds by foreign firms. The Korean government places no limits on foreign ownership of listed bonds or commercial paper, no longer restricts foreign ownership of securities traded in local markets and has removed almost entirely foreign investment ceilings on Korean stocks. By the end of 2003, foreigners owned more than 40 percent of the shares on Korean stock exchanges, according to Korean government statistics. Despite this liberalization, foreign securities firms in Korea continue to face some non-prudential barriers to their operations.

### INVESTMENT BARRIERS

The Roh Moo-hyun government has continued to voice a strong commitment, shared by the previous administration, to create a more favorable investment climate and to facilitate foreign investment. This welcoming attitude for foreign investment on the part of the Korean government, many in private industry and by a growing number of Koreans, could accelerate opening of the Korean economy. But this is not a complete process and nationalist pride and latent resistance on the part of some Koreans still adversely impacts efforts to transform the country into a fully open market economy. While progress has been made in recent years, additional steps are needed to more fully improve the environment for foreign investment, including the removal of remaining structural (and cultural) barriers. U.S. industry has noted reform of labor practices, increased corporate and regulatory transparency, and the undertaking of true structural reform of the economy as being the highest priorities for U.S. investors.

The 1998 Foreign Investment Promotion Act: (1) increased the number of business sectors open to foreign investment (currently, two remain fully closed to foreign direct investment (FDI) including television and radio stations, and 27 remain partially closed); (2) provided more tax incentives; (3) simplified investment procedures; and (4) established Foreign Investment Zones. The Korean government must automatically approve a foreign investor's notification unless the activity appears on an explicit "negative list" or is related to national security, the maintenance of public order or the protection of public health, morality or safety. Since May 1998, foreigners have been permitted to engage in hostile takeovers and may purchase 100 percent of a target company's outstanding stock without consent of its board of directors.

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

The Korean government has taken several important steps to privatize state-owned corporations, although there were no new privatizations in 2003. The Korean government has also removed restrictions on the direct purchase of land by foreigners through the 1998 revision of the Alien Land Registration Acquisition Act. Non-Koreans, however, still cannot produce certain agricultural products for commercial purposes, nor can agriculturally zoned land be taken out of agricultural production.

General Motors (GM) took over Daewoo Motor, the ailing Korean automaker, in April 2002 and launched a new company, GM-Daewoo Auto and Technology in October of that year. Throughout 2003, local creditor banks, in cooperation with the Korean government, have engaged in negotiations to sell key Korean firms such as Hyundai Investment and Trust Securities to U.S. companies. In November 2003, American International Group (AIG) and U.S. venture capital firm Newbridge Capital purchased Hanaro, a telecommunications company.

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While the more liberalized Korean investment regime has increased U.S. investor interest in Korea, additional changes, including a more transparent and predictable regulatory environment, more sustained intellectual property protection, significant progress on structural reform and market opening, and enhanced labor-market flexibility would greatly improve Korea's attractiveness as a destination for foreign investment. The country continues to rely on parochial standards, standards that often benefit local businesses and technologies and discriminate unfairly against foreign companies, in several key sectors. Specifically, multinational investors most often cite labor market inflexibility and labor-management disputes and insufficient regulatory transparency as the most serious obstacles to attracting more foreign direct investment to Korea. The Roh Moo-hyun Administration has stated its goal to transform Korea into an economic "hub" in Northeast Asia, but such a transformation will require policy changes that would both liberalize and open up Korea's economy for U.S. and other investors. The Korean government has announced a plan to address some of these changes and is opening up Free Economic Zones (FEZs) with an extensive range of incentives including tax breaks, tariff-free importation, relaxed labor rules, and improved living conditions for expatriates, such as housing, education and medical services. But while establishing these zones is an important stepping-stone to making Korea's business environment more open, liberal and responsive to economic needs, the FEZ's may not address the key factors inhibiting additional foreign investment in Korea.

### ANTICOMPETITIVE PRACTICES

#### Competition Policy

The Korean government's enforcement of its competition policy, although historically weak, has been improving. The Korea Fair Trade Commission (KFTC) has been playing an increasingly active role both in enforcement of Korea's competition law and in advocating for regulatory reform and corporate restructuring. KFTC's powers to conduct investigations and to impose tougher penalties were enhanced in January 1999 with the revision of the Monopoly Regulation and Fair Trade Act. The Act was subsequently revised in December 2000 to broaden KFTC's authority in corporate and financial restructuring and to raise substantially the administrative fines for violations and/or for failure to cooperate with KFTC investigations. In support of the KFTC's more aggressive stance, in October 2003, the Roh Administration submitted legislation to the National Assembly that would extend the KFTC's monopoly regulation authority under that act to allow it to trace the bank accounts of domestic companies through 2007. The proposed legislation would also ban cross-investment between affiliates of parent companies, and double maximum fines (from 5 percent of annual sales to 10 percent) for businesses found engaging in cartels and other unlawful collusive activity. In December 2001, the KFTC fined seven mid-ranking conglomerates (chaebol) \$5.5 million for illegally subsidizing affiliates. In October 2003, the KFTC fined the "Big Five" chaebol (Samsung, LG, SK, Hyundai Motor and Hyundai Heavy Industries) \$27 million for illegal insider deals.

### ELECTRONIC COMMERCE

South Korea is considered by many to be a leader in technology trends. It was among the first countries to see widespread use of wireless phones, and it has more high-speed Internet connections per person than any other country. The Government has actively pursued legislation to encourage electronic commerce.

In August 2003, the government drafted a bill to prevent private information from landing in the wrong hands. Under the bill, the government and public offices could collect private information only with the consent of individuals. Furthermore, both the legal basis and the reason for collecting the information, and the individuals' rights with respect to information collection must be clearly stated either on related

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websites or documents. The bill, if passed at the National Assembly, will take effect as early as July 2005, according to the Ministry of Government Administration and Home Affairs.

In December 2003, the South Korean government teamed up with the private computer security industry to cope with the emergence of digital threats. The Ministry of Information and Communication launched a national cybersecurity agency under its roof, aimed at protecting critical infrastructure and enhancing Internet security. The new organization, the Korea Internet Security Center (KISC), is similar to the Computer Emergency Response Team in the United States, which provides timely alerts, coordinates information among private companies and government agencies, and monitors backbone Internet networks.

The Basic Law on Electronic Commerce establishes the validity and enforceability of digital signatures, as well as the validity and admissibility of electronic messages. The Law addresses the retention of electronic messages and the security necessary to facilitate the growth of electronic commerce. A digital signature certified by the authorized certification authority is deemed a valid signature or seal, and as a general rule, an electronic message shall not be denied effectiveness or validity, relative to other forms of paper-based messages, on the grounds that it is in an electronic form. Similarly, an electronic message shall not be denied admissibility into evidence in any legal proceedings on the grounds that it is in an electronic form.

Korea has also strengthened its regulation of spam. New laws, enacted in July, require online marketers in South Korea to flag their e-mails as advertisements and to set up a free telephone hot line so people can opt out of future e-mails. The laws also forbid marketers from scanning web sites for e-mail addresses. The Ministry of Information and Communication can impose a fine of up to 10 million Korean Won (US\$8305.65) on spam violators. The law also provides criminal penalties for the use of illegal technology or the distribution of maleficent advertisements to minors.

### OTHER BARRIERS

#### Lack of Transparency

The lack of transparency in rule making and in Korea's regulatory system continues to be one of the principal problems cited by investors or exporters seeking to compete in the Korean market. While the Korean government has made some progress in certain areas, many Korean trade-related laws and regulations lack specificity and the implementing regulations often diverge from the objectives of the laws. Korean officials exercise a great deal of discretion in applying broadly drafted laws and regulations, resulting in inconsistency in their application and uncertainty among businesses. Compounding this problem is the Korean government's frequent failure to provide specific and timely notification of planned or actual changes to laws and regulations to all stakeholders. When public comments are solicited, time frames for submission of the comments are frequently insufficient. Furthermore, final legislation, regulations, and rules which do not reflect the extensive comments provided by stakeholders are frequently promulgated by the Korean government. Moreover, vague laws or regulations may be reinterpreted and then applied retroactively, even in cases where companies have sought to fully follow Korean government guidance on implementing domestic regulations. These transparency-related problems continue to be serious problems for market entry in a wide variety of sectors, including agriculture, pharmaceuticals, telecommunications, and automobiles as well as related to the protection of intellectual property. Food producers are particularly negatively affected by the ability of individual Korean government officials to apply their own interpretations of vague or ambiguously worded labeling and product categorization standards. The U.S. Government will place a high priority on these deficiencies in 2004.

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## Anti-Import Bias

The Korean government is no longer directly involved in anti-import campaigns and has taken some steps to discourage overt anti-import activity, but concerns about anti-import biases remain. The legacy from past anti-import campaigns has proven difficult to overcome in several key industrial, agricultural and technology sectors, and among Koreans at large. For example, a 2001 survey revealed that the main factor restraining imported car sales in Korea is social pressure and the negative public image of foreign cars in Korea. Another Korean study completed in January 2002 confirmed these findings and found that such attitudes weaken the competitiveness of the Korean automotive sector.

In 2003, the Korean government continued to take steps to improve attitudes toward foreign cars and there was gradual, but steady improvement in Koreans' perception of imported vehicles. Much of the improvement can be attributed to public statements encouraging Koreans to purchase imported cars, along with tax authorities' public statements that audits will not be conducted on the basis of foreign car ownership. In an important symbolic step, the Korean government purchased 50 U.S.-made cars in 2002 and purchased another 50 imported cars in 2003 for use as highway patrol cars for Korea's National Police Agency. These 100 cars equal more than one-third of the Agency's fleet. The Korean government also lent its support to the establishment of an "imported car" taxi fleet with 100 imported mini-vans prior to the opening of the 2002 World Cup games. Senior-level officials from the Korean government publicly supported the May 2003 Import Motor Show. Finally, the Korean government disseminated the results of twin studies by U.S. and Korean economic research institutes on the contribution of foreign automakers and foreign autos to the development of the Korean automotive industry and the overall Korean economy. It is essential that the Korean government continue to launch these kinds of targeted activities in the future and make sustained and vigorous efforts to help eliminate the negative attitudes of Koreans toward foreign cars.

In December 2003, the Hanwoo Association, which represents Korean beef producers, indicated that it planned a mid-December protest against the import of U.S. cattle, alleging a lack of "U.S. beef safety." Korean agricultural industry attitudes in this regard have a long history. In April 2001, the National Agricultural Cooperative Federation (NACF), a quasi-government producer group that allocates Ministry of Agriculture (MAF) policy-directed loans, showed solidarity with several Korean livestock-related farmer associations in demonstrations against Korea's liberalization of its live cattle market as is required by its Uruguay Round commitment. In the past, demonstrators killed or injured imported cattle as they were offloaded from detained transport trucks while riot police, sent to protect such animals, stood by watching. The U.S. Government relayed its serious concerns about NACF's activities, especially given its links to the Korean government.

Last year, farmer associations also approached the Cheju Citrus Cooperative, the administrator of Korea's citrus import quota, regarding importing citrus that the farmers claimed undermined prices of various domestic fruits and vegetables. The Cheju Citrus Cooperative subsequently chose not to tender for the remaining quota, the third year Korea failed to do so.

Effective July 1, 2002, the Korean Fair Trade Commission (KFTC) began requiring the inclusion of a notification of the presence of biotechnology-enhanced components in advertisements. KFTC defines the "presence" of a biotechnology component as principal information to be provided in an advertisement for any food product required to be labeled by MAF or FDA in the revision of the guideline entitled, "Notification of Principle Information on Labeling and Advertisement." According to KFTC's advertisement notification, the requirement applies to anyone who manufactures or sells biotechnology-enhanced products and advertises such products in printed materials such as newspaper or magazine or through broadcast media such as television. U.S. officials have encouraged Korea to

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eliminate this unique non-science-based requirement on the grounds that it duplicates existing labeling requirements and creates an unfounded negative perception of biotechnology products among consumers.

### Motor Vehicles

In 1998, the United States and Korea concluded a Memorandum of Understanding (MOU) to improve market access for foreign motor vehicles. Although the Korean government has implemented many of its commitments under the 1998 MOU, the United States continues to have serious concerns about the lack of progress toward the key goals of the agreement including substantially increasing market access for foreign motor vehicles and establishing conditions so that the Korean motor vehicle sector operates according to market principles. While Korean auto exports to the U.S. market hit record levels in 2003, the sales of foreign autos in Korea totaled 19,461 vehicles which represented only 1.9 percent of the Korean market. In 2003, U.S. exports to Korea totaled only 4,100 vehicles.

The United States continues to strongly urge Korea to take additional meaningful actions to open the automotive sector as envisioned in the MOU, including elimination or reduction of Korea's eight percent tariff on automobiles, which would signal to Korean consumers that the Korean government is serious about opening the automobile market to foreign competition. The U.S. Government presented a written proposal in late 2003 requesting the Korean government to consider basing the calculation of Korea's multiple cascading automobile taxes on the actual value of imported vehicles at port of entry (cif) rather than on the cif value plus the tariff as under the current system. However, this proposal does not lessen the priority the U.S. Government places on Korea's effort to reach its MOU commitment to develop and implement a plan to re-structure and simplify the automotive tax regime in a manner that enhances market access for imported vehicles. U.S. industry has provided the Korean government with ideas on how this very important MOU commitment can best be met. The U.S. Government expects a lowering of the overall tax burden, a reduction in the number of taxes assessed on vehicles, and a movement away from engine-displacement taxes towards a value-based system.

The U.S. Government looks forward to detailed discussions with the Korean government on its plans to streamline the tax structure in 2004. The United States also looks toward the positive resolution of the remaining standards and certification issues, including the successful implementation of Korea's self-certification system, and continued efforts to address any anti-import sentiments and negative perceptions that could serve as significant barriers to the purchase of a foreign automobile. While steps in each of these areas are critical, reduction of the tariff - which a Korean study showed would increase foreign auto imports to 12 percent of the total market in 5 years if the tariff were reduced to 2.5 percent - and simplification of the auto tax system would have the most immediate and significant impact.

The United States continued to hold frequent consultations with Korea to resolve outstanding issues (*See also "Standards and Conformity Assessment Procedures"*). During 2003 the auto standards experts working group met on an ad hoc basis and made progress in resolving concerns with the implementation of self-certification and other standards issues. In July 2003, the Korean government modified the Special Consumption Tax from a three-tier to a two-tier system that is still based on engine displacement size. After the modification, vehicles with engine displacement up to 2000 cc were taxed at 5 percent while vehicles with engine size of 2000 cc or greater were levied a 10 percent tax. Even though the U.S. Government continues to urge the Korean government to undertake such changes in a transparent manner which fully involves all stakeholders, this decision was made by the National Assembly with only a few days notice, allowing little time for industry or U.S. Government comments. It is highly unfortunate that such important decisions are being made in a such non-transparent manner. The U.S. Government will work closely with the Korean government in 2004 to encourage the development of more transparent processes that allow for input from all stakeholders, domestic and foreign.



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The United States and Korea have reviewed corporate restructuring in the Korean motor vehicle sector. A portion of the Daewoo Motor Company, which went bankrupt in July 1999, was purchased by General Motors in October 2002 after several months of negotiations and due diligence. GM Daewoo began production of a new model small sedan the same month. The U.S. Government will continue to urge Korea to rely on market-based solutions to restructure the automotive and other sectors and will closely monitor actions that may have a direct impact on the ability of U.S. firms to compete in the Korean market.

### Motorcycles

Although progress was made in 2002 to resolve U.S. concerns over Korea's pass-by-noise standard, several market access issues remain including a highway ban, tariff and tax levels, and standards and certification procedures. Korea's highway ban is the most serious of these barriers because it prohibits the use of motorcycles on expressways and on designated bridges and severely restricts the market penetration potential for heavyweight motorcycles, safely designed for highway use. Korea is the only major world market in which heavy motorcycles are denied access to major highways and designated overpasses in cities. Traffic safety statistics from other developed countries and research organizations demonstrate that highways are actually safer for motorcycles than are other types of roads with numerous intersections and hazards. The U.S. and Korean governments continue on-going consultations on lifting the ban.

### Pharmaceuticals

Korea's pharmaceutical policies disadvantage research-based pharmaceutical firms and diminish Korea's contribution to research and development of new, innovative pharmaceutical products. The Korean government often has developed its policies in this sector in a non-transparent manner without adequate input from domestic or foreign stakeholders. Moreover, the Korean government has largely failed to consult in advance with the U.S. Government on proposed measures, despite the 1999 U.S.-Korea agreements on pharmaceuticals. To address U.S. concerns about transparency and pre-notification, Korea agreed in January 2002 to establish a bilateral health-care reform working group. The group provides a forum for foreign pharmaceutical companies to discuss their view of changes the Korean government is contemplating and to establish a dialogue on health-care reform. The U.S. and Korean governments serve as observers on the working group. The United States supports the continuation of the working group, which it hopes will address transparency concerns by sharing information with industry and other key stakeholders in a timely manner.

In 2002, Korea adopted new Triennial Repricing and Lowest Transaction Pricing measures and issued new proposals on Reference Pricing. Under the LTP system, Korea reduced the reimbursement price of a pharmaceutical from the weighted average price of the previous quarter's sales to the lowest transaction price of the previous quarter's sales. The Korean government failed to consult with the United States on this issue as agreed. The Korean government subsequently decided not to continue the Lowest Transaction Price pilot program, and returned to a system of reimbursement based on the average weighted price, beginning in September 2003. While this is a positive step, the U.S. Government is seriously concerned that the initial round of price cuts based on the LTP methodology will not be rescinded. Despite some progress made in 2003 in improving transparency and information flow to the private sector, as a general matter the Korean government still fails to provide adequate transparency in its policy-making process for pharmaceuticals.

*Actual Transaction Price:* One of the major problems with the Korean pharmaceuticals market remains how to institute a fair and transparent pricing regime. In 1999, Korea agreed to price innovative drugs at the average ex-factory price of A-7 countries (United States, United Kingdom, Germany, France, Italy,

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Switzerland, and Japan). All other drug prices would be determined using the Actual Transaction Price (ATP) system. The ATP was intended to end hospital practices of demanding a discount from pharmaceutical manufacturers when purchasing drugs, and then receiving a full reimbursement from the government-operated national health insurance system. As mentioned above, ATP has only recently been reinstated after being replaced by LTP for a period of one year. Currently, Korea allows wholesalers to bundle their sales of drugs to hospitals and doctors. Consequently, there is difficulty in accurately determining the individual transaction cost of pharmaceutical sales. Bundled products that are sold include both low-margin and high-margin products in one package. The reimbursement price based on an average of the prices thus favors the low-margin drugs and disadvantages the high-margin drugs. The Korean government established a distribution task force (DTF) in September 2003 with the hope of that it would resolve such problems in the wholesale distribution system. The U.S. Government is currently working with Korean government on this issue.

*Triennial Repricing:* The Triennial Repricing system was adopted in August 2002 for all drugs registered on the national reimbursement list as of the end of 1999. All registered drugs will be subject to repricing every three years under this system, which took effect on January 1, 2003. The system is expected to reduce prices for 2,732 products by an average of 7.2 percent in its first year. The U.S. Government and industry have expressed concern that the repricing system does not properly reflect innovation and discriminates against foreign producers. In addition, the repricing system does not allow for price increases when data supports such action. The repricing system was implemented without meaningful consultation, and the lack of transparency continues to be a problem.

*Reimbursement Guidelines:* As part of its efforts to trim health-care costs, the Health Insurance Reimbursement Agency (HIRA) has imposed restrictive reimbursement guidelines on the innovative drugs of several foreign pharmaceutical companies without a rigorous transparent scientific review. These guidelines are initially set by the Korea Food and Drug Administration, but can later be modified by guidelines established by HIRA. The process for establishing these modified guidelines is non-transparent. Although an appeals process exists, it is not codified by law, and the appeal is not made to a separate appeals panel but to the same office that made the initial ruling. The U.S. Government has raised concerns regarding the guidelines with the Ministry of Health and Welfare (MHW) and HIRA since 2002, and continues to urge the Korean government to develop a transparent process for revising reimbursement guidelines. The government-industry working group initiated a task force to look at improving transparency in the reimbursement guideline-setting process. Korea has pledged to examine how reimbursement guidelines are set in other developed countries. Since February 2003, the Korean government has also provided advance notification to companies whose products will be subject to a review of the reimbursement guidelines.

In addition to pricing and reimbursement problems, other issues under MHW's purview include Drug Master File requirements, redundant local testing of biologics and vaccines, and requirements that clinical trials completed elsewhere be duplicated in Korea (See also "Standards and Conformity Assessment Procedures").

### Medical Devices

The United States continues to be concerned about reimbursement pricing practices (particularly related to orthopedic devices and cardiovascular / endovascular devices), hospitals' buying practices, proposed provisions of the Medical Devices Act, and a proposal for third party review of product approvals. There is a need for more transparency and streamlining of the regulatory approval process.

In late 2002, MHW approved proposed HIRA price reductions on medical products from 2 percent to 75 percent, depending on the product and category. These reductions, effective January 1, 2003, are

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especially burdensome for all categories of orthopedic devices, for which reimbursement prices have been reduced between 14 percent and 60 percent.

In October 2003, the Korea Health Industry Development Institute (KHIDI) completed a study containing various recommendations for pricing, re-pricing, and disposable medical device management (including re-use and processing of human organs for surgical treatment). On pricing, KHIDI recommended setting price ceilings for new medical products at 90 percent or below the prices of similar products; using cost data (manufacturing costs for local manufactured products and import Free On Board prices for imported products) for calculations; setting a ceiling of 10 percent above the current market price for new medical technology; using prices in other countries (including Japan, France and Taiwan) as pricing benchmarks; and conducting re-pricing every two years. Industry has expressed concern, and asked for a hearing on the study results.

The Medical Device Act (MDA) was passed by the National Assembly in May 2003 and Implementing Regulations were being drafted in late 2003. The MDA, which takes effect on May 29, 2004, establishes a new legal framework for the regulation of medical devices, currently governed along with pharmaceuticals under the Pharmaceutical Affairs Act. The new legislation includes a modification of the current classification system of three categories of medical devices into four by creating two categories from the original class II category. This revised four-class system will be consistent with global trends and will allow U.S. device firms to use global data for registration approvals with less need for data specific to Korea.

In compliance with WTO obligations to eliminate tariffs on medical products, in 2000 the Korean government eliminated tariffs on orthopedic devices and in 2004 plans to eliminate tariffs on other medical products.

### **Cosmetics and Cosmeceuticals**

The United States welcomes the Korean government's stated goal of moving toward self-regulation in the cosmetics sector; however, there is a significant amount of work left to be done for Korea to achieve this goal, and obstacles to the entry and distribution of foreign cosmeceutical products in Korea remain. Korea has testing and import authorization requirements for cosmeceuticals that appear excessive.

When the Korean Cosmetic Products Act (KCPA) became effective July 1, 2000, a new product category "cosmeceuticals" was created. Under KCPA, cosmeceuticals must be reviewed for safety and efficacy by the Korean Food and Drug Administration (KFDA) and must not be "falsely advertised" to have functions beyond proven efficacy. The KCPA regulations relating to cosmeceuticals go far beyond requirements in this area set by Europe, the United States, or Japan, and the approval process is lengthy. Compliance with Korean regulations remains difficult, particularly for foreign manufacturers who must incur additional expenses for onerous and duplicative testing and labeling requirements. Because imported products are produced overseas, foreign companies must submit more data to prove their efficacy, which often is business proprietary. Furthermore, Korea is in the process of drafting a new Cosmetic Act, which will broaden the definition of "cosmeceuticals" and likely create more challenges to foreign cosmetic companies in Korea.

Moreover, the process of introducing new products in Korea is difficult because of a tendency on the part of the Korean bureaucracy to resist products and procedures that are different from those used by domestic companies. Foreign cosmetics often contain different ingredients or different concentrations of common ingredients and often use differing testing procedures in their home country, and the KFDA has tended to be conservative when foreign product applications come before it. This problem has been exacerbated since the cosmeceutical product approval process has been taken over by the KFDA, as that

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agency is still refining its approval procedures. KFDA has also added another requirement for foreign cosmetic companies to submit original Certificates of Manufacture and Sales prior to import, both of which contain company proprietary information. The stated purpose of this requirement is to ensure that no cosmetic products containing prohibited ingredients are imported into Korea. However, local manufacturing companies are not required to submit such documents to ensure the safety and quality of the ingredients used in their cosmetic products. The United States continues to work with the Korean government to further simplify and increase the transparency of the cosmetics testing procedures and product approvals process and to ensure that all cosmetics companies fully understand the scope and requirements of the KFDA regulations.

### Telecommunications

As one of the world's most advanced telecommunications markets, Korea is actively commercializing a variety of cutting-edge wireless technologies, such as IMT 2000, cdma2000 1ev-do, and W-CDMA, as well as introducing terrestrial and satellite-based digital TV broadcasting. Despite rapid growth in the sector, U.S. suppliers have been hurt by excessive governmental influence over private operators' selection of technologies and interference in issues such as foreign licensing and technology transfers. This governmental influence on the equipment and technology choices of private companies is often implied in the licensing process for operators and is clearly evident in localization policies for procurement. The Korean government's control over tariff rate approvals, equipment certification, and other regulatory authority provides it the means to exert strong influence over industries' selection of specific standards or technologies.

The Korean government appears to be discouraging use of foreign-sourced goods and services for certain telecommunications applications, while simultaneously supporting development of a national standard for those applications based upon a domestic technology. The Ministry of Information and Communications funds development of domestic telecommunications technologies through its research and development arm, the Electronics and Telecommunications Research Institute (ETRI). The U.S. Government has recently stepped up efforts to urge Korea to ensure that Korea allows fair and open competition in this sector. In particular, the U.S. Government has urged the Korean government not to mandate specific technologies or intervene in private sector negotiations. Failure to do so on Korea's part would send a negative signal regarding the receptivity of the Korean market to foreign investment.

A key issue for U.S. industry and the U.S. Government is implementation of the domestic Wireless Internet Platform for Interoperability (WIPI) standard for mobile phone applications. The U.S. Government continues to have a number of concerns related to WIPI, including: inappropriate government involvement in the creation, standardization and deployment of WIPI; recent actions taken by the Korean government to discourage Korean telecommunications service providers from subscribing to competing foreign technologies; overly-restrictive WIPI specifications which appear designed to keep competing foreign systems out of the market; and possible infringement on U.S. companies' intellectual property in the creation/promulgation of the WIPI standard. These issues have been raised at recent bilateral meetings and the U.S. Government continues to urge the Korean government to fulfill all of its bilateral and multilateral commitments related to the deployment of new standards in the market, whether or not such standards are mandatory. The Korean government has stated that it will not make any decisions on whether to mandate WIPI in the Korean marketplace until it has fully consulted bilaterally and within the WTO.

The Korean government has also announced plans to reallocate the 2.3-gigahertz spectrum to a new portable broadband Internet system and has informed the U.S. Government that it will only permit one technology standard to be used for this service. At the insistence of the United States, the Korean government provided a written justification for its one-technology preference in January 2004. The U.S.

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Government and private sector have found serious flaws in Korea's justification, some of which call into question Korea's adherence to its bilateral and WTO commitments. As with WIPI, consultations between the governments, which include participation by experts from the private sector, are ongoing.

The Korean government's plans for deployment of WIPI and broadband Internet in Korea appear indicative of larger policy goals being pursued by the Korean government that could put a serious strain on U.S.-Korea trade relations. The Korean government has publicly initiated an aggressive policy of reducing royalty payments made to foreign firms and encouraging the development of domestic standards and core technologies. The U.S. Government views this development as necessarily discriminatory against foreign technology producers. The U.S. Government has expressed repeatedly its strong concerns that the decision to limit permissible service to a single technology is overly trade restrictive, and that the current selection process discriminates against foreign technology and favors selection of the standard under development by government-funded ETRI.

In the services sector, foreign ownership restrictions, including a ceiling of 49 percent foreign ownership for facilities-based (Type 1) carriers also impede the access of foreign firms in the Korean market. The Korean government divested the government's final holdings in Korea Telecom (KT) in May 2002. The United States believes that full privatization should inject much-needed competition into the market and allow more U.S. suppliers to qualify for KT procurement through locally qualified agents and distributors. However, the true measure of effectiveness of privatization will be demonstrated through KT's commitment to make needed changes to ensure a fair, transparent, and non-discriminatory procurement process.