

United States International Trade Commission

U.S.-Korea Free Trade Agreement: Passenger Vehicle Sector Update

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Executive Summary

On February 10, 2011, the United States and the Republic of Korea (Korea) exchanged the legal texts reflecting the agreement they concluded on December 3, 2010, to modify certain provisions of the 2007 U.S.-Korea Free Trade Agreement (FTA) regarding the passenger vehicle sector.¹ These texts (hereinafter referred to as the “accompanying agreement”), as noted in the letter requesting this report, are to provide additional market access for U.S. exports to Korea, in particular by addressing nontariff measures (NTMs) affecting U.S. exports. This report updates the Commission’s 2007 assessment of the likely impact of the FTA on the U.S. passenger vehicle sector. The report focuses on the impact of the accompanying agreement and provides additional analysis of the effects of the reduction or removal of NTMs.

U.S. exports of passenger vehicles to Korea would likely rise significantly in the long term under the provisions of the 2007 FTA as modified by the accompanying agreement. The probable increase in U.S. exports results primarily from three factors: (1) the immediate reduction (from 8 percent to 4 percent) and eventual elimination of Korean tariffs on passenger cars during the first five years of the FTA’s implementation, (2) a substantial increase in the number of U.S. passenger vehicle exports to Korea that would be deemed compliant with Korean safety standards, and (3) changes to the qualification requirements for Korean imports of U.S. passenger vehicles to meet Korean environmental standards. Any increase in U.S. exports of passenger vehicles to Korea is likely to be tempered by the longer phase-in period under the accompanying agreement for the elimination of Korean tariffs, as compared with the 2007 FTA, and may be affected by Korean market preferences. In this report, the Commission’s economic simulation estimates that removal of Korean NTMs that affect U.S. exports of passenger cars could lead to an increase in U.S. exports of \$48–66 million (41–56 percent).

The Commission’s 2007 report included the results of its economic simulations of the effects on the broader motor vehicles and parts sector of implementing the 2007 FTA. The changes in the tariff staging in the accompanying agreement do not affect the results of the economic simulation because the Commission’s simulation applies only to the full implementation of the FTA. Although the trade effects that are estimated by such simulations tend to be reasonably stable in terms of percentage changes, the estimated effects in terms of changes in dollar value can be sensitive to annual changes in trade flows. Therefore, differences between the 2007 estimated effects and the effects estimated in the current update are not the result of changes in the FTA’s passenger vehicle tariff provisions, but rather stem from changes to the economic environment (e.g., the recent economic downturn) and declines in trade flows in 2009 (the absolute volume of trade in motor vehicles and parts between the United States and Korea was 30 percent lower in 2009 than in 2007).

Using 2009 data, the Commission’s economic simulation of the broader motor vehicles and parts sector estimates that implementing the 2007 FTA would likely lead to an increase in U.S. sector exports to Korea of \$194 million (a 54 percent increase); this estimated percentage increase is similar to the 2007 Commission estimate (46–59 percent), whereas the estimated dollar-value increase in this update is lower, reflecting the economic downturn and reduced trade flows of 2009.

¹ The signed texts consist of (1) an exchange of letters containing new commitments for the motor vehicle sector, (2) Agreed Minutes on regulations pertaining to motor vehicle fuel economy and greenhouse gas emissions, and (3) Agreed Minutes on intracompany transferee (L-1) visas.

U.S. tariffs on imports of Korean passenger vehicles also will eventually be eliminated under the FTA. The effect of the FTA on U.S. imports of these goods will likely be less pronounced in terms of percentage increase in the short term than in the case of Korean imports of U.S. passenger vehicles. There are three reasons for the difference: (1) the U.S. tariff elimination for passenger cars will be implemented only in the fifth year of the FTA's implementation, with no reduction in the interim; (2) current U.S. tariffs on passenger vehicles are already lower (2.5 percent) than Korean tariffs (8 percent) on these goods; and (3) passenger car production by Korean manufacturers in the United States may increase as a result of capacity expansion. The Commission's economic simulation estimates that U.S. imports from Korea of products in the broader motor vehicles and parts sector would likely rise by \$907 million (11 percent) following implementation of the 2007 FTA, including removal of U.S. passenger vehicle tariffs; this estimated percentage increase is similar to the 2007 Commission estimate (9–12 percent), whereas the estimated increase in dollar value in this update is lower, again reflecting the economic downturn and reduced trade flows of 2009.

Introduction

This report, requested by the U.S. House of Representatives Committee on Ways and Means (Committee) in a letter dated January 27, 2011,¹ updates a 2007 U.S. International Trade Commission (Commission) assessment regarding the likely impact of the U.S.-Korea Free Trade Agreement (FTA) on the U.S. passenger vehicle sector.² The Committee requested that the Commission update its 2007 assessment of those FTA provisions affecting the passenger vehicle sector, to reflect any changes affecting only that sector as detailed in the accompanying agreement to the 2007 FTA, dated February 10, 2011 (hereinafter referred to as “the accompanying agreement”).³ The Committee also asked that the Commission include an economic simulation of the effects of nontariff measures (NTMs) affecting the passenger vehicle sector in its report. The Committee requested that the Commission provide its report by March 15, 2011.

The Commission’s 2007 assessment of the likely impact of the FTA on the U.S. passenger vehicle sector was part of a comprehensive report that the Commission transmitted to the President and the Congress in September 2007. Following a public hearing and receipt of information from multiple sources, that report assessed the likely impact of the 2007 FTA on the U.S. economy as a whole, on specific industry sectors, and on U.S. consumers.⁴

The information and data in the present report were gathered primarily from public sources, submitted written comments, and interviews.⁵ The Commission did not hold a public hearing for the receipt of information because of the short time frame requested by the Committee for the report’s delivery. The report includes published data and information available through February 2011.

Effect of Changes to U.S.-Korea FTA on the Passenger Vehicle Sector

Assessment

In the long term, when the FTA has been fully implemented, U.S. exports of passenger vehicles to the Republic of Korea (Korea) would likely increase significantly as a result of modifications to provisions in the 2007 FTA agreed to in the accompanying

¹ For a copy of the letter requesting this report, see appendix A. For a copy of the *Federal Register* notice instituting the investigation to produce this report, see appendix B.

² For the purposes of this study, “passenger vehicles” includes cars (classifiable in Harmonized System [HS] subheadings 8703.21, 8703.22, 8703.23, 8703.24, 8703.31, 8703.32, 8703.33, and 8703.90) and light trucks (HS subheadings 8704.21 and 8704.31).

³ For a copy of the legal text of the accompanying agreement and related Agreed Minutes, see appendix C. For information on the passenger vehicle–related provisions in the FTA that were not changed by the accompanying agreement, such as those concerning purchase and ownership taxes, see USITC, *U.S.-Korea Free Trade Agreement*, 2007.

⁴ USITC, *U.S.-Korea Free Trade Agreement*, 2007.

⁵ For summaries of the public submissions for this report, see appendix D.

agreement.⁶ The specific changes contributing to this expected growth include an increase in Korean import limits per U.S. manufacturer for vehicles that meet U.S. safety standards, and changes in qualification benchmarks for U.S. vehicles with regard to Korean environmental standards.⁷

The elimination of Korean import tariffs on passenger vehicles agreed to under the FTA would also contribute substantially to an increase in U.S. exports of passenger vehicles to Korea. However, the accompanying agreement applies a two-step phase-in period to the tariff elimination; the tariff will fall from 8 percent to 4 percent upon entry into force and be reduced to free in the fifth year after implementation of the FTA. The phase-in will delay the full impact of the FTA on U.S. exports beyond the short term.

The accompanying agreement also delays the phase-in period for eliminating U.S. tariffs on most imports of Korean passenger vehicles. This change is likely to minimize the impact of the FTA on U.S. import levels in the short to medium term. U.S. imports of passenger cars from Korea would likely increase upon complete elimination of the 2.5 percent tariff in the fifth year after the FTA enters into force. However, the impact of removal of the 25 percent tariff on light trucks is less clear, because Korea is currently not a leading manufacturer or exporter of light trucks.

U.S. Exports

The 2007 FTA and the accompanying agreement address certain tariff and tax measures, as well as NTMs, that have impacted market access for U.S. exports of passenger vehicles to Korea,⁸ and prescribe a system for consultation and dispute settlement on related issues (table 1). The resulting staged reduction and eventual elimination of tariffs on U.S. passenger vehicle exports to Korea, along with changes to policies that previously acted as NTMs affecting these exports, could lead to a significant increase in U.S. exports, according to the Commission's economic simulations. Much of the increase in the early years of the FTA's implementation will likely be in passenger cars, as U.S. exports of light trucks to Korea were quite small in 2010.⁹ This early increase is unlikely

⁶ For the legal texts examined in this updated assessment, see USTR, "Final United States–Korea FTA Texts," 2007; USTR, "Exchange of Letters between U.S. Trade Representative Kirk and Korean Trade Minister Jong-Hoon Kim," February 10, 2011; USTR, "Agreed Minutes on Regulations," February 10, 2011.

On February 10, 2011, the United States and Korea exchanged the legal texts reflecting the agreement they concluded on December 3, 2010, to modify certain provisions of the 2007 FTA. The signed texts consist of (1) an exchange of letters containing new commitments for the motor vehicle sector, (2) Agreed Minutes on regulations pertaining to motor vehicle fuel economy and greenhouse gas emissions, and (3) Agreed Minutes on intracompany transferee (L-1) visas. For a copy of the legal text of the accompanying agreement and related Agreed Minutes, see appendix C.

⁷ Various provisions of the FTA are intended to address some of the NTMs affecting Korea's market for passenger vehicles, including provisions in chapter 2 ("National Treatment and Market Access for Goods"), chapter 9 ("Technical Barriers to Trade"), the confirmation letter on specific auto regulatory issues, and annex 22-B of the chapter on institutional provisions and dispute settlement, concerning alternative procedures for disputes concerning automotive products. Provisions addressing passenger vehicle-related NTMs are also a main component of the accompanying agreement dated February 10, 2011.

⁸ USITC, *U.S.-Korea Free Trade Agreement*, 2007, 3-75 to 3-78; industry officials, interview by USITC staff, Washington, DC, February 3, 2011; industry officials, interview by USITC staff, Washington, DC, February 4, 2011.

⁹ The United States exported 135 light trucks to Korea in 2010, which was 0.04 percent of total U.S. light truck exports in that year. USITC, DataWeb (accessed March 3, 2011).

TABLE 1 Changes to FTA provisions related to U.S. exports of passenger vehicles to Korea

Provision	Original (2007 FTA)	New (accompanying agreement)
Cars (HS subheadings 8703.21, 8703.22, 8703.23, 8703.24, 8703.31, 8703.32, 8703.33)	Immediate tariff reduction from 8 percent to free	Immediate tariff reduction from 8 percent to 4 percent and reduction to free in the fifth year on all subheadings
Cars with neither spark or compression ignition engines (e.g., electric cars) (HS subheading 8703.90)	Tariff reduced from 8 percent to free in 10 equal annual stages	Immediate tariff reduction from 8 percent to 4 percent, then reduction by 1 percent annually until free in the fifth year
Safety standards	U.S. producers selling fewer than 6,500 units in Korea exempt from Korean standards as long as U.S. standards are met	Limit raised to no more than 25,000 units per manufacturer
Environmental standards	U.S. producers that sell 10,000 or fewer units in Korea would be considered compliant with certain agreed environmental standards	During 2012–15, U.S. producers will be considered compliant with Korean environmental standards if their emissions are within 19 percent of Korean requirements
Purchase tax	Number of engine-displacement categories was lowered, and taxes on each category were reduced	In addition to 2007 FTA provisions, agreed to increase transparency in the creation of new regulations, including a public comment period and an implementation period of usually not less than 12 months
Annual vehicle tax	Simplified and reduced	In addition to 2007 FTA provisions, agreed to increase transparency in the creation of new regulations, including a public comment period and an implementation period of usually not less than 12 months
Safeguard measures	May be applied one time only, for a period of up to two years plus a one-time extension of up to one year, during the 10-year transition period that runs from the time the FTA enters into force. If the period of the measure exceeds one year, the importing party must liberalize the measure at regular intervals. The importing party is required to pay compensation, and in the absence of agreement on compensation, the exporting party may suspend concessions having trade effects substantially equivalent to the safeguard measure.	May be applied more than once, for a period of up to two years plus a one-time extension of up to two years, during the transition period that begins upon entry into force of the FTA and ends on the date that is 10 years after the end of the tariff elimination period (e.g., 15 years for passenger cars and 20 years for light trucks). There is no requirement to liberalize a measure that exceeds one year. There is the same compensation obligation or right to suspend concessions as for other products, except that, in the case of a measure involving motor vehicles, the exporting party may not exercise its right to suspend concessions during the first 24 months that a safeguard measure is in effect.

Sources: USTR, "Final United States–Korea FTA Texts," 2007; USTR, "Exchange of Letters between U.S. Trade Representative Kirk and Korean Trade Minister Jong-Hoon Kim," February 10, 2011; and USTR, "Agreed Minutes on Regulations," February 10, 2011.

to include many plug-in, electric, or fuel cell vehicles, as few to no vehicles of this type are expected to be exported to Korea in 2011.¹⁰

Simulation Results

The Commission's economic simulation¹¹ of the effects on the broader motor vehicles and parts sector¹² of implementing the 2007 FTA estimates that implementation would likely lead to an increase in U.S. sector exports to Korea of \$194 million (54 percent); in percentage terms, this estimated increase is similar to the 2007 Commission estimate (46–59 percent), whereas the estimated increase in terms of dollar value is lower, reflecting the economic downturn and reduced trade flows of 2009.¹³ A separate Commission economic simulation estimates that removal of NTMs affecting U.S. exports of passenger cars could lead to an increase in U.S. exports of \$48–66 million (an increase from approximately \$119 million to approximately \$167–185 million, or 41–56 percent) (box 1).¹⁴ An estimated 50 percent of this increase would be attributable to the displacement of imports into Korea from other countries.

The effect of Korean NTMs in raising the cost of U.S. passenger vehicle exports appears to have been significant. During 2008–10, the average price of U.S. small-displacement passenger cars¹⁵ imported into Korea was 16.6 percent higher than the price of comparable U.S. exports worldwide. This price gap is similar to the price gap of 20 percent found in the 2007 assessment.¹⁶ Imports of U.S. large-displacement passenger cars,¹⁷ which were not examined in the 2007 assessment, showed a price gap of 1.2 percent. The figures resulting from the Commission's economic simulation of the effects of removing NTMs on exports of U.S. passenger cars to Korea are likely an upper bound estimate, as it is possible that implementation of the FTA would not completely eliminate the price gap. In addition, factors that could not be addressed by the economic simulation may affect this estimate.¹⁸

Korean consumer preferences, for example, could lessen the impact of NTM (and tariff) removal on U.S. passenger vehicle exports to Korea. The Korean market has long been

¹⁰ Jung, "Chevrolet Volt to Set EV Pace in Korea," October 22, 2010.

¹¹ The quantitative analysis in this section regarding the tariff provisions of the FTA is based on Global Trade Analysis Project (GTAP) sector 38, Motor Vehicles and Parts. The information presented in this section regarding the effects of Korean NTMs is based on the Commission's economic simulation as detailed in box 1.

¹² The qualitative analysis herein focuses on the subset of passenger cars and light trucks, or passenger vehicles. Other GTAP sector 38 products include automotive parts and engines, commercial trucks, buses, specialty vehicles, and certain containers and trailers.

¹³ These estimates are based on incorporating 2009 trade data into the economic simulation used for the 2007 Commission study. Use of the updated data accounts for any difference between the 2007 and current results. See USITC, *U.S.-Korea Free Trade Agreement*, 2007, 2-8. Total trade between the United States and Korea in motor vehicles and parts was \$12.0 billion in 2007 and \$8.5 billion in 2009.

¹⁴ For an explanation of the economic simulation results, see appendix E. The estimates of the impact of the tariff removal and the removal of the NTMs use separate economic simulations and assumptions and should not be combined in this form to construct a single estimate.

¹⁵ Small-displacement passenger cars have an engine displacement of 1,500–3,000 cubic centimeters (cc) (e.g., the Dodge Caliber).

¹⁶ USITC, *U.S.-Korea Free Trade Agreement*, 2007, 3-77.

¹⁷ Large-displacement passenger cars have an engine displacement of greater than 3,000 cc (e.g., the Ford Taurus).

¹⁸ See appendix E for further discussion of the limitations of the economic simulations.

BOX 1 Potential price and quantity effects of Korean NTMs on imports of certain U.S. passenger cars

U.S. producers seeking to export passenger cars to Korea have identified nontariff measures (NTMs) that may have impeded their access to the Korean market. These measures include burdensome standards, testing, and certification requirements; special taxes; and an opaque regulatory environment. They may restrict the quantity of U.S. passenger car imports into the Korean market, raise the price of these imports, or both.

NTM Quantification

Korean imports of small-displacement passenger cars^a are substantially lower in quantity than imports of the same product into most other economies, relative to the size of the Korean economy. Moreover, the unit value for these imports is substantially higher than for most other countries. The existing tariff of 8 percent ad valorem appears to be too low by itself to account for the relatively low quantity or the relatively high price of imports. The price difference may reflect the effects of Korean NTMs, but it could also be influenced by such factors as market structure, product differentiation, and consumer preferences.

Korean imports of small-displacement passenger cars in 2007–09 represented 0.03 vehicles per million dollars of gross domestic product (\$ GDP), compared to the median figure for 55 comparable countries of 0.35 vehicles per million \$ GDP. Korea ranked 53rd out of the 55 countries in imports of these cars relative to the size of its economy, with only Japan and India ranking lower. This is the most recent period for which such a broad international comparison can be made. Available data for Korea for 2010 show an increase in imports of these cars for that year, to 0.05 per million \$ GDP, but this would still leave Korea ranking 53rd compared to other countries' imports for 2007–09.

The Korean average import price (cost-insurance-freight) for small-displacement passenger cars imported from the United States for the period January 2008–November 2010 was \$18,108 per car. This price is 17.6 percent higher than the average U.S. export price (f.o.b.) of similar cars (\$15,393) over the same period. Allowing for a 1 percent markup for transport costs, the resulting estimated Korean price gap for small-displacement passenger cars from the United States is 16.6 percent. The estimated Korean price gap for large-displacement passenger cars^b from the United States is 1.2 percent.

Simulated Effects

The price gap for a combination of small-displacement and large-displacement passenger cars imported from the United States is 7.5 percent. This price gap is a trade-weighted average of the price gaps that could be attributed to Korean NTMs applied to these passenger cars imported from the United States during January 2008–November 2010, subject to the caveats stated above. The effects of the removal of the 7.5 percent price gap are estimated with economic simulations. These effects are likely upper bound estimates of the probable effects of the FTA's provisions regarding Korean NTMs for U.S. passenger cars.

These simulations suggest that, in the absence of the 7.5 percent price gap, U.S. exports of passenger cars to Korea would rise from an average level of approximately 7,700 units to approximately 10,800–12,000 units, an increase of 41–56 percent. The value of U.S. exports of passenger cars to Korea would increase from approximately \$119 million to approximately \$167–185 million, also an increase of 41–56 percent. The economic simulations suggest that less than 10 percent of the increase in U.S. passenger car exports is attributable to an expansion in the Korean passenger car market; approximately 50 percent of the increase would displace imports from other sources, and approximately 40 percent would displace domestic production.

For further information on these two topics—specifically, the calculation and interpretation of the quantity and unit-value information, and the simulated effects of NTM removal—see appendix E.

Source: USITC staff analysis.

^a Small-displacement passenger cars have an engine displacement of 1,500–3,000 cubic centimeters (cc) and are classifiable in HS subheading 8703.23.

^b Large-displacement passenger cars have an engine displacement of greater than 3,000 cc and are classifiable in HS subheading 8703.24.

perceived as preferring domestic over imported passenger vehicles, which could make Korean consumers less sensitive to changes in price and increased availability of imported passenger vehicles.¹⁹ In addition, there is a concern that consumers will view vehicles that do not meet Korean safety standards as unsafe and avoid purchasing them,²⁰ although U.S. safety standards reportedly are currently “among the most stringent in the world.”²¹

Some observers claim that the market for imported cars in Korea is already gradually improving, as evidenced by imports’ growing market share (table 2).²² In addition, the Korean market tends to be more brand conscious than the U.S. market, suggesting that Korean consumers may be less responsive to changes in price.²³ This may be an advantage for U.S. manufacturers; for example, in January 2011, General Motors eliminated the Daewoo brand name in Korea and began to brand GM vehicles in Korea as Chevrolets, in response to its Korean customers’ preference for the Chevrolet name.²⁴

TABLE 2 Korea: Passenger vehicle market, by source; U.S. producer imports; and imports from the United States, in units, 2006–10

	2006	2007	2008	2009	2010
Total	976,211	1,039,806	1,020,502	1,235,736	1,192,780
Domestic production	935,681	986,416	958,854	1,174,743	1,102,218
Market share (percent)	95.9	94.9	94.0	95.0	92.4
Imports	40,530	53,390	61,648	60,993	90,562
Market share (percent)	4.2	5.1	6.0	4.9	7.6
Imports of GM, Ford, and Chrysler vehicles ^a	4,556	6,235	6,980	6,140	7,450
Market share (percent)	0.47	0.60	0.68	0.50	0.62
Total Korean imports from United States ^b	3,435	6,849	7,773	6,642	13,044
Market share (percent)	0.35	0.66	0.76	0.54	1.09

Sources: GTIS, Global Trade Atlas Database (accessed February 25, 2011); Korean Automobile and Distributors Association, Statistics: New Registrations (accessed February 25, 2011).

Note: Data presented in terms of vehicle registrations with the Korean government. Figures may not sum because of rounding.

^aDoes not include passenger vehicles produced by GM, Ford, or Chrysler in Korea, or brands that were once owned by Ford or GM (e.g., Saab and Volvo), but includes GM, Ford, and Chrysler imports from the United States and other countries.

^bIncludes passenger vehicles produced in the United States by foreign-based producers, such as Nissan.

Korean Passenger Vehicle Market

The Korean passenger vehicle market is the 12th largest in the world, with more than one million registrations per year.²⁵ This market is unusual because of the extremely low level

¹⁹ This preference may continue to be influenced by earlier public practices—e.g., government-led “buy Korean” campaigns as well as overt bureaucratic pressure, such as automatic tax audits for purchasers of foreign vehicles—even though these specific practices have long been ended. Schott, “Negotiating the Korea-United States Free Trade Agreement,” June 2006, 9; Public Citizen, written submission to the USITC, February 14, 2011, 3.

²⁰ Public Citizen, written submission to the USITC, February 14, 2011, 3.

²¹ Biegun, testimony before the House Ways and Means Committee, January 25, 2011, 2.

²² Industry official, interview by USITC staff, Washington, DC, February 17, 2011.

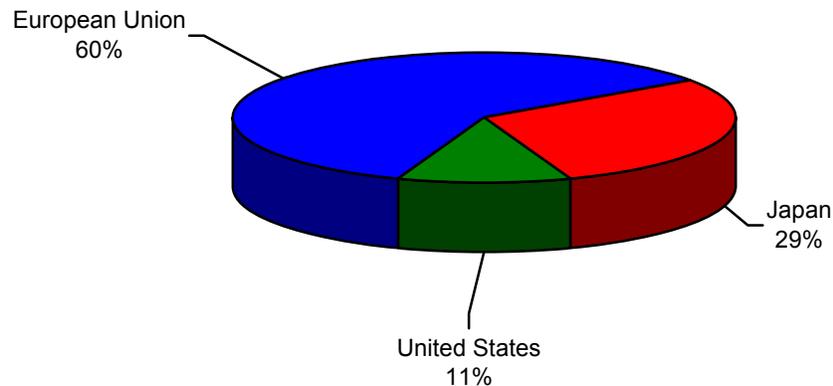
²³ Industry official, interview by USITC staff, Washington, DC, February 16, 2011.

²⁴ Greimel, “GM to Drop Daewoo Name in Korea, Switch to Chevrolet,” January 20, 2011.

²⁵ EIU, “Data Tool” (accessed February 28, 2011).

of import penetration;²⁶ domestic production accounted for 92–96 percent of Korean vehicle registrations from 2006 to 2010 (table 2). During this period, passenger vehicles built in the United States accounted for only 11 percent of Korean imports (figure 1), or less than 1 percent of the Korean passenger vehicle market.

FIGURE 1 Korean imports of passenger vehicles, by trading partner, 2006–10



Source: GTIS, Global Trade Atlas (accessed February 25, 2011).

Changes to the 2007 FTA Provisions in the Accompanying Agreement

With respect to tariffs, Korea agreed in the accompanying agreement to immediately reduce its passenger car tariff from 8 percent to 4 percent and to reduce the tariff to free in the fifth year after implementation.²⁷ For passenger cars with neither spark nor compression ignition engines (e.g., electric and fuel cell vehicles), the tariff will be reduced from 8 percent to 4 percent upon entry into force, and then reduced in equal annual stages until the tariff is completely eliminated in the fifth year. As noted earlier, tariff elimination will likely lower the cost of vehicles imported into the Korean market from the United States, which would contribute substantially to an increase in U.S. exports of passenger vehicles to Korea.²⁸

With respect to NTMs, the accompanying agreement addresses two significant issues—Korean safety regulations and emissions requirements—that reportedly impose the largest NTM-related costs on U.S. passenger vehicle exports because of the costs of research, design, and implementation to meet Korean requirements.²⁹ The United States

²⁶ AAPC, written submission to the USITC, February 14, 2011, 1; Public Citizen, written submission to the USITC, February 14, 2011, 3. For further discussion on a comparison of import penetration in Korea and other markets, see box 1.

²⁷ Korea will immediately eliminate its tariff on light trucks under the 2007 FTA.

²⁸ USITC, *U.S.-Korea Free Trade Agreement*, 2007, 3-78; industry officials, interview by USITC staff, Washington, DC, February 16, 2011; industry officials, interview by USITC staff, Washington, DC, February 17, 2011.

²⁹ Industry official, interview by USITC staff, Washington, DC, February 3, 2011.

and Korea agreed to increase the number of U.S. vehicles produced to U.S. safety standards that can be sold in the Korean market, which has different safety standards.³⁰ As a result, “an originating motor vehicle produced by a manufacturer that sold no more than 25,000 originating motor vehicles in the territory of Korea during the previous calendar year” will be deemed compliant with Korean motor vehicle safety standards if the manufacturer certifies that its motor vehicles exported to Korea meet U.S. safety standards.³¹ The previous limit for calendar-year exports was 6,500 units, and at least one U.S. producer was concerned that such a limit would keep exports per manufacturer at a permanently low level.³²

Upon full implementation of the FTA,³³ these changes will reportedly lower the cost of entering the Korean market for U.S. firms, as they will be able to export vehicles from the United States without incurring the additional research and development (R&D) and production costs associated with vehicle modification.³⁴ When a firm’s annual sales in Korea approach the 25,000-unit threshold, upon the request of either FTA party, the United States and Korea will conduct a review to reconsider that threshold.³⁵

Another important change regarding NTMs provided in the Agreed Minutes of the accompanying agreement allows vehicles exported to Korea by companies that sold less than 4,500 vehicles in Korea in 2009 to be considered compliant with Korean fuel economy and greenhouse gas emissions standards during 2012–15 if they are within 19 percent of either the Korean fuel economy or greenhouse gas emissions standards (table 1).³⁶ There is no limit on the number of passenger vehicles that can qualify to be sold in Korea under this provision, which is a change from the 2007 FTA provision. The Korean emissions standard limits greenhouse gas emissions to no more than 225 grams per mile and requires, in effect, a fleet average fuel efficiency of 40 miles per gallon (mpg) by 2015.³⁷ A new U.S. standard requires fleet average fuel efficiency to reach

³⁰ Korea’s safety standards are a combination of U.S., European, and unique Korean standards. Cooper et al., “The Proposed U.S.-South Korea Free Trade Agreement (KORUS FTA),” November 12, 2010; Platzer, “Pending U.S. and EU Free Trade Agreements with South Korea,” September 1, 2010.

³¹ USTR, “Exchange of Letters between U.S. Trade Representative Kirk and Korean Trade Minister Jong-Hoon Kim,” February 10, 2011.

³² Biegun, testimony before the USITC, June 20, 2007, 241.

³³ According to one source, some of the NTM-related provisions may not be passed by the Korean legislature. USW, written submission to the USITC, February 14, 2011, 1–2.

³⁴ Industry official, interview by USITC staff, Washington, DC, February 3, 2011.

³⁵ USTR, “Exchange of Letters between U.S. Trade Representative Kirk and Korean Trade Minister Jong-Hoon Kim,” February 10, 2011.

³⁶ USTR, “Agreed Minutes on Regulations,” February 10, 2011. GM, Ford, and Chrysler will qualify for this exception, as will certain other motor vehicle manufacturers, while BMW, Honda, Mercedes, Nissan, and Toyota will not. For a more complete explanation and list, see Korean Ministry of Environment, Environmental Transportation Division, “Confirmation on the Scope of Small-scale Manufacturers Concerning the Environmental Regulations for Automotives,” n.d. (accessed March 3, 2011) [in Korean]. For an unofficial translation, see http://trade.ec.europa.eu/doclib/docs/2011/january/tradoc_147432.pdf (accessed March 3, 2011).

³⁷ Schott, “KORUS FTA 2.0,” December 2010, 2.

35.5 mpg (39 mpg for passenger cars) by 2016.³⁸ With the 19 percent allowance provided in the accompanying agreement, U.S. automakers will be able to export U.S.-made passenger vehicles to Korea during 2012–15 as they increase their fuel efficiency levels to meet the 2016 U.S. standard.³⁹ With the allowance, U.S. producers can target 2016 for fuel efficiency improvement in U.S.-made vehicles and export vehicles to Korea without incurring additional R&D expenditures to meet Korean emissions requirements during 2012–15.⁴⁰

Designing (or redesigning) U.S. passenger vehicles to meet Korean safety standards and emissions requirements would be especially expensive because the near-term costs would be spread among the small volume of vehicles currently destined for the Korean market.⁴¹ Although estimates of the cost of meeting the requirements are unavailable, one industry source estimated that, for example, a local retrofit (no extra R&D or redesign) of a vehicle to meet a single Korean safety standard would cost \$500 per vehicle.⁴² Another industry source indicated that Korean safety standards and emissions requirements increase the cost of exporting to Korea to such a level that only vehicles in less price-sensitive sectors (e.g., luxury vehicles) are able to compete in the Korean market.⁴³

In addition to reducing the effects of Korean safety standards and emissions requirements on U.S. passenger vehicle exports, the accompanying agreement improves the regulatory transparency of Korean motor vehicle regulations and taxation.⁴⁴ The accompanying agreement binds the United States and Korea to treat motor vehicle taxation initiatives related to emissions and fuel efficiency as they would any other regulation, with advance notice and a public comment period.⁴⁵ Furthermore, increased regulatory transparency and institution of a comment period, combined with a “period usually not less than 12 months”⁴⁶ for U.S. automakers to meet new standards, would likely provide U.S. automakers time to incorporate design or technological changes needed to meet certain new or changed Korean standards without disrupting exports to Korea.⁴⁷

³⁸ For the 2012 model year, the United States will require a fleet average fuel efficiency of 29.7 mpg (33.3 mpg for passenger cars and 25.4 mpg for light trucks), which increases each year until it reaches the 2016 standard of 37.8 mpg for passenger cars and 28.8 mpg for light trucks for a combined corporate average fuel efficiency of 34.1 mpg. This standard is aimed at reducing fleet average carbon dioxide to 250 grams per mile. The 34.1 mpg standard assumes that some of the reduction in CO₂ emissions will come from changes to the air conditioning system; if all gains resulted from increased fuel efficiency, the required fleet average would be 35.5 mpg (39 mpg for cars). Further increases in the U.S. fleet average fuel efficiency standard have not yet been determined. EPA and NHTSA, *Light-Duty Vehicle Greenhouse Gas Emissions Standards and Corporate Average Fuel Economy Standards; Final Rule*, 40 C.F.R. Parts 85, 86, and 600; 49 C.F.R. Parts 531, 533, 536, et al.

³⁹ Schott, “KORUS FTA 2.0,” December 2010, 2.

⁴⁰ Biegun, testimony before the House Ways and Means Committee, January 25, 2011.

⁴¹ Industry official, interview by USITC staff, Washington, DC, February 3, 2011.

⁴² Industry official, interview by USITC staff, Washington, DC, February 16, 2011.

⁴³ Industry official, interview by USITC staff, Washington, DC, February 3, 2011.

⁴⁴ In the 2007 FTA, the Korean government agreed to simplify its vehicle purchase tax, which is determined by engine displacement size, and reduce the taxes imposed on each category of passenger vehicles, with a particular emphasis on reducing the tax rate for vehicles in the largest engine-displacement-size categories, which includes most U.S. exports. USITC, *U.S.-Korea Free Trade Agreement*, 2007, 3-77.

⁴⁵ USTR, “Exchange of Letters between U.S. Trade Representative Kirk and Korean Trade Minister Jong-Hoon Kim,” February 10, 2011.

⁴⁶ *Ibid.*

⁴⁷ Industry official, interview by USITC staff, Washington, DC, February 16, 2011; industry official, interview by USITC staff, Washington, DC, February 17, 2011.

U.S. Imports

The 2007 FTA and the accompanying agreement remove U.S. tariffs that may have affected market access for U.S. imports of passenger vehicles from Korea. The Commission's economic simulation of implementing the 2007 FTA estimates that U.S. imports from Korea of products in the broader motor vehicles and parts sector would rise by \$907 million (11 percent); this estimated percentage increase is similar to the Commission's 2007 estimate (9–12 percent), whereas the estimated increase in dollar value is lower, again reflecting the economic downturn and reduced trade flows of 2009. An estimated 44 percent of this increase would likely be attributable to the displacement of other countries' exports to the United States.⁴⁸ Because the U.S. import tariff on passenger cars will not be completely eliminated until the fifth year of implementation, and until year 10 for light trucks, most of the impact on U.S. imports of Korean passenger vehicles will likely be experienced in the medium to long term (table 3). Although the U.S. tariff on passenger vehicles without an internal combustion engine (e.g., electric and fuel cell vehicles) will be reduced immediately upon the FTA's entry into force and completely removed in the fifth year of implementation, the impact will be minimal in the near term, as no Korean company currently produces such vehicles commercially. Although the Hyundai Group is developing electric and fuel cell vehicles, it has not publicly announced any plans to export them to the United States.⁴⁹

Changes in the U.S. Passenger Vehicle Industry

The U.S. market for all passenger vehicles declined 30 percent by volume from 2006 to 2010, to 11.6 million units (table 4), largely because of the recent economic downturn. Despite these relatively low sales levels, the United States ranked as the second-largest passenger vehicle market in the world in 2010.⁵⁰

This decreased demand contributed to the restructuring of GM and Chrysler in 2009,⁵¹ which resulted in the shuttering of large amounts of passenger vehicle production capacity in North America.⁵² In 2010, the Hyundai Group, which owns the two Korean brands (Hyundai and Kia) that sell passenger cars in the United States, added a new Kia production facility in West Point, GA, increasing the Hyundai Group's production capacity in the United States to more than 630,000 units.⁵³

This decreased demand contributed to the restructuring of GM and Chrysler in 2009,⁵⁴ which resulted in the shuttering of large amounts of passenger vehicle production

⁴⁸ These estimates are based on incorporating 2009 trade data into the economic simulation used for the 2007 Commission study. Use of the updated data accounts for any difference between the 2007 and current results. See USITC, *U.S.-Korea Free Trade Agreement*, 2007, 2-8. Total trade between the United States and Korea in motor vehicles and parts was \$12.0 billion in 2007 and \$8.5 billion in 2009.

⁴⁹ Hyundai Motor America, "Hyundai Unveils Tucson ix FCEV," February 14, 2011; Hyundai Motor Company, "Hyundai Unveils Its First Electric Car," September 9, 2010.

⁵⁰ EIU, "Data Tool" (accessed February 28, 2011). China was the world's largest market in 2010.

⁵¹ Binder, *Ward's Automotive Yearbook*, 2009, 153.

⁵² *Ibid.*

⁵³ Beene, "Hyundai Ponders 2nd U.S. Plant as Sales Rise," January 17, 2011; Greimel, "Hyundai May Need to Source Elantra from Korea to Meet Demand," January 28, 2011; industry official, interview by USITC staff, Washington, DC, February 28, 2011; Kia Motors Manufacturing Georgia, Inc., http://www.kmmgusa.com/our_company.aspx (accessed March 7, 2011).

⁵⁴ Binder, *Ward's Automotive Yearbook*, 2009, 153.

TABLE 3 Changes to FTA provisions related to U.S. imports of Korean passenger vehicles

Provision	Original (2007 FTA)	New (accompanying agreement)
Cars (HS subheadings 8703.21, 8703.22, 8703.23, 8703.24, 8703.31, 8703.32, 8703.33)	Tariff of 2.5 percent immediately reduced to free upon entry into force for HS subheadings 8703.21, 8703.22. and 8703.23; tariff of 2.5 percent on other subheadings reduced in three equal annual stages until free	Tariff of 2.5 percent in place for four years, then free in fifth year
Cars with neither spark or compression ignition engines (e.g., electric cars) (HS subheading 8703.90)	Tariff of 2.5 percent reduced to free in 10 equal annual stages	Tariff of 2.5 percent reduced to free in five equal annual stages
Light trucks (HS subheadings 8704.21 and 8704.31)	Tariff of 25 percent reduced to free in 10 equal annual stages	Tariff of 25 percent in place for seven years, then reduced to free in three equal annual stages
Safeguard measures	May be applied one time only, for a period of up to two years plus a one-time extension of up to one year, during the 10-year transition period that runs from the time the FTA enters into force. If the period of the measure exceeds one year, the importing party must liberalize the measure at regular intervals. The importing party is required to pay compensation, and in the absence of agreement on compensation, the exporting party may suspend concessions having trade effects substantially equivalent to the safeguard measure.	May be applied more than once, for a period of up to two years plus a one-time extension of up to two years, during the transition period that begins upon entry into force of the FTA and ends on the date that is 10 years after the end of the tariff elimination period (e.g., 15 years for passenger cars and 20 years for light trucks). There is no requirement to liberalize a measure that exceeds one year. There is the same compensation obligation or right to suspend concessions as for other products, except that, in the case of a measure involving motor vehicles, the exporting party may not exercise its right to suspend concessions during the first 24 months that a safeguard measure is in effect.

Source: USTR, "Exchange of Letters between U.S. Trade Representative Kirk and Korean Trade Minister Jong-Hoon Kim," February 10, 2011.

TABLE 4 U.S. passenger vehicle market and sales by Korean producers, in units, 2006–10

	2006	2007	2008	2009	2010
Total sales	16,559,625	16,089,222	13,194,741	10,401,682	11,554,576
Sales of Korean imports	690,802	643,949	562,947	577,042	561,626
Market share (percent)	4.2	4.0	4.3	5.5	4.9
Sales of Hyundai Group (Hyundai and Kia)	749,882	772,482	675,139	735,127	894,496
Market share (percent)	4.5	4.8	5.1	7.1	7.7
Sales of imports	581,677	534,493	486,788	534,756	512,991
Market share (percent)	3.5	3.3	3.7	5.1	4.4
Sales of U.S. production	168,145	237,989	188,351	200,371	381,505
Market share (percent)	1.0	1.5	1.4	1.9	3.3
Sales of GM Daewoo (imports)	109,125	109,456	76,159	42,286	48,635
Market share (percent)	0.7	0.7	0.6	0.4	0.4

Sources: Binder, *Ward's Automotive Yearbook*, 2008–10; *Ward's Automotive Reports*, "Light Vehicle Sales Segmentation," January 17, 2010.

Note: Totals may not sum due to rounding.

capacity in North America.⁵⁵ In 2010, the Hyundai Group, which owns the two Korean brands (Hyundai and Kia) that sell passenger cars in the United States, added a new Kia production facility in West Point, GA, increasing the Hyundai Group's production capacity in the United States to more than 630,000 units.⁵⁶

In spite of a smaller U.S. passenger vehicle market, total sales by the Hyundai Group increased during 2008–10, with a corresponding increase in market share from 5.1 percent in 2008 to 7.7 percent in 2010. The Hyundai Group's market share reportedly increased because of the progressively more favorable perception of their vehicles in the U.S. market due to improved quality and design changes.⁵⁷

Effects of Tariff Removal

The removal of the 2.5 percent U.S. import tariff on passenger cars in the fifth year of the FTA's implementation would likely result in increased U.S. imports of passenger cars from Korea. However, in a development that could partially offset the effect of tariff removal, the Hyundai Group may be considering adding a third production facility in the United States because it is already producing at capacity at its two existing U.S. factories.⁵⁸ During the 2007 FTA assessment, some concern was expressed that removal

⁵⁵ Ibid.

⁵⁶ Beene, "Hyundai Ponders 2nd U.S. Plant as Sales Rise," January 17, 2011; Greimel, "Hyundai May Need to Source Elantra from Korea to Meet Demand," January 28, 2011; industry official, interview by USITC staff, Washington, DC, February 28, 2011; Kia Motors Manufacturing Georgia, Inc., http://www.kmmgusa.com/our_company.aspx (accessed March 7, 2011).

⁵⁷ *Economist*, "Hyundai's Surprising Success," March 5, 2009; Griffith, "Hyundai's 'Overnight' Success a 20-Year Project," March 1, 2010.

⁵⁸ Characterizations of capacity are current as of early 2011 and are not reflected in the 2010 data. Beene, "Hyundai Ponders 2nd U.S. Plant as Sales Rise," January 17, 2011; Greimel, "Hyundai May Need to Source Elantra from Korea to Meet Demand," January 28, 2011; industry official, interview by USITC staff, Washington, DC, February 28, 2011; Kia Motors Manufacturing Georgia, Inc., http://www.kmmgusa.com/our_company.aspx (accessed March 7, 2011).

of the tariff would eliminate the incentive to expand production in the United States,⁵⁹ but tariff changes are only one variable in a firm's decision to build in a foreign location.⁶⁰

The effect on U.S. imports of removal of the 25 percent tariff on light trucks is more uncertain. Currently, the United States does not import light trucks from Korea, and the Hyundai Group (the largest vehicle company in Korea and vehicle exporter to the United States) does not currently produce a light truck for sale in the U.S. market.⁶¹ However, given the 3- to 5-year design cycle for vehicles, it is conceivable that a Korean-owned company could produce a light truck for sale in the U.S. market by the time the tariff on light trucks is removed fully in 10 years.⁶² A Korean producer that does not currently export to the United States, Ssangyong, produces a light truck called the Actyon Sports that it exports to Australia and Europe. Ssangyong is in the process of being purchased by India-based Mahindra & Mahindra Ltd.,⁶³ which is seeking approval for the export of its own light truck to the United States.⁶⁴

Safeguards

The accompanying agreement modifies the procedures for applying safeguard measures to imports of passenger vehicles using the procedures in the trade remedies chapter (chapter 10) of the FTA.⁶⁵ In contrast to the provisions in chapter 10 that apply to safeguard measures in general, in the case of passenger vehicles, the changes allow the importing country (1) to apply a measure for a period of up to 10 years after the end of the tariff elimination period; (2) to extend a measure for up to two years beyond the end of the initial period of the measure; (3) to apply a measure more than once; and (4) to apply a measure without having to progressively liberalize it if it extends beyond one year.

The modifications also create an exception to what would otherwise be the right of an exporting party to suspend trade concessions on goods having substantially equivalent trade effects if the importing party applies a safeguard measure and the parties are unable

⁵⁹ Levin, written submission to the USITC, June 20, 2007; Meyer, "The United States-Korea Free Trade Agreement (KORUS FTA)," written submission to the USITC, June 20, 2007.

⁶⁰ Industry official, interview by USITC staff, Washington, DC, February 28, 2011; Figueiredo, Guimaraes, and Woodward, "Asymmetric Information and Location," 2002, 1–2; Invest in Canada, "Automotive," July 8, 2010; MacCarthy and Atthirawong, "Critical Factors in International Location Decisions: A Delphi Study," 2001, 1–2; Blonigen, "A Review of the Empirical Literature on FDI Determinants," 2005; Helpman, "Trade, FDI, and the Organization of Firms," 2006; Sturgeon and Van Biesebroeck, "Crisis and Protection in the Automotive Industry: A Global Value Chain Perspective," September 2009, 2–3.

⁶¹ Binder, *Ward's Automotive Yearbook*, 2009, 176–177, 179–180.

⁶² Industry official, interview by USITC staff, Washington, DC, February 3, 2011.

⁶³ Seo, "Mahindra May Complete Acquiring Ssangyong Controlling Stake in Early 2011," October 13, 2010.

⁶⁴ Dolan, "Mahindra's U.S. Truck Waylaid by Distributor Lawsuit," July 27, 2010.

⁶⁵ The accompanying agreement modifies the procedures for motor vehicles generally classifiable in HS headings 8703 and 8704. Under Article 10.1 of the FTA, a party may apply a safeguard measure if, as a result of the reduction or elimination of a duty under the FTA, an originating good of the other party is being imported in such increased quantities, in absolute terms or relative to domestic production, and under such conditions that the imports of such a good from the other party constitute a substantial cause or threat of serious injury to a domestic industry producing a like or directly competitive good. The safeguard measure may be in the form of a suspension of the further reduction of the rate of duty on the good provided for under the Agreement, or an increase in the rate of duty to a level not to exceed the lesser of the current applied most-favored-nation (MFN) rate of duty on the good in effect that the action is taken; and the MFN applied rate of duty on the good in effect on the day immediately preceding the date this agreement enters into force.

to agree on compensation. In the case of a safeguard measure involving passenger vehicles, the exporting country would not be permitted to exercise its right to suspend concessions for the first 24 months during which the measure is in effect.⁶⁶

⁶⁶ Consultations on compensation between the importing and exporting parties would nevertheless be expected to take place within 30 days after a measure is applied.

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APPENDIX A
Request Letter

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES
WASHINGTON, DC 20515

DOCKET NUMBER
2783
Office of the Secretary Int'l Trade Commission

January 27, 2011

Dear Chairman Okun,

In September 2007, the Commission published its report on the Korea-U.S. (KORUS) Free Trade Agreement (FTA) pursuant to section 2104(f) of the Trade Act of 2002 (*U.S. - Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects*, Investigation No. TA-2104-24 (USITC pub. 3949)).

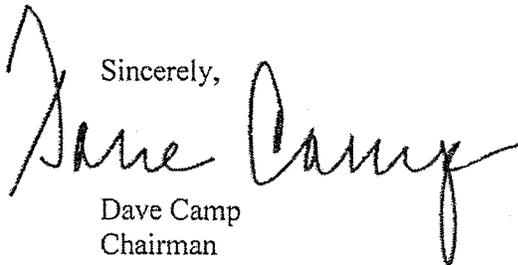
As you know, the United States and South Korea recently concluded negotiations that will provide additional market access for U.S. auto exports to South Korea, in particular, by addressing non-tariff barriers to U.S. exports. Accordingly, pursuant to Section 332(g) of the Tariff Act of 1930, as amended, and on behalf of the Committee on Ways and Means of the House of Representatives, I request that the Commission update its assessment of the impact of the motor vehicle-related provisions in the KORUS FTA, including the supplemental autos agreement, on the U.S. passenger vehicle sector. The Commission should use the most recent data available and should include a modeling simulation of the effects of the auto non-tariff barriers in its assessment.

In preparing its updated assessment, the Commission should consider the text of the Agreement, which we understand will be made public by the end of January, as well as any other information appropriate and consistent with the Commission's statutory mandate. I ask that this assessment be delivered at the earliest possible date, but no later than March 15, 2011.

As we intend to make the report available to the public, we request that the Commission not include confidential business information in its report.

Thank you for your continued cooperation and assistance in this matter.

Sincerely,



Dave Camp
Chairman

APPENDIX B
Federal Register Notice

INTERNATIONAL TRADE COMMISSION**[Investigation No. 332–523]****U.S.-Korea Free Trade****Agreement:****Passenger Vehicle Sector Update****AGENCY:** United States

International Trade Commission.

ACTION: Institution of investigation and request for written statements.**SUMMARY:** Following receipt of a request dated January 27, 2011, from the U.S. House of Representatives Committee on Ways and Means (Committee) under section 332(g) of the Tariff Act of 1930 (19 U.S.C. 1332(g)), the U.S. International Trade Commission (Commission) instituted investigation No. 332–523, *U.S.-Korea Free Trade Agreement: Passenger Vehicle Sector Update*.**DATES:** February 14, 2011: Deadline for filing written statements. March 15, 2011: Transmittal of Commission report to the Committee.**ADDRESSES:** All Commission offices are located in the United States International Trade Commission Building, 500 E Street, SW., Washington, DC. All written submissions should be addressed to the Secretary, United States International Trade Commission, 500 E Street, SW., Washington, DC 20436. The public record for this investigation may be viewed on the Commission's electronic docket (EDIS) at <https://edis.usitc.gov/edis3-internal/app>.**FOR FURTHER****INFORMATION CONTACT:**Brian Allen, Co-Project Leader, Office of Industries (202–205–3034 or brian.allen@usitc.gov) or Deborah McNay, Co-Project Leader, Office of Industries (202–205–3425 or deborah.mcnay@usitc.gov) for information specific to this investigation. For information on the legal aspects of this investigation, contact William Gearhart of the Commission's Office of the General Counsel (202–205–3091 orwilliam.gearhart@usitc.gov). The media should contact Margaret O'Laughlin, Office of External Relations (202–205–1819 or margaret.olaughlin@usitc.gov). Hearing-impaired individuals may obtain information on this matter by contacting the Commission's TDD terminal at 202–205–1810. General information concerning the Commission may also be obtained by accessing its Internet server (<http://www.usitc.gov>).

Persons with mobility impairments who will need special assistance in gaining access to the Commission should contact the Office of the Secretary at 202–205–2000.

Background: In April 2007, the U.S. Trade Representative (USTR) requested that the Commission prepare a report, as specified in section 2104(f) of the Trade Act of 2002 (19 U.S.C. 3804(f)), assessing the likely impact of the U.S.-Korea Free Trade Agreement (FTA) on the U.S. economy as a whole and on specific industry sectors and the interests of U.S. consumers. The Commission transmitted its report (*U.S.-Korea Free Trade Agreement: Potential Economy-wide and Selected Sectoral Effects*, inv. No. TA–2104–24, USITC pub. 3949) to the USTR in September 2007.

The United States and Korea recently concluded negotiations to modify the FTA, including certain provisions relating to the passenger vehicle sector.

In its request letter, the Committee requested that the Commission, under section 332(g) of the Tariff Act of 1930, update its 2007 assessment with respect to the passenger vehicle sector. The Committee asked that the Commission use the most recent data available and include a modeling simulation of the effects of the auto nontariff measures in its assessment.

Written Submissions: Because of the short time frame requested by the Committee, the Commission will not hold a public hearing in connection with this investigation.However, interested parties are invited to submit written statements concerning this investigation. All written submissions should be addressed to the Secretary, and should be received not later than 5:15 p.m., February 14, 2011. All written submissions must conform with the provisions of section 201.8 of the *Commission's Rules of Practice and Procedure* (19 CFR 201.8). Section 201.8 requires that a signed original (or a copy so designated) and fourteen (14) copies of each document be filed. In the event that confidential treatment of a document is requested, at least four (4) additional copies must be filed, in which the confidential information must be deleted (see the following paragraph for further information regarding confidential business information). The Commission's rules authorize filing submissions with the Secretary by facsimile or electronic means only to the extent permitted by section 201.8 of the rules (see Handbook on Electronic Filing Procedures, http://www.usitc.gov/docket_services/documents/handbook_on_electronic_filing.pdf). Persons with questions regarding electronic filing should contact the Secretary (202–205–2000). Any submissions that contain confidential business information (CBI) must also conform with the requirements of section 201.6 of the *Commission's Rules of Practice and Procedure* (19 CFR 201.6). Section 201.6 of the rules requires that the cover of the document and the individual pages be clearly marked as to whether they are the "confidential" or "non-confidential" version, and that the confidential business information be clearly identified by means of brackets. All written submissions, except for confidential business information, will be made available for inspection by interested parties. In its request letter, the Committee stated that it intends to make the Commission's report available to the public in its entirety, and asked

that the Commission not include any confidential business information in the report that the Commission sends to the Committee. Any confidential business information received by the Commission in this investigation and used in preparing this report will not be published in a manner that would reveal the operations of the firm supplying the information.

By order of the Commission.

Issued: January 28, 2011.

William R. Bishop,
Hearings and Meetings
Coordinator.

[FR Doc. 2011-2286 Filed 2-1-11;
8:45 am]

BILLING CODE P

APPENDIX C
Legal Text of the Agreement and Agreed
Minutes Accompanying the U.S.-Korea Free
Trade Agreement

EXECUTIVE OFFICE OF THE PRESIDENT
THE UNITED STATES TRADE REPRESENTATIVE
WASHINGTON, D.C. 20508

February 10, 2011

The Honorable Jong-Hoon Kim
Minister for Trade
Seoul, Republic of Korea

Dear Minister Kim:

I have the honor to confirm the following understanding reached between the representatives of the Government of the Republic of Korea and the Government of the United States of America (“the Parties”) during the course of discussions regarding issues related to the *United States – Korea Free Trade Agreement* (KORUS):

Section A: Tariffs

1. Notwithstanding paragraph 2 of Article 2.3 and the United States Schedule to Annex 2-B of the KORUS, the United States shall eliminate duties on certain goods as follows:
 - (a) For originating goods of heading 8703 subject to staging category “A” or “C”, duties shall remain at the base rate during years one through four. Such goods shall be duty-free, effective January 1 of year five;
 - (b) For originating goods of subheading 870390, duties shall be reduced in five equal annual stages, and such goods shall be duty-free, effective January 1 of year five; and
 - (c) For originating goods of heading 8704 subject to staging category “G”, duties shall remain at the base rate during years one through seven. Beginning on January 1 of year eight, duties on such goods shall be reduced in three equal annual stages, and such goods shall be duty-free, effective January 1 of year ten.

2. Notwithstanding paragraph 2 of Article 2.3 and Korea’s Schedule to Annex 2-B of the KORUS, Korea shall eliminate duties on certain goods as follows:
 - (a) For originating goods of heading 8703 subject to staging category “A”, duties shall be reduced to four percent *ad valorem* on the date the KORUS enters into force. Duties shall remain at four percent *ad valorem* during years one through four, and such goods shall be duty-free, effective January 1 of year five;
 - (b) For originating goods of subheading 870390, duties shall be reduced to four percent *ad valorem* on the date the KORUS enters into force. Beginning on January 1 of year two, duties shall be reduced in four equal annual stages, and such goods shall be duty-free, effective January 1 of year five; and
 - (c) For originating goods of item 0203299000, duties shall be reduced to 16 percent *ad valorem*, effective January 1, 2012; 12 percent *ad valorem*, effective January 1, 2013; eight percent *ad valorem*, effective January 1, 2014; four

percent *ad valorem*, effective January 1, 2015; and such goods shall be duty-free, effective January 1, 2016.¹

Section B: Safety Standards

1. In lieu of paragraphs 2(a) and 2(b) of the self-certification provisions of the letters the Parties exchanged on June 30, 2007 regarding Chapter Nine of the KORUS, Korea shall provide that an originating motor vehicle² produced by a manufacturer that sold no more than 25,000 originating motor vehicles in the territory of Korea during the previous calendar year shall be deemed to comply with Korean Motor Vehicle Safety Standards (KMVSS) if the manufacturer certifies that the motor vehicle complies with U.S. Federal Motor Vehicle Safety Standards (FMVSS).^{3,4}

2. When the Parties consider that annual sales by a manufacturer of originating motor vehicles in the territory of Korea are approaching the 25,000 vehicle threshold set forth in paragraph 1, and upon request of a Party, the Parties shall conduct a review to consider further acceptance of the operation of paragraph 1.

3. Notwithstanding paragraph 1, commercial vehicles⁵ shall comply with the KMVSS items identified in the attached Annex. On request of either Party, the Automotive Working Group as established by Annex 9-B of the KORUS shall discuss modification of the Annex, including its coverage.

4. (a) In exceptional circumstances, where the operation of paragraph 1 creates a serious risk for road safety, human health, or the environment based on substantiated scientific or technical information, Korea may take measures necessary to address the risk, provided that the measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination against the products of the other Party or a disguised restriction on trade.

(b) Before it implements any such temporary emergency measure, and as soon as practicable, Korea shall notify the United States and the importer, and provide an objective, reasoned and sufficiently detailed explanation of the motivation of the measure. Korea should in most cases provide interested persons and the United States a reasonable opportunity to comment on the measure.

¹ For greater certainty, duties shall remain at the base rate until December 31, 2011 or the date that the KORUS enters into force, whichever is later.

² "Originating motor vehicle" means a motor vehicle that qualifies as an originating good of the United States for purposes of the KORUS.

³ For purposes of this Section, "U.S. FMVSS" refers to the whole set of safety standards with which motor vehicles of a particular type must comply in order to be sold or offered for sale in the United States.

⁴ For greater certainty, nothing in this paragraph shall prevent Korea from applying relevant provisions of Korea's Automobile Management Act, as amended, relating to post-market verification and associated regulations pertaining to witnessing of tests and comments on the results of the compliance investigation, to verify the compliance of the originating motor vehicles with U.S. FMVSS. For that purpose, the United States shall, upon request, provide Korea with relevant scientific and technical information related to U.S. FMVSS.

⁵ "Commercial vehicles" does not include pickup trucks with a gross vehicle weight of 4.5 metric tons or less that comply with all U.S. FMVSS relevant for that vehicle type and are produced for general consumers rather than custom-built to a specific order.

5. (a) Neither Party shall prevent or unduly delay the placing on its market of a motor vehicle product on the ground that the product incorporates a new technology or a new feature which has not yet been regulated unless the Party can demonstrate, based on scientific or technical information, that this new technology or new feature creates a risk for human health, safety, or the environment.
- (b) When a Party decides to refuse the placing on its market or require the withdrawal from its market of a motor vehicle product on the ground that the product incorporates a new technology or a new feature creating a risk for human health, safety, or the environment, the Party shall immediately notify the other Party and the importer of the product of its decision. The notification shall include all relevant scientific or technical information.

Section C: Transparency

1. Except in those urgent circumstances referred to in Articles 2.10 and 5.7 of the TBT Agreement, for any technical regulation or conformity assessment procedure that would require a substantial change in motor vehicle design or technology, each Party shall provide an interval between the date of publication of the technical regulation or conformity assessment procedure and the date on which compliance with the measure becomes mandatory that is usually not less than 12 months.

2. Each Party shall periodically⁶ conduct post-implementation reviews of its existing significant regulations affecting motor vehicles. For purposes of this paragraph, “post-implementation review” means an examination of the effectiveness of a standard, technical regulation, or conformity assessment procedure after it has been implemented, including an assessment of whether it achieves its stated objectives, the burden it imposes, and its compatibility with other standards, technical regulations, or conformity assessment procedures the Party has adopted. This paragraph shall apply to Korea beginning two years after the date the KORUS enters into force.

3. Notwithstanding Article 23.3 of the KORUS, Article 21.1 of the KORUS shall apply to a new taxation measure of Korea on motor vehicles that is based on fuel economy or greenhouse gas emissions. The Parties shall make every attempt through cooperation and consultations to arrive at a mutually satisfactory resolution of any matter that might affect the operation of this paragraph. Neither Party may have recourse to dispute settlement under this understanding for any matter arising under this paragraph.

Section D: Motor Vehicle Safeguard

A Party may apply a safeguard measure with respect to a motor vehicle of heading 8703 or 8704 using the procedures set forth in Chapter Ten of the KORUS, with the following procedural modifications:⁷

⁶ “Periodically” means normally at least once no later than ten years after the date a measure is adopted, and as appropriate thereafter.

⁷ For greater certainty, for purposes of a safeguard measure on a motor vehicle good referenced in Section A of this understanding, references to “the Agreement” or a Party’s “Schedule” in Chapter Ten shall be understood to refer to Section A of this understanding, and the term “end of the tariff elimination period” shall be understood to refer to the end of the tariff elimination period set out for that good in Section A of this understanding.

- (a) In lieu of paragraph 5(b) of Article 10.2, the following shall apply: Neither Party may apply a safeguard measure for a period exceeding two years, except that the period may be extended by up to two years if the competent authorities of the importing Party determine, in conformity with the procedures specified in Article 10.2, that the measure continues to be necessary to prevent or remedy serious injury and to facilitate adjustment and that there is evidence that the industry is adjusting, provided that the total period of application of a safeguard measure, including the period of initial application and any extension thereof, shall not exceed four years;
- (b) Paragraphs 6 and 7 of Article 10.2 and paragraph 2 of Article 10.3 shall not apply;
- (c) In lieu of Article 10.4, the following shall apply:⁸
 - (i) A Party applying a bilateral safeguard measure shall consult with the other Party in order to mutually agree on appropriate trade liberalizing compensation in the form of concessions having substantially equivalent trade effects or equivalent to the value of the additional duties expected to result from the safeguard measure. The Party shall provide an opportunity for such consultations no later than 30 days after the application of the bilateral safeguard measure;
 - (ii) If the consultations under subparagraph (c)(i) do not result in an agreement on trade liberalizing compensation within 30 days after the consultations begin, the Party whose goods are subject to the safeguard measure may suspend the application of substantially equivalent concessions to the Party applying the safeguard measure; and
 - (iii) The right of suspension referred to in subparagraph (c)(ii) shall not be exercised for the first 24 months during which a safeguard measure is in effect, provided that the safeguard measure conforms to the provisions of the KORUS with the procedures in this understanding; and
- (d) In lieu of the definition of transition period contained in Article 10.6, the following definition shall apply: **transition period** means the period beginning on the date the KORUS enters into force and ending on the date that is ten years after the end of the tariff elimination period, as the case may be for each good.

Section E: Measures Related to Pharmaceutical Products

Notwithstanding paragraph 1 of Article 18.12 of the KORUS, paragraph 5(b) of Article 18.9 of the KORUS shall apply to Korea beginning three years after the date the KORUS enters into force.

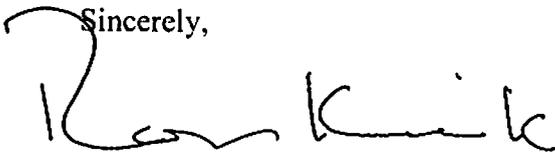
⁸ The absence of a provision on termination of the right of suspension shall not prejudice a panel's interpretation of this paragraph.

Section F: Final Provisions and Dispute Settlement

1. The Parties shall apply Article 1.3 (Extent of Obligations), paragraphs 2 through 5 of Annex 2-B, Article 22.16 (Private Rights), paragraph 1 of Article 23.1 (General Exceptions), Article 23.2 (Essential Security), Article 23.4 (Disclosure of Information), and Article 24.6 (Authentic Text) of the KORUS to this understanding, *mutatis mutandis*.
2. Except as otherwise provided in this understanding, terms used in this understanding that have an assigned meaning in Article 1.4, Article 2.15, Article 9.10, or Article 10.6 of the KORUS shall have that assigned meaning for purposes of this understanding.
3. The Joint Committee established pursuant to the KORUS shall address a matter arising under this understanding, and to this end the Parties shall apply Section A of Chapter 22 of the KORUS to this understanding, *mutatis mutandis*.
4. The Parties shall apply Section B of Chapter 22 and Annex 22-A of the KORUS to this understanding, *mutatis mutandis*.⁹
5. The Annex and footnotes to this understanding constitute an integral part of this understanding.

I have the honor to propose that this letter and your letter in reply confirming that your Government shares this understanding shall constitute an agreement between our two Governments, which shall enter into force on the date that the KORUS enters into force and terminate on the date that the KORUS terminates.

Sincerely,



Ron Kirk

Attachment

⁹ For greater certainty: (a) Where a matter arises under the KORUS and this understanding, a Party may include claims regarding provisions of either or both agreements in a single consultations request, Joint Committee referral, and panel request, and a single dispute settlement proceeding shall address the matter set forth by the Party; (b) The contingent list, model rules of procedure, and code of conduct under Chapter 22 of the KORUS shall be used for this understanding; (c) For purposes of this understanding, the reference to “a benefit the Party could reasonably have expected to accrue to it” in Article 22.4(c) refers to a benefit the Party could reasonably have expected to accrue to it under Section A of this understanding; (d) For purposes of this understanding, the reference to “benefits” that a Party may suspend in Article 22.13 includes benefits accruing to the other Party under this understanding and benefits accruing to the other Party under the KORUS; and (e) Neither Party may claim in a dispute settlement proceeding that a measure is inconsistent with one or more provisions of the KORUS if the measure is consistent with the relevant provisions of this understanding.

Annex

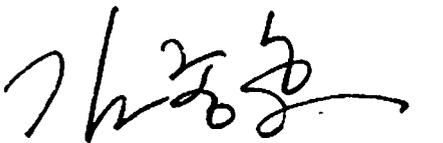
No.	KMVSS Items	KMVSS Citations
1	Maximum length, width and height	Article 4
2	Maximum gross vehicle weight	Article 6
3	Weight distribution	Article 7
4	Maximum stable inclination angle	Article 8
5	Minimum turning radius	Article 9
6	Driving system: mudguard	Article 12.3
7	Steering effort	Articles 14 & 89
8	Brake systems (with or without anti-lock brake system) (except passenger cars)	Articles 15 & 90 (except 90.1)
9	Fuel device (including liquefied petroleum gas container)	Article 17
10	Frame and body: side guard	Article 19.3
11	Rear underrun protection (except trailers)	Articles 19.4 & 96
12	Inside height and width for standing passengers	Articles 28 & 31
13	Militarization device: pintle hook	Article 46
14	Retro-reflection device	Articles 49 & 107
15	Speedometer	Articles 54.1 & 110
16	Speed limiter	Articles 54.2-4 & 110-2

February 10, 2011

Agreed Minutes

1. With regard to Korea's new automobile fuel economy and greenhouse gas emissions regulation, the draft of which was made public by the Ministry of Environment Notice No. 2010-295 on September 30, 2010, Korea will provide that, from 2012 through 2015, a manufacturer that sold up to 4500 motor vehicles in the territory of Korea in calendar year 2009 shall be deemed to comply with the target level set forth in the regulations if either the average fuel economy or the average CO₂ emissions level for the vehicles the manufacturer sold in the territory of Korea during the relevant calendar year meets a target level that is 19 percent more lenient¹ than the relevant target level provided in the regulation that would otherwise be applicable to that manufacturer.

2. In developing any new or amended technical regulations establishing mandatory standards for automotive fuel economy or greenhouse gas emissions ("fuel economy or greenhouse gas regulations"), each Party will take into account improvements in manufacturers' fuel economy and greenhouse gas emissions performance through the development of relevant technologies, and international standards with respect to fuel economy or greenhouse gas emissions in a manner consistent with Article 2.4 of the WTO Agreement on Technical Barriers to Trade.



Jong-Hoon Kim
Minister for Trade
On behalf of Korea



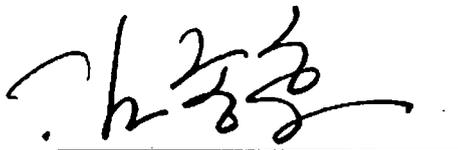
Ron Kirk
United States Trade Representative
On behalf of the United States

¹ In the case of CO₂ emissions, "19 percent more lenient" means a level no more than 119 percent of the relevant target level using the 70 percent slope expressed by the mathematical formula provided in paragraph 2 of Table 1 of the draft regulation.

February 10, 2011

Agreed Minutes

The United States will increase, as soon as required administrative procedures are completed but no later than the date that the KORUS enters into force, the visa validity period for intracompany transferees¹ to five years for nationals of Korea.²



Jong-Hoon Kim
Minister for Trade
On behalf of Korea



Ron Kirk
United States Trade Representative
On behalf of the United States

¹ Intracompany transferees is defined in 8 C.F.R. 214.2(l)(ii)(A).

² The United States decided to take this action, having recognized Korea's visa policy toward U.S. intracompany transferees.

APPENDIX D

Summary of Positions of Interested Parties

Summary of Positions of Interested Parties¹

American Automotive Policy Council (AAPC)²

In a written submission, the AAPC provided comments on behalf of its member companies—Chrysler Group, LLC; Ford Motor Company; and General Motors Company—in support of the United States–Korea Free Trade Agreement (FTA). The AAPC stated that because of Korea’s long use of tariff and nontariff barriers to protect its domestic auto industry from international competition, at least 75 percent of the total U.S. trade deficit with Korea is attributable to trade in autos and auto parts. The AAPC noted the difficulty of penetrating Korea’s market with the following trade statistics: its members “were limited to selling” 1,238 vehicles in a market of 1.4 million vehicles in 2000; its members sold 7,450 vehicles in a market of 1.5 million vehicles in 2010; and Korea had the second-lowest import market share (5.8 percent) for vehicles among member countries of the Organisation for Economic Co-operation and Development in 2010.

The AAPC stated that the FTA negotiated and signed in 2007 with Korea was “insufficient to gain real market access for autos.” It identified the following areas of improvement in the modified automotive provisions in the December 2010 agreement that is to accompany the FTA: automotive safety and environmental standards, taxes, transparency, car and truck tariff phaseouts, and the inclusion of a special motor vehicle safeguard and enforcement mechanism. The AAPC stated that its members’ products will be more successful and competitive in the Korean market if the U.S.-Korea FTA is fully implemented and enforced as modified.

Public Citizen³

In a written submission, Public Citizen said that it is a nonprofit public interest organization with 150,000 members and supporters that advocates for citizen interests before Congress, executive branch agencies, and the courts. Public Citizen’s submission does not specifically state support for or opposition to the modifications to the Korea FTA that affect passenger vehicles, but it provides its assessment of the Commission’s economic simulation exercise for the 2007 Korea FTA study and offers considerations for modeling the new supplemental auto agreement. Public Citizen identified and referenced studies to support the following key concerns relative to the Commission’s 2007 Korea FTA economic simulation exercise, as follows:

- (1) The reliance on the results of a computable general equilibrium (CGE) model to develop quantitative predictions of the effect of the Korea FTA on the U.S. economy, which they found “disturbing” because past results of CGE-based modeling have underestimated the economic effects of FTAs on the U.S. economy and resulted in “very poor accuracy.”

¹ This appendix reflects only the principal points made by the particular party. The views summarized are those of the submitting parties and not the Commission. Commission staff did not undertake to confirm the accuracy of, or otherwise correct, the information described. For the full text of written submissions, see entries associated with investigation no. 332-523 at the Commission’s Electronic Docket Information System (<http://edis.usitc.gov/edis3-internal/app>).

² AAPC, written submission to the USITC, February 14, 2011.

³ Public Citizen, written submission to the USITC, February 14, 2011.

(2) The tendency of CGE models to take tariff changes into account exclusive of other less quantifiable factors such as the attraction for multinational corporations to shift production to the territory of FTA partners because of the limited options for governments to regulate foreign and domestic companies.

(3) The application of the same Armington elasticity (2.8) to both Korean and U.S. auto consumers despite information that Korean and U.S. auto consumers view imported cars at different degrees of substitutability for domestic cars.

(4) The use of “coarse categorizations”—little or no adverse effect, significant adverse effect, and substantial adverse effect—to describe the quantitative results of a partial equilibrium model. Public Citizen suggests using the full numerical results in conjunction with the standard categories.

To model the potential effect of the accompanying agreement, Public Citizen suggested that the Commission take into account “less quantifiable mitigating factors” and separate completion dates for tariff eliminations and implementation of changes to nontariff measures. Public Citizen explains that the changes in the regulatory requirements for U.S. autos imported into Korea mandated in the accompanying agreement will likely result in a “negligible” increase in U.S. autos exported to Korea because (1) previous Korean commitments to reduce barriers to U.S. auto imports did not result in higher Korean consumption and (2) the exemption of U.S. autos from Korea’s environmental and safety standards may intensify an “already existent perception” by Korean consumers that U.S. autos are inferior to their domestic manufactured product in terms of safety and environmental safeguards. Also, Public Citizen cautioned against including environmental exemptions (scheduled to expire in year 2015) with phased-out tariffs (scheduled for year 10 of implementation) when modeling for long-term effect, because the environmental exemptions will no longer be in place.

United Steelworkers (USW)⁴

In a written submission, the USW said that it represents 850,000 members that produce products used in the manufacture of automotive vehicles, including steel, tires, glass, and aluminum. The USW stated that after analyzing the original U.S.-Korea FTA in conjunction with the recently negotiated provisions, they determined “that the FTA would undermine U.S. economic interests” and the USW would oppose its passage.

The USW expressed concern that the recently negotiated provisions are not “self-executing” and that if the United States acts before Korea to pass both the original FTA and the recently negotiated provisions, the Korean government may subsequently enact only the original agreement without the follow-on amendments.

The USW stated that, under the rules of origin provisions of the 2007 agreement, the methodology for calculating regional value content would allow a producer an average content threshold of 35 percent over that producer’s fiscal year for a class of vehicles, meaning that Korea could produce a qualifying model vehicle using 100 percent Korean originating content for domestic consumption and produce another vehicle of the same class using only 5 percent Korean content and 95 percent third-country content for export to the United States. The USW expressed concern that this regional-value content provision could allow a third country to produce the majority of the components that

⁴ USW, written submission to the USITC, February 14, 2011.

would receive preferential tariff treatment under the U.S.-Korea FTA (after incorporation into a qualifying passenger vehicle) even though those components would be subject to existing U.S. antidumping and countervailing duties and safeguards. The USW also noted that the 2007 rules of origin provisions allow auto producers to choose among three different methodologies to calculate percent of content, depending on which is most advantageous, and that the producers have the option of switching methodologies at any time. The USW recommends that the Commission's investigation include an analysis as to how these methodologies could be used to minimize content from the FTA partner countries and maximize content from other countries.

The USW also expressed concerns about the Kaesong Free Trade Zone (FTZ) in southern North Korea. The USW stated that there appears to be no commitment that would limit benefits from accruing to the North Koreans for components produced within the Kaesong FTZ if such components were to be included in final products exported to the United States. Instead, the original U.S.-Korea FTA transfers authority concerning the treatment of products for the Kaesong FTZ to a committee scheduled to be created after the FTA enters into force. The USW recommends that the Commission take into consideration the long-term potential of products or components from Kaesong FTZ entering the United States and receiving preferential trade benefits under the U.S.-Korea FTA.

APPENDIX E

Description of Possible Nontariff Measures Analysis and Simulation of the Absence of NTMs

Description of Possible Nontariff Measures Analysis and Simulation of the Absence of NTMs

The first section in this appendix provides further information on the calculation and interpretation of the quantity and unit-value information reported in box 1 of the main text of the study. The second section provides further information, including some caveats, about the economic model used to simulate the absence of the estimated price gap that can be attributed to Korean nontariff measures (NTMs) on imports of U.S. passenger cars.

Use of Indicative Quantitative Information to Assess Possible Nontariff Measures Affecting Korean Imports of U.S. Products

The analysis of NTMs affecting trade begins with the understanding that their effects are analogous to tariffs—i.e., NTMs restrict the quantity of imported goods and raise their prices. An import tariff raises the price to consumers of an internationally traded product and creates a “wedge,” or “gap,” between the price paid by consumers/importers and the price received by sellers/exporters of the product. In similar ways, importing-country policies that add to the cost of selling the good in their countries also create such a price gap.¹ Policies that restrict quantities raise prices as well, because the scarcity induced by the quantity restriction causes consumers to pay more.

In the absence of NTMs, one would expect the import prices for a good of uniform specifications and quality to be identical in all countries, varying only by differences in transportation costs. Leaving aside transportation costs, if the only trade policy affecting import prices were tariffs, one would expect differences across countries in the price of a good including any tariffs, known as the landed-duty-paid price, to be roughly equivalent to differences in tariff rates. The more widely available, internationally comparable measure of import prices is the cost-insurance-freight (c.i.f.) price, which does not include tariffs. In an ideal case, in which one country exports an identical good to many different countries, differences in c.i.f. import prices should reflect only differences in transport costs. However, if there are several varieties for the product in question, then different countries might import a different mix of varieties, which could also lead to a difference in average c.i.f. import prices.²

This report uses various comparisons of international trade data in assessing the potential effects of NTMs in the Korean market. Directly comparing import unit values and import quantities for a small number of products of importance to U.S. exporters may help

¹ For example, cumbersome customs procedures or regulatory measures such as certification of technical standards may raise the cost of imported goods. Higher prices in turn lead to lower quantities of imports because the final consumer is less willing to pay the higher price. The analysis presented here is intended to address these market effects, not the extent to which such measures may or may not promote domestic policy objectives related to health or safety.

² Partner-specific export taxes and subsidies also could induce variation in the c.i.f. price.

illustrate the impacts of these measures.³ In the presence of NTMs, one would expect either that Korean import unit values are noticeably higher than one might expect, that quantities imported by Korea are noticeably lower than one would expect, or both. In previous work, USITC analysts and others have used a variety of methods to assess the effects of NTMs on goods trade.⁴

If products were homogeneous, i.e., all countries imported exactly the same type and quality of products within a trade classification, calculating price effects of trade policy measures would be straightforward; comparing the import price of a particular country that applies NTMs with that of countries known not to apply NTMs (and adjusting for transportation cost differences) would provide a reasonable estimate of a price differential. However, products within a trade category (e.g., products grouped according to a given 6-digit Harmonized System [HS] code) are generally more heterogeneous than this. Countries do not import the same mix of products, and a country's imports within a particular category may differ in quality as well from those of another country.

In developing NTM price gaps for this report, we calculate the percentage by which Korea's unit value of imports from the United States exceeds the U.S. export unit value to the world. (This comparison, in effect, assumes that what U.S. exporters sell to Korea is comparable to what they sell to the world.) Some of this discrepancy may be attributable to shipping costs, but where the import unit value differences are relatively large, one may infer that some are due to the capture of rents by various parties involved in the international transaction.

We also perform quantity comparisons in which average Korean import quantities from the world, at the HS-6 level, are compared with import quantities of other countries. Because one would expect that larger economies import more, the comparisons are made in terms of import quantity per million dollars of gross domestic product (GDP).⁵

Price and quantity data were taken from Global Trade Analyzer, a product of GTIS, which reports primary-country trade data for a sample of more than 60 countries, a group that includes most large traders. Prices are calculated as unit values and averaged for the period January 2008–November 2010. Quantity comparisons are averaged for the period 2007–09. The relative unit for passenger vehicles is number of vehicles. Comparisons of

³ Because prices charged for goods subject to an NTM are likely higher than those that would be generated from production and transport costs alone, they may generate benefits, or "rents," for some entity in the supply chain. Depending on where in the supply chain these measures are implemented and on the bargaining power of different agents in the supply chain, the higher prices arising from NTMs may be observed at points other than at the point of unloading (the c.i.f. price). For example, "behind-the-border" restrictions, such as excise taxes, may lead to higher wholesale or retail prices. Comparisons in this study are made in terms of c.i.f. prices not only because of the availability of internationally comparable data, but because c.i.f. prices are in effect import prices, and the measures in question are usually understood to affect the act of importing in some way. NTM price gaps presented in this report are meant to be suggestive rather than dispositive.

⁴ See USITC, *India*, 2009; USITC, *Global Beef Trade*, 2008; Linkins and Arce, "Estimating Tariff Equivalents of Non-Tariff Barriers," 2002 (foundational discussion of estimating price gaps of NTMs); Dean, Feinberg, and Ferrantino, "Estimating the Tariff-Equivalent of NTMs," 2005, 289–310 (econometric methods using price data); Ferrantino, "Quantifying the Trade and Economic Effects of Non-Tariff Measures," 2006 (broader review including both price and quantity methods by a variety of researchers).

⁵ This is equivalent to maintaining the hypothesis that import demand of the representative international consumer is unit elastic with respect to income, i.e., that a 1 percent increase in income leads to a 1 percent increase in import demand. Exploratory econometrics showed that this is a reasonable assumption for the products under consideration in this study and, in most cases, is a conservative assumption. Consequently, most of the true income elasticities are likely to be somewhat higher than 1. If these were used in the analysis, it would be more likely to find that Korean import quantities appeared unusually low.

quantities exclude a few countries whose unit of measure for passenger vehicles is kilograms or some other noncomparable unit. This may affect the quality of the comparisons and has been noted when applicable.

The Applied General Equilibrium Simulation Model

The applied general equilibrium (AGE) model that is used to simulate the effects of Korean NTMs for U.S. passenger cars is similar to the comparative-static Global Trade Analysis Project (GTAP) model that was used to simulate the U.S.-Korea FTA in the 2007 USITC report regarding the potential economy-wide effects of the FTA.⁶ Unlike the standard GTAP model, however, the model used in this report tracks demand for U.S. products by specific industry and consumers in Korea; in other words, the sourcing of imported products is implemented at the industry and consumer level.⁷ This feature of the model allows a more precise specification of the simulation. Assuming that imported passenger cars in Korea are destined for final demand use and that they are not used as intermediate inputs, the simulation can focus on Korean demand for U.S. passenger cars even though, in the model's database, passenger cars are aggregated with other products in the GTAP sector "MVH," which represents motor vehicles and parts. The data are from GTAP version 7.⁸

Simulation Specification

The results reported in box 1 in the main text of the study are from a simulation of the results of removing the estimated 7.5 percent price gap for U.S. passenger cars that are imported into Korea. No other policy is changed in this simulation.

The 7.5 percent price gap is a trade-weighted average of the estimated price gaps that could be attributed to Korean NTMs, applied to imports of small-displacement (HS 8703.23) and large-displacement (HS 8703.24) passenger cars from the United States during 2008–10. The estimated price gap for small-displacement passenger cars is 16.6 percent, and the estimated price gap for large-displacement passenger cars is 1.2 percent.

Sensitivity Analysis

The range of the effect on U.S. passenger car exports to Korea reported in box 1 is from the sensitivity analysis regarding demand and trade elasticities for Korean demand for passenger cars. The more substitutable U.S. passenger cars are with Korean passenger cars, the greater the U.S. export effect is likely to be. Three Korean final demand elasticities were selected for sensitivity analysis in this simulation: the own-price final demand elasticity for all (domestic and imported) passenger cars in Korea; the Armington trade elasticity that determines the sourcing of imported passenger cars (parameter σ_M in the GTAP model) for final demand; and the Armington trade elasticity that determines substitution possibilities between domestic and imported passenger cars in Korea

⁶ For a discussion of the comparative-static GTAP model, see USITC, *U.S.-Korea Free Trade Agreement*, 2007, app. F.

⁷ The standard GTAP model applies the assumption of national product differentiation. According to this assumption, the model tracks the sourcing of imported products for the economy as a whole. Thus, the assumption of national product differentiation does not allow the model to track the use of U.S. products by specific industries and consumers.

⁸ Narayanan and Walmsley, *Global Trade, Assistance, and Production*, 2008.

(parameter σ_D in the GTAP model, which is computed as $\sigma_D = \sigma_M/2$). Table E.1 lists the range of elasticity values that were considered in the sensitivity analysis.

TABLE E.1 Specification of sensitivity analysis: Range of parameters in Korean final demand for passenger cars

Parameter	Standard GTAP value	Low value	High value
Own-price elasticity for passenger cars in Korean final demand	-0.42	-0.23	-0.60
Armington elasticities: σ_M ($\sigma_D = \sigma_M/2$)	5.60 (2.80)*	4.87 (2.435)*	6.33 (3.165)*

* Source: Hertel *et al.*, *How Confident Can We Be in CGE-Based Assessments of Free Trade Agreements?* May 2003.

Simulation Results

The simulation results for Korean imports of U.S. passenger cars from the removal of the 7.5 percent price gap are presented in table E.2. No other policy is changed in this simulation.

TABLE E.2 Simulated effects for Korean imports of U.S. passenger cars from the removal of the 7.5 percent price gap that could be attributed to Korean NTMs under different values for selected parameters in Korean final demand (percent change)

Own-price elasticity for passenger cars in Korean final demand	Armington sourcing elasticity for passenger cars: σ_M ($\sigma_D = \sigma_M/2$)		
	Low	Standard GTAP	High
Low	40.6603	47.9792	55.6602
Standard GTAP	40.6714	47.9912	55.6731
High	40.6819	48.0025	55.6853

Source: USITC staff simulations.

All the variation in the simulated effects stems from variations in the Armington trade elasticities. The own-price elasticity of overall demand for passenger cars is not influential because total imports represent a small share of total demand for passenger cars in Korea.

The simulated results suggest that, in the absence of the estimated 7.5 percent price gap, Korean imports of U.S. passenger cars would experience an increase in the range of 40.66–55.69 percent.

During 2008–10, the average annual level of Korean imports of U.S. passenger cars was approximately 7,700 units. Thus, the percent changes reported in table E.2 suggest that, in the absence of the estimated 7.5 percent price gap, Korean imports of U.S. passenger cars would have increased from roughly 7,700 units to roughly 10,800–12,000 units; the value of U.S. exports of passenger cars to Korea would have increased from roughly \$119 million to roughly \$167–\$185 million, also an increase in the range of 40.66–55.69 percent.⁹ As noted above and in box 1 in the main text of the study, Korean NTMs applied to U.S. passenger cars likely contribute to this price gap.

⁹ The simulated percent changes in the volume and value of U.S. passenger car exports to Korea are the same because the removal of the 7.5 percent price gap causes the U.S. export price of passenger cars to increase only slightly.

Measuring the Impacts of Korean NTMs for U.S. Passenger Cars and Model Limitations

The probable effects of Korean NTMs for U.S. passenger cars are estimates of the marginal effects of the NTMs, which are summarized by the estimated price gaps, holding constant all other exogenous variables, such as changes in technology and business practices, changes in consumer preferences, or changes in macroeconomic policy or other trade policies. These model results should not be considered as forecasts or predictions of future trade flows because many things affect those flows, including other economic variables that were not considered in this analysis.

As stated, changes in U.S. exports of passenger cars to Korea are calculated as percentage deviations from the base data and are quite stable with respect to changes in the database. That is to say, if the base data referred to a different time period, the marginal percentage effects of the price gap on U.S. exports of passenger cars to Korea estimated by the model likely will still be similar to those presented here, relative to the new database.

Economic models capture the most important factors for the question under consideration. They are limited, however, in their ability to reflect the degree of complexity evident in the real world.¹⁰ Thus, a number of caveats are necessary regarding this modeling framework. One source of bias, found in virtually any quantitative analysis of economic data, arises from the process of data aggregation. International trade occurs in thousands of different products and services: the United States collects trade data under about 17,000 statistical categories and some 10,000-plus tariff rate lines. For most general equilibrium analyses, these groupings represent far too much detail to be tractable computationally. Furthermore, analysis and comparison of data collected from different economies require that data be aggregated into categories that are generally comparable from one economy to another; finding or constructing comparable categories can be very difficult.

This aggregation process introduces two general types of bias into a modeling exercise. One type involves the calculation of price gaps for aggregated product categories. In this study, a trade-weighted average price gap was calculated. The value of trade in a tariff line provides the weight for the price gap for that tariff line. This procedure tends to mask the importance of those products within the aggregated product categories that have particularly high price gaps and that therefore present a greater barrier to imports than would be the case if all goods within the aggregation had the same average price gap. As a result, the analysis may understate the effect of removing the price gap of a high-price-gap component (in this case, small-displacement passenger cars) of the aggregated product categories. Another type of aggregation bias is the likelihood that goods within an aggregated product category may not be close substitutes for one another. Imported goods of a particular category may be quite dissimilar to an economy's domestic product in that category. When the price of an import falls, for example, the model may indicate a certain amount of substitution of that import for the domestic product when, in fact, they

¹⁰ Examples of real-world complexities that are difficult to reflect in the model include the changing relative growth of different economies; politically motivated export-oriented investment; relationships between multinational subsidiaries that influence trade patterns; and such things as catastrophic weather or violence that are inherently unpredictable (at least in their details).

are not close substitutes. In this case, the model would overstate the effect of a given average price gap removal.¹¹

Despite these limitations, the simulations performed here can be quite useful in providing insights on the effects of Korean NTMs for U.S. exports of passenger cars. The model presents a unified framework in which to assess the likely effects of the policy.

¹¹ This type of bias is reduced in empirical trade models, such as the GTAP model, that apply the Armington assumption, which treats products from different economies as imperfect substitutes.

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