

U.S.-KOREA BUSINESS COUNCIL
AMERICAN CHAMBER OF COMMERCE IN KOREA

2005 Policy Paper

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Business Council



AMERICAN CHAMBER
OF COMMERCE IN KOREA

The views contained in this report are solely those of the U.S.-Korea Business Council and the American Chamber of Commerce in Korea, and do not necessarily reflect the views of the Korea-U.S. Business Council, our counterpart organization in Korea.

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**U.S.-KOREA BUSINESS COUNCIL/AMERICAN CHAMBER OF COMMERCE
IN KOREA: 2005 POLICY PAPER**

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U.S.-KOREA BUSINESS COUNCIL
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MESSAGE FROM THE COUNCIL PRESIDENT

Myron Brilliant

President, U.S.-Korea Business Council

The U.S.-Korea Business Council is pleased to release its *2005 Policy Paper*. This report is intended to provide senior Korean government officials with recommendations for actions that will enhance Korea's global competitiveness and attract new investment to its dynamic market. Additionally, it outlines the priorities of the U.S. business community in Korea and the importance of the bilateral economic relationship between the two countries. We are pleased that previous versions of this report generated constructive debates among both Korean and U.S. government and business leaders, and we hope that this year's paper will further contribute to these policy discussions.

We recognize the challenging political situation in Korea limiting resolution of many long-standing trade issues, and we are encouraged that the Korean government is increasingly recognizing the need to take actions promoting labor market flexibility, strengthening intellectual property rights protections, and implementing regulatory reforms and removing obstacles to trade. However, it is crucial that Korea acts on these issues now to ensure that it does not lose key opportunities to position itself as a regional economic hub, and that it remains a global competitor as China's economy continues its rapid growth. Given Korea's role as host country of APEC 2005, now is a critical time for the Korean government to demonstrate leadership because investors worldwide will be watching Korea closely.

We want to thank Council members for contributing their time and input to enhance this report. Moreover, we want to extend a special thank you to Maurice R. Greenberg for his important leadership as Council chairman over the past three years. Mr. Greenberg has been a strong voice in promoting U.S.-Korea relations and has played an essential role in raising the profile, size, and influence of the Council.

This year the Council is jointly releasing this paper with the American Chamber of Commerce in Korea (AMCHAM Korea). As the premier bilateral business organizations promoting U.S.-Korea relations, we wanted to combine our voices to emphasize the importance of progress on the issues raised in this report in order to facilitate even closer economic ties, and for Korea to take advantage of its role as host country of APEC 2005. Our two organizations welcome opportunities to work with Korean government and business leaders in facilitating greater awareness of the concerns and interests of the foreign business community in Korea, and we urge policymakers in both countries to build upon our critical relationship.

MESSAGE FROM THE CHAIRMAN OF THE AMERICAN CHAMBER OF COMMERCE IN KOREA

Wayne Chumley

Chairman

American Chamber of Commerce in Korea

This year marks the 52nd anniversary of the American Chamber of Commerce in Korea. During the past 50-plus years that our members have been doing business in Korea, we have witnessed and experienced Korea's dramatic change toward an open and transparent economy with the adoption of global practices into its everyday business practices. These extraordinary changes have not always come easily or smoothly. However, Korea has transformed into one of the leading economic powerhouses in the region, also serving as a great example of a country enjoying the benefits of free trade, an open economy, and a dynamic democracy.

We believe that the Korean government fully understands the importance of continuing to move toward global best practices and is fully committed to taking the necessary steps to ensure success. As recently as the early 1990s, AMCHAM Korea used to say that Korea was one of the most difficult places to do business, but today we confidently recommend Korea as the best place to do business in Asia. What happened? Korea made courageous choices and moved away from a command economy toward a free and open market, which has resulted in Korea becoming the world's 10th largest economy.

AMCHAM Korea is proud to be partnering with our friends at the U.S.-Korea Business Council to produce this joint report, which highlights some of the top priorities of the American business community and offers our recommendations to improve the business environment for all companies in Korea.

As active participants in the Korean economy, we all benefit from a stronger and more competitive domestic economy. It is in the spirit of constructive engagement that we offer this joint paper in order to share constructive ideas that will help Korea move closer to becoming a true business hub of Northeast Asia, offering a fully open market for all investors.

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William R. Rhodes
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As of Summer 2005

INTRODUCTION

The U.S.-Korea Business Council and the American Chamber of Commerce in Korea (AMCHAM Korea) are pleased to present our *2005 Policy Paper*. This paper is intended to provide input to senior Korean government officials on the priority issues of our members in the bilateral economic relationship between the United States and Korea, and to propose policy actions for enhancing Korea's business climate and for strengthening its position as a global competitor. In this paper, we also highlight one particular issue that requires U.S. government action: U.S. visa policy toward Korean business travelers and visitors to the United States.

Korea is the United States' seventh-largest export market and seventh-largest trading partner in terms of two-way trade. Total U.S. goods exported to Korea in 2004 amounted to \$26.3 billion, while U.S. imports of Korean goods reached \$46.1 billion. The United States is the largest foreign investor in Korea with total investment levels of \$32 billion in 2004. Investment in Korea by Council and AMCHAM members, especially in the financial services and manufacturing sectors, has played a positive role in promoting greater competitiveness in the Korean market. American business confidence in the performance of Korea's

economy was at a two-year high in 2004—testimony to the solid work of Korea's economic officials amidst an at-times turbulent and unpredictable political environment.

Council and AMCHAM member companies have invested in Korea for the long term and are eager to promote closer economic and political ties between the United States and Korea. Our two organizations had positive and constructive dialogue with Korean and U.S. government officials in 2004 on the priorities of the U.S. business community in Korea, as well as on ways to advance our countries' economic partnership. However, several outstanding trade issues still present significant barriers to tightening this relationship.

This paper takes up a number of issues important to U.S. businesses in the Korean market and puts forth several proposed policy actions that would foster a more welcoming environment in Korea for outside investors. Our two organizations urge continued efforts by the Korean government to promote an open market and welcome environment for outside investors. At a time when China's rapid economic growth and increasing competitiveness with Korea are leading many foreign investors to bypass the Korean market, it is in Korea's

interest to proactively address these long-standing issues that keep it from realizing its full economic potential.

Following the 2004 plenary meeting of the U.S.-Korea Business Council and its Korean counterpart organization, the Korea-U.S. Business Council, four joint working groups were established that have fostered candid and constructive discussions on the priority policy issues shared by members of both business communities. This paper reflects many of the key issues identified by these working groups and their recommendations for positive actions moving forward.

Key recommendations to the Korean government include the following:

- **Move rapidly to significantly reduce the screen quota, and make progress on other long-standing trade issues across several sectors, in order to facilitate the launching of future U.S.-Korea free trade agreement (FTA) negotiations.**
- **Increase labor market flexibility.**
- **Strengthen intellectual property rights protections and enforcement, with special emphasis on combating digital piracy.**
- **Enhance a challenging regulatory environment to attract outside investment and make Korean companies more globally competitive.**

This paper also addresses the importance of reducing delays in the U.S. visa issuance process in order to better facilitate travel by Korean

business travelers and other visitors to the United States, as well as how this will help improve business ties between our two countries and strengthen our economic engagement.

Finally, we want to mention the importance of Korea hosting the APEC Leaders Meeting and CEO Summit in November 2005. APEC provides an opportunity for Korea to demonstrate leadership by promoting foreign trade on the world stage, and at the same time for advancing its regional hub goals. Bold actions by the Korean government to resolve outstanding trade issues will build momentum for a successful APEC Meeting, and our two organizations are committed to helping Korea meet these goals.

PROSPECTS FOR A FUTURE U.S.-KOREA FREE TRADE AGREEMENT

The U.S.-Korea Business Council and AMCHAM Korea have a strong interest in the opening of free trade agreement (FTA) negotiations between the United States and Korea. Our two organizations believe that an FTA would bring significant economic benefits to both countries by increasing bilateral trade flows and investment. We call upon the Korean and U.S. governments to remove any outstanding impediments to the launching of FTA talks.

Our two organizations find strong empirical evidence that a U.S.-Korea FTA would bring tangible benefits to both the United States and Korea. A 2001 study by the United States International Trade Commission (USITC) estimated that four years after the implementation of a U.S.-Korea FTA, total U.S. exports could rise by \$7 billion (0.8%), and total U.S. imports could rise by \$13 billion (1%) over the respective totals without an FTA. Additionally, in regards to bilateral trade between the United States and Korea, the USITC estimated that U.S. exports to Korea following the implementation of an FTA would be \$19 billion (54%) higher than if there were no FTA and that U.S. imports from Korea would be \$10 billion (21%) higher. More recently, a 2004 study by the Institute for International Economics estimated that U.S. exports to Korea would rise by 43.2% following

an FTA, while Korean exports to the United States would rise by 22.9%.

To facilitate an announcement to launch FTA negotiations, our two organizations call on the Korean government to take bold actions to resolve key long-standing trade issues with the United States, especially in the entertainment, agricultural, pharmaceutical, automotive, and telecommunications sectors. In particular, reduction of Korea's screen quota would send an important signal of Korea's readiness to enter into FTA talks. The screen quota, which limits the dates and screen time allowed for foreign films, is an unfair impediment to commerce for the U.S. movie industry and has held up conclusion of a bilateral investment treaty (BIT) between the United States and Korea for several years. Moreover, the continued success of Korean films in capturing domestic market share—close to or exceeding 50% in each of the four past years—demonstrates the strength of the Korean film industry, which no longer needs the protection of the screen quota.

The Council and AMCHAM Korea have actively raised the importance of reducing the screen quota, both for concluding a BIT and for ultimately opening the door to FTA discussions, at the highest levels of the Korean and U.S. governments. In the past year, we

note that a growing number of top Korean government officials have called for reducing the screen quota. Ongoing discussions between the Korean Ministry of Culture and Tourism and the domestic film industry have so far generated limited progress. However, overall opinion in Korea appears to be shifting toward support for dropping the screen quota as the Korean film industry continues to prosper. Our two organizations urge the Korean government to reduce the screen quota as soon as possible, hopefully before the APEC Leaders Meeting in Korea in November 2005. Immediate action would send an important signal of Korea's commitment to open markets ahead of APEC.

We also urge the Korean government to take positive actions toward resolving long-standing issues in the automotive, pharmaceutical, and telecommunications sectors, as outlined in later sections of this paper. Progress made in these areas will indicate to the U.S. business community and to the U.S. government that Korea is ready to tackle the more challenging trade issues that will need to be addressed within an FTA. Without resolution on these issues, it will be difficult for the U.S. business community to garner support in the United States for FTA negotiations with Korea.

Moreover, it is important for Korean government and business leaders to understand the current challenging political climate in the United States for trade issues. The U.S. Congress, which will have final say in approving a U.S.-Korea FTA, will want assurances that key U.S. stakeholders support entering into such an agreement. Therefore, it is critical for the Korean government to

demonstrate openness and readiness to make the politically difficult decisions necessary for the successful completion of an FTA with the United States.

Our two organizations welcome the initial discussions held between the U.S. and Korean governments on the feasibility of launching FTA negotiations, and we hope that these will build momentum toward resolving the screen quota and other outstanding trade issues. We are committed to working together with the two governments, and our Korean business counterparts in the Korea-U.S. Business Council, in developing solutions that will advance this process.

POLICY RECOMMENDATIONS

The Korean government should take the following actions to facilitate the launching of U.S.-Korea FTA negotiations:

- **Move rapidly to significantly reduce Korea's screen quota.**
- **Make significant progress on key issues in the agricultural, pharmaceutical, automotive, telecommunications, and other sectors to demonstrate Korea's readiness to enter into comprehensive FTA negotiations.**

LABOR

A key objective of U.S.-Korea Business Council and AMCHAM Korea members is the establishment of an open, fair labor market in Korea where wages, benefits, and work rules are based on the supply and demand for local skills, subject to the minimum standards under the law. Korea's talented workforce is one of its most attractive features for foreign companies doing business in Korea or looking to invest there. However, Korea's labor market poses challenges for both Korean and foreign companies. International perceptions of labor strife in Korea can be a barrier to potential investors and ultimately to Korea's regional hub aspirations as competition from China and other neighboring economies intensifies. Progress in improving labor market flexibility and in realigning labor-management relations to meet Korea's long-term economic needs is crucial for Korea to realize its great potential as a regional economic leader.

Our two organizations have identified five central goals for achieving this objective: increasing labor market flexibility; moving to defined contribution retirement plans; improving balance in labor-management relations; allowing labor substitution during work stoppages; and introducing multiyear contracts for employees.

INCREASE LABOR MARKET FLEXIBILITY

It is important that management reacts quickly to fluctuations in global and local demand and competitive pressure through hiring, dismissing, and transferring employees at management's discretion according to the needs of business, provided that employees are fairly treated and not subject to discriminatory practices.

Korea's labor market is one of the most inflexible among member countries of the Organization for Economic Co-operation and Development (OECD), and under Korea's Labor Standards Act, it is difficult for employers to terminate employees. One result of this is the frequent use of voluntary severance programs, such as Early Retirement Programs (ERP), for workforce reductions. As highlighted in the Council's *2004 Policy Paper*, ERPs often result in significant severance payments that sometimes attract valuable employees not intended to be laid off. Additionally, Korea's requirement of 60 days' notification for a layoff is longer than the 30 days' notice common in other OECD member countries and can heighten the possibility of extended labor disputes.

Temporary Workers: Directly related to Korea's lack of labor market flexibility is the issue of temporary or contract workers. Contract workers are generally not members of a union, do not enjoy the substantial wages or benefits of union members, and can be terminated at the end of their contracts without excessive severance payments. In recent years, many domestic and foreign companies have hired contract workers to replace union and nonunion employees given Korea's inflexible labor market, which has increased concern about job security. It was estimated in early 2005 that contract workers make up 49% of all Korean employees, while average wages for contract workers are roughly 60% those of regular union/nonunion workers.² Under current labor laws, contract workers who have their contracts extended more than once become de facto permanent employees and are protected by termination provisions. As a result, many businesses turn over a large percentage of their work forces every two years and are reluctant to hire new workers.

More flexibility in Korean labor laws to allow companies to adjust their workforces would have a positive impact on the creation of jobs and would help resolve the challenges posed to the Korean economy by the current contract worker situation. Legislation was introduced by the Korean government in 2004 and again in 2005 to make it easier for businesses to hire contract workers while improving legal protections for contract workers. However, this proposal does not begin to address the issues that make Korea's labor market inflexible and that led to the rapid rise in the number of contract employees. Our two organizations encourage the Korean government to move

ahead with policy actions to promote true labor flexibility and, in doing so, enhance Korea's economic competitiveness.

On a related note, our two organizations welcome the announcement by the Korean government in April 2005 of its proposal to significantly upgrade Korea's employment support system and vocational training services over the next three years, which will positively contribute to labor market flexibility.

MOVE TO DEFINED CONTRIBUTION PLANS

Employers and employees would benefit from a shift by the Korean government to defined contribution retirement plans and to make retirement and severance programs portable and equitable from a tax perspective. This model has been successful in the United States and would further enhance labor market flexibility in Korea. Aggressive tax incentives, similar to 401(k) tax deductions in the United States, would encourage employee participation in these plans. Moreover, a stronger social safety net for employees in Korea is important for resolving many of the challenges facing Korea's labor market. Both Korean and foreign companies have pointed to the retirement grants system as outmoded and as an impediment to their competitiveness in Korea.

IMPROVE BALANCE IN LABOR-MANAGEMENT RELATIONS

Korean labor laws should protect management's right to allocate resources and manage the

business according to market conditions and to the law without outside interference. One of the fundamental problems faced by employers in Korea is the excessive bargaining power of labor unions relative to management. Open dialogue and consultation with employees is appropriate and should be sought as long as it does not evolve into a requirement of agreement. The less interventionist approach the Korean government has taken recently in labor disputes is viewed by the private sector as positive. In particular, moving laws regarding the violation of industrial relations from under the jurisdiction of the criminal law to the civil law, and ensuring that these laws are applied equally to labor unions and their members, would help Korea's image as an investment destination.

ALLOW LABOR SUBSTITUTION DURING WORK STOPPAGES

The Korean government would enhance Korea's business climate by allowing substitution of the workforce during a labor action to ensure the long-term viability and sustainability of enterprises during protracted work stoppages. The Korean government should specifically consider removing Article 43 of the Law on Labor Union and Labor Relations, which restricts management from employing any substitute labor during labor disputes. This hurts businesses—and the Korean economy as a whole—by disrupting production, leading to significant losses in revenues. The United States, Germany, and other developed economies do not have such restrictions in employing substitute labor.

Current labor laws require unions to vote before taking any industrial actions and not to engage in any industrial actions during a cooling-off period for a specified number of days following the vote. Unions frequently take this vote early in the negotiation process to circumvent the cooling-off period and to increase pressure on management before a final offer is made or there is an impasse in negotiations. This practice renders the union employees' votes and the cooling-off period meaningless. Revising these laws to require that unions take a vote of members regarding industrial actions only after the normal process of negotiations is concluded could promote more constructive dialogue and reduce work stoppages.

INTRODUCE MULTIYEAR CONTRACTS FOR EMPLOYEES

Instituting multiyear wage contracts and extending collective bargaining agreements beyond the current two-year period would enhance Korea's business climate by minimizing disruptions to businesses and would help facilitate harmonious labor relations. Wage negotiations annually or every other year would increase the potential for work stoppages and labor disputes, which are disruptive to the economy and contribute to Korea's international image as having a challenging labor environment. By promoting multiyear contracts, the Korean government would help reduce the need for such frequent negotiations, in turn improving its business environment for both management and employees.

POLICY RECOMMENDATIONS

The Korean government should take the following actions to establish an open, flexible labor market where wages, benefits, and work rules are based on the supply and demand for local skills, subject to the minimum standards under the law:

- Ensure management's ability to react quickly to fluctuations in global and local demand and competitive pressure through hiring, dismissing, and transferring employees at management's discretion.**
- Begin shifting to defined contribution retirement plans and make retirement and severance programs portable and equitable from a tax perspective.**
- Protect management's right to allocate resources and manage the business according to market conditions and to the law without outside interference.**
- Ensure the long-term viability and sustainability of the enterprise during protracted work stoppages by allowing substitution of the workforce during a labor action.**
- Institute multiyear wage contracts and extend collective bargaining agreements beyond the current two-year period to minimize disruptions to businesses and to facilitate harmonious labor relations.**

INTELLECTUAL PROPERTY RIGHTS

Strengthening intellectual property rights (IPR) protections and enforcement in Korea is a top priority of the U.S.-Korea Business Council and AMCHAM Korea. In today's information age, protecting innovation and creativity is key to sustaining economic development and growth. Given Korea's focus on promoting its technology sector, the Korean government and business community have much at stake in nurturing IPR and in ensuring enforcement. Like U.S. companies, many Korean companies are going global and increasingly finding themselves the target of counterfeiting and piracy around the world—putting their growth and success at risk. Our two organizations welcome opportunities to work with Korean business organizations and our two governments in promoting joint initiatives to fight the international trade in pirated and counterfeit goods.

The critical importance of IPR protections for the Korean economy is illustrated by the challenges Korea faces in combating digital or online piracy. Korea leads the world in broadband penetration, with nearly 75% of all Korean households having access. An estimated 24.4 out of every 100 Koreans were broadband subscribers in 2004.³ While Korea has emerged as a leader of innovation in the digital economy, online piracy of copyrighted works—movies, music, entertainment and

business software, and books—has surged, with significant and negative impact on rights holders of copyrighted materials. The International Intellectual Property Alliance has estimated that trade losses to U.S. businesses due to copyright piracy totaled \$696.3 million in 2004.⁴

This total does not reflect the millions of dollars that Korean businesses are losing each year from copyright piracy, nor is the impact limited to rights holders. Retailers of copyrighted materials also lose sales, with a corresponding loss of jobs and tax revenue to the government. Moreover, piracy hurts innovation—an area in which Korea is increasingly a global leader. Strong IPR protections and active enforcement of IPR laws are critical for Korea to ensure that its digital economy does not undercut the growth of its overall economy.

There are four key IPR goals that our two organizations urge the Korean government to focus on: strengthen and make more transparent the enforcement of IPR laws, with priority on efforts to combat online piracy; extend protection of copyright terms to bring Korea in-line with other developed economies; ensure protection of data exclusivity under the WTO TRIPS agreement; and prevent patent infringement during the

pharmaceutical product approval process by creating better linkages between health regulatory approval agencies and patent authorities.

STRENGTHEN IPR ENFORCEMENT

Korea has recently taken steps to improve IPR enforcement and has recognized IPR protection as a top economic policy priority. The Master Plan for IPR Protection issued by the Korean government in May 2004 set forward 15 major policy tasks for Korean ministries to implement in reducing IPR infringement, enhancing Korea's legal and regulatory framework for IPR, and promoting public awareness of the importance of IPR protection. The Master Plan also pointed to areas where closer coordination between government ministries with jurisdiction over IPR issues will promote more effective enforcement of IPR laws.

The Council and AMCHAM Korea urge the Korean government to continue following through with and expand its efforts under the Master Plan. Of particular importance is ensuring alignment between different government agencies, including Korean Customs, the Ministry of Health and Welfare, the Public Prosecutor's Office, and the police, in anti-counterfeiting efforts. Our two organizations have taken note of a recent positive development, the establishment of a Copyright Protection Center by the Korean Ministry of Culture and Tourism, which will conduct IPR enforcement activities and promote educational awareness on copyright use with respect to both online

and off-line materials. Further, we urge more transparent enforcement of IPR laws and stronger, more deterrent sentences for criminal offenders. While Korean courts recently issued heavy civil penalties against music file-sharing Web sites, these actions are not the norm.⁵

Online Piracy: A growing concern in Korea is how to address the challenge of digital or online piracy. Online piracy and peer-to-peer file sharing are pervasive in Korea and present the greatest current challenges to IPR protection. Online piracy has generated significant losses for rights holders of copyrighted works—movies, music, entertainment and business software, and books. Overall sales of all recorded music in Korea fell by nearly one-half between 2001 and 2003, with an estimated \$2.3 million in trade losses for the U.S. recording industry in 2004. In addition, losses for the U.S. motion picture industry due to piracy in 2004 were estimated to be \$40 million.⁶ An estimated 58% of Korean Internet users have downloaded movies. Of those downloading movies, 52% report that they purchase movies on DVD or video less frequently than in the past.⁷

Of particular significance is end-user piracy of business software, which was estimated at a rate of 46% and translated into losses of \$263 million for U.S. companies in 2004. How pervasive this problem is was demonstrated when a major Korean company was accused in March 2005 of having pirated software valued at \$3 million installed on 61% of the computers in its offices. Both foreign and local Korean software vendors have voiced concern over a streaming technology widely used to share

application programs through LAN or the Internet—and frequently abused as a means of reducing required software licenses. However, a nonbinding ruling issued in August 2004 by the Program Deliberation and Mediation Committee—affiliated with the Ministry of Information and Communication (MIC)—held that this technology did not constitute an infringement on software copyrights. This ruling sends a misleading signal to Korean consumers, and our two organizations encourage a public announcement by MIC to correct the committee’s recommendation and recognize the copyright infringement involved.

Our two organizations encourage the Korean government to use as guidance the Model Principles to Control Online Piracy (see insert on page 16) developed by the U.S. APEC Business Advisory Council (ABAC) and recently endorsed by the full ABAC representing the business communities of all APEC member countries. These Model Principles put forth a comprehensive set of legislative tools for combating online piracy, which ABAC members propose that all APEC member countries implement. Korea’s leadership in implementing these Model Principles would resonate among APEC member economies and would help to advance APEC’s larger IPR agenda.

Pharmaceutical Sector Counterfeit

Problems: Strengthening IPR protections and enforcement remains a top priority for the pharmaceutical industry in the Korean market. Of special concern are counterfeit pharmaceuticals, which represent a significant public health and safety issue.

Strengthening anti-counterfeiting laws to include mandatory criminal liability for the manufacture, distribution, trafficking, or sales of counterfeit pharmaceuticals, and ensuring that appropriate resources are in place to effectively execute anti-counterfeit efforts, would not only help both foreign and Korean manufacturers but—even more importantly—protect Korean consumers from the risks of counterfeit drugs. We urge the Korean government to work with industry to develop strategies for reducing the amount of Internet-facilitated sales and distribution of counterfeit products.

In addition, our two organizations urge Korea to closely collaborate with other governments—not just the U.S. government but also the European Union and China—to share information and intelligence with respect to anti-counterfeit operations.

EXTEND TERMS OF COPYRIGHT PROTECTION

As a major content producer, Korea would benefit from joining the current international trend for longer periods of copyright protection. The United States, all European Union member countries, Japan, Australia, and India are among the nearly 100 countries that have extended their terms of protection for copyrighted materials beyond the minimum 50-year term required under the Berne Convention. Korea’s copyright term is currently 50 years from publication for films and for any works made as works for hire, and 50 years from the death of the author for other works. Korean industry would benefit from equivalent

Model Principles to Control Online Piracy

- Ratify and fully implement both WIPO Internet Treaties (WCT and WPPT).
- Ensure adequate and effective prohibitions on the circumvention of technological protection measures that protect copyright through copy and access controls, including trafficking in circumvention tools.
- Ensure that widespread, willful unauthorized distribution of copyrighted material is a criminal offense even if not undertaken for profit.
- With regard to material residing or stored on an Internet service provider's (ISP) network or system, adopt a formalized notice and takedown system, imposing the following obligations on ISPs as a condition for protection from monetary liability:
 - Require ISPs to remove or take down infringing material expeditiously upon receiving notification from rights holders.
 - Require ISPs to take action against known or obvious infringers even when no notification has been received from a copyright holder (except that an ISP should not be required to monitor its service or affirmatively seek out infringing activity).
 - Require ISPs to notify alleged infringers of notification received from rights holders.
- Establish meaningful and effective administrative or judicial procedures enabling rights holders to obtain from a service provider information in its possession identifying the alleged infringer.
- Support consumer education campaigns to promote understanding of and respect for copyright and discourage infringing behavior.

periods of copyright term protection, as this would give producers of copyrighted material additional incentive to invest in creation of content. Moreover, if Korea were

to extend its term of copyright protection, Korean films would be accorded reciprocal benefits in other markets worldwide. This would make Korean films a more attractive

investment for U.S. studios and promote cooperation between the two film industries.

Korea's accession to the World Intellectual Property Organization (WIPO) Copyright Treaty in 2004 was a favorable development toward bringing its copyright laws into compliance with widely accepted international standards. Korea will further benefit by ratifying and implementing the WIPO Performances and Phonograms Treaty (WPPT), to which it has already committed.

PROTECT DATA EXCLUSIVITY

The protection of commercially valuable clinical data (data exclusivity) is required under the World Trade Organization Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS) Article 39.3. This provision states that parties to the TRIPS agreement must protect from disclosure and unfair commercial use any undisclosed test or other data required as a condition for approving the marketing of pharmaceutical or agricultural chemical products that utilize new chemical entities. Korea currently addresses this through its new drug reexamination procedure, in which four to six years of protection are provided in respect of the sponsor's effort to provide the data required by the Korean government. However, outside of this procedure, the Korean government lacks proper regulatory provisions honoring its obligations under TRIPS on pharmaceutical data exclusivity, and there have been issues of enforcement of data protection in Korea. Our two organizations encourage the Korea Food and Drug Administration (KFDA) to ensure

that data exclusivity rights are adequately protected under Korea's TRIPS obligations.

CREATE PATENT LINKAGES

U.S. businesses remain concerned by the absence of any direct linkage between the KFDA and the Korean Industrial Patent Office (KIPO). The KFDA holds responsibility for safety and efficacy review, but it does not adequately ensure that competitors do not market products covered by existing patents through linkage to the KIPO. Consequently, both domestic and foreign patent owners must resort to the court system after infringement has occurred, which has a significant commercial impact on producers of innovative drugs and other products. Our two organizations encourage the Korean government to establish a linked system where parties seeking marketing approval must certify that products do not infringe on existing patents and that health authorities do not approve products for which marketing would infringe on a patent.

POLICY RECOMMENDATIONS

The Korean government should take the following actions to strengthen its IPR protections and enforcement:

- **Ensure stronger administration of criminal penalties for violators of IPR and anti-counterfeiting laws to ensure that counterfeiting is deterred in the Korean marketplace, with priority on addressing the challenge of online piracy and peer-to-peer file sharing.**

- **Extend terms of copyright protection to bring Korea in-line with other developed economies.**
- **Ensure compliance with obligations under TRIPS Article 39.3 to protect data exclusivity.**
- **Create linkages between health regulatory approval agencies and patent authorities to prevent patent infringement during the product approval process.**

FINANCIAL SERVICES AND TAXATION

The U.S.-Korea Business Council and AMCHAM Korea support Korea's goal of positioning itself as a financial hub in East Asia. To successfully compete with other regional financial centers, attract new investment, and strengthen the global competitiveness of Korean financial institutions, it is in the Korean government's interest to continue moving forward with market liberalization and reforms that bring its financial system and regulations in-line with widely accepted international models and standards. Our two organizations encourage Korea's Ministry of Finance and Economy (MOFE), which recognizes the importance of progress in these areas for Korea's competitiveness as a regional hub, to continue to hold the course on these efforts.

Our two organizations urge the Korean government to take the following actions to promote its financial hub goals: move to a more open, universal financial system; ensure fair competition and a level playing field for all entities in the Korean financial services market; move to a "negative list" regulatory environment from the current "positive list" regulatory environment; move to more open, global operating standards by bringing its financial services sector regulations and standards in-line with those of other major economies; increase labor market flexibility;

and simplify and improve the predictability of its taxation system. Positive developments in each of these areas would improve the business environment for foreign and Korean businesses alike in the financial services sector.

MOVE TO A MORE OPEN, UNIVERSAL FINANCIAL SYSTEM IN KOREA

As the Korean government continues moving forward with liberalization of the financial services sector, an "open" or universal financial model is increasingly appropriate for Korea. The barriers between banking, securities, and insurance are coming down in virtually all developed markets, and Korea would boost its global competitiveness by doing likewise. MOFE has identified the reduction of these barriers as an important priority for 2005. The Korean government should incorporate global operating standards as part of this process to reinforce and maximize the benefits of a universal model for the financial services market.

Bancassurance will play an important role in Korea's efforts to move to a universal financial system. Since it was introduced in Korea in 2003, bancassurance has created new products and has increased the total size of the insurance market, benefiting both the banking and insurance

sectors. Moreover, the increased competition that bancassurance fosters has benefited Korean customers by contributing to improved quality in consulting sales skills based on customer needs. However, the significant reduction in the scope of Phase II sale allowed in the recently amended bancassurance regulations—which was originally intended to be implemented in April 2005—is neither consistent with stated policy nor justified by the actual evidence following the launch of Phase I of bancassurance. Repeated delays in implementing the original schedule of bancassurance sale, coupled with fundamental and material changes in the proposed bancassurance policy and direction, would burden businesses with unnecessary costs, make long term planning difficult, harm market confidence, and create uncertainty over Korean government policy.

In moving toward a universal model, Korea should consider a review of the current policyholder protection fund contribution requirements to achieve a more fair and equitable system of protecting consumers of financial products, including the allocation of contributions by different financial services companies, the uniform basis of assessment of financial services company contributions, and the current high level of contribution for certain products in comparison to similar arrangements in other developed markets.

ENSURE FAIR COMPETITION AND A LEVEL PLAYING FIELD IN KOREA'S FINANCIAL SERVICES SECTOR

The Korean Post Office and other quasi-governmental financial institutions that sell

insurance products, such as the agricultural cooperatives and fisheries and livestock cooperatives, should be subject to the same laws, regulations, taxes, and standards in Korea as private sector companies. Korea allows the Post Office—which is run through the Ministry of Information and Communication—and quasi-governmental financial institutions favorable competitive advantages compared to the environment in which private financial institutions operate, including different tax regimes and supervisory requirements. This privileged treatment has enabled Korea Post to become one of the five largest life insurers in the Korean market measured on total premiums and accumulated asset size.

The privileges granted Korea Post and quasi-governmental financial institutions are inconsistent with the Korean government's commitments under the WTO General Agreement on Trade in Services (GATS) to provide national treatment to all companies of WTO signatory countries doing business in Korea. There is consensus between domestic and foreign companies in this sector that for Korea to be a fair market, the Korean government should ensure a level playing field. Moreover, quasi-governmental financial institutions should be regulated in a way that is consistent with the private sector and subject to the same legislative and regulatory measures.

In the more specialized mortgage insurance market, only products offered by Seoul Guarantee Insurance (SGI)—a Korean government-owned entity—are permitted. Changing this policy to allow foreign and domestic insurers to participate in the owner-occupied housing mortgage insurance market

would help develop the mortgage insurance market with credible players and enable banks to look more carefully at obtaining mortgage insurance for owner-occupied housing. It would also improve SGI's revenues and support the Korean government's policy of eliminating speculation in the housing market and making homes more affordable.

In addition, a branch of a foreign insurance company is lawfully licensed in Korea and deemed to be an "insurance company" for the purpose of the Insurance Business Law (IBL), and it is therefore governed by every aspect of the laws and regulations that apply to all companies doing insurance business in Korea. Nevertheless, certain provisions in the IBL treat foreign branches differently from locally incorporated Korean insurance companies. The provision in Article 75 of the IBL requiring the branch of a foreign insurer to hold a certain amount of assets in Korea would result in unfair discrimination because the provision only applies to a branch.

MOVE TO A "NEGATIVE" REGULATORY ENVIRONMENT FROM THE CURRENT "POSITIVE" REGULATORY ENVIRONMENT

At present, a "positive list" regulatory system exists in Korea, whereby regulations specify the types of activities permitted with the understanding that all unspecified activities are prohibited. The implementation of a "negative list" system—whereby the regulations specify activities that are prohibited or excluded and permit all unspecified activities—would enable a broader and more effective interpretation of existing

regulations. For example, securities firms would be able to sell and distribute a broader scope of securities and develop more diverse products.

This is an important issue for any future U.S.-Korea FTA because services negotiations in recent U.S. free trade agreements have been conducted on a "negative list" basis. Under the "negative list" mechanism, countries negotiate an agreement based on the principle that all services sectors are completely open unless a specific reservation is taken. This approach ensures comprehensive coverage and enables negotiators to focus on a relatively small number of reservations, which are spelled out in an annex of nonconforming measures. This is the opposite of the approach taken under GATS, where each country specifically lists those sectors that will be open and makes no commitments where a given sector is not listed in its GATS schedules. The "positive list" approach entails longer and more complex negotiations than the "negative list" approach and makes it considerably more difficult to achieve comprehensiveness.

Our two organizations applaud the Korean government's stated goal of moving to a "negative list" regulatory environment and look forward to concrete policy actions that facilitate this shift.

MOVE TO MORE OPEN, GLOBAL OPERATING STANDARDS IN KOREA'S FINANCIAL SERVICES SECTOR

In moving to a universal financial system and a "negative" regulatory environment, the Korean government would reinforce these

efforts by bringing its financial services sector regulations and standards in-line with those of other major economies. There are a number of unique laws in Korea that currently present barriers to foreign companies and will serve as constraints to Korea's financial hub aspirations if not addressed. Of specific concern are the restrictions under the Private Data Protection Law and the Real Name Law, which make it difficult for foreign companies to outsource and offshore activities. These restrictions present a disincentive to investing in Korea for financial institutions with global operations, which often have a consolidated data center in one country to maximize cost efficiencies and to take advantage of central expertise with the latest security technology to protect customers.

Excessive regulation hinders competitiveness and makes it difficult for some foreign companies to enter certain sectors in the Korean market. In this regard, the Financial Supervisory Service (FSS) would contribute positively by macromanaging and focusing its energies on promoting a strong, solvent industry and establishing a regulatory framework that protects consumers through proper disclosure rather than by micromanaging product design. One example of this issue is that, while life insurance companies have freedom under Korean law in setting premium rates, the FSS has directly contested this by arguing on what is a "reasonable" assumption or loading within a premium rate. Further, the FSS has indirectly challenged this through the Korea Insurance Development Institute, which must approve all risk rates used regarding whether the rate is fair.

Another example from the life insurance sector illustrates how efforts by top Korean

regulatory authorities to promote deregulation are sometimes undermined by actual practices. Korean regulatory agencies exercise indirect control in the form of "guidelines" and "practices" to manage key components that contribute to a final premium and ultimately profitability. This tendency has increased since the dramatic reduction in available participating products (where a percentage of profits are shared with customers) following the introduction of a required 90% policyholder/10% shareholder split.

The reduction in participating products has resulted in an increased regulatory focus on nonparticipating products (where there is no profit sharing with the customer), specifically on ensuring that insurance companies charge what the authorities deem to be an "appropriate premium." This has resulted in increased indirect control over expense loadings, mortality and morbidity tables, and investment (assumed interest rate). The practices used to achieve an "appropriate premium" have proliferated under numerous guises such as local customs and culture, consumer protection, best practice guidelines, and insurance market stability. Moreover, there is no formal appeals process available.

As a result of these tendencies to control the three key components of a life insurance premium to determine an "appropriate premium," regulators are still effectively setting premiums. In addition, less product innovation occurs, resulting in a reversion to product standardization among insurers. Consequently, there are fewer choices for customers, reducing their ability to meet changing financial needs. Finally, globally accepted product designs and structures,

together with pricing methodologies, are not available in Korea. Regulators seeking to address concerns related to customer complaints could do so through more relevant means, for example as part of sales processes and in the transparency of information provided to customers. Many of these means are already in place with required disclosures on the Internet of policy provisions, rates, and illustrations.

In an example of excessive regulation in the nonlife insurance sector, product filings with the FSS require an explicit expense ratio loading. New products are generally filed with a market average expense ratio to be competitive, but foreign insurers in Korea often have not reached the targeted ratio because they still lack economies of scale or have large investments in marketing, training, and development. Korean tax laws limiting deductibility of expenses to roughly the filed expense ratios create further challenges. Removing the tax penalty capping the expense deduction keyed to filed expense ratios would foster proliferation in market expertise and products.

As Korea positions itself as a regional financial hub, bringing currency-matching rules (asset-liability matching, or ALM) in-line with global standards would also increase the competitiveness of Korea's financial services sector and give Korean consumers more choices. The IBL and its subordinate decree restrict foreign currency-denominated assets held by an insurer to 20% of its total assets. This makes it impossible for any insurer who is selling, or wishes to sell, a foreign currency-denominated product to maintain ALM when sales of foreign currency products exceed 20%

of the insurance company's total. This rule is based on an erroneous assumption that all insurance products in Korea are Korean won-denominated, even though in reality the FSS has already approved U.S. dollar-denominated products to be sold in the Korean market. Ironically, this rule exposes insurance companies to the very exchange risk that the rule was meant to limit.

The Enforcement Decree of the IBL was recently amended to relax this restriction to 30%, but this does not adequately address the problem because it would continue to require mismatching on foreign currency-denominated products above that level between asset and liability, contrary to ALM policy. It is interesting to note that Japan had a similar ALM law and addressed the issue by exempting asset-liability matching for foreign currency-denominated products from the investment restriction in foreign currency-denominated assets. Korea could implement similar amendments to its ALM rule, which could be amended to recognize as an exception cases where investment in assets denominated in the same foreign currency as the policy is written are required to maintain asset-liability matching. This would eliminate exchange risk and achieve the original purpose of the rule.

Additionally, some foreign firms have suggested that deregulation on capital requirements would enhance the financial services market in Korea. Examples include the requirement to keep excess capital for licenses that companies do not utilize, and obscure requirements to keep other licenses, such as the number of Ph.D.s or years in the industry.

INCREASE LABOR MARKET FLEXIBILITY IN THE KOREAN FINANCIAL SERVICES SECTOR

While covered in more detail in the Labor section of this paper, labor market flexibility is an issue of fundamental importance to the financial services industry in Korea. Many companies in the financial services sector, both foreign and domestic, are concerned that their ability to run their businesses flexibly from a labor standpoint has deteriorated over the past couple of years. Of particular concern are recent proposals for contract workers—particularly insurance sales agents—that would allow for the unionization of agents, social program participation, and provisions for no termination of service employment contracts without “just cause.” These proposals, if implemented, would significantly increase the cost of doing business for companies, limit their willingness to take on new employees, and reduce the quality of services provided to customers. Our two organizations encourage the Korean government to promote policies that advance true labor market flexibility, a prerequisite for Korea to achieve its financial hub aspirations.

SIMPLIFY AND INCREASE PREDICTABILITY IN KOREA’S TAXATION SYSTEM

There is consensus between foreign and Korean financial services sector companies that Korea would enhance its business climate by simplifying and modernizing its tax regime. This is an area where the Korean government has made, and continues to make, some significant improvements, such as allowing

multiparty netting and flexibility in income repatriation. Bringing Korea’s tax rates and tax base closer to that of other regional financial centers and simplifying Korea’s tax codes—while at the same time clarifying them and making them less subjective and open to interpretation—are key elements in promoting Korea’s global competitiveness.

Our two organizations have identified the following taxation system reforms as positive steps that the Korean government should take:

- **Reduce tax rates and tax base to compete with other regional financial centers.** Korea’s economy would benefit by reducing both its tax rates and tax base—at least as they apply to the financial services sector—to be more competitive with other regional financial centers. The chart on page 25 illustrates how Korea’s tax rates and tax base compare unfavorably with those of Hong Kong and Singapore. Our organizations welcome recent indications by MOFE that it intends to push for bringing Korea’s tax rates to more competitive levels.
- **Reduce the compliance burden by consolidating various taxes and by implementing flexible tax year-ends.** Relative to other markets, Korea has a large number of different types of taxes, including value-added taxes, corporate and personal taxes, resident taxes, education taxes, acquisition taxes, registration taxes, special consumption taxes, and real estate taxes. Moreover, almost all taxpayers are on calendar-year bases, and almost no automatic extensions

Comparison of Korea's Tax Rates and Tax Base with Regional Financial Centers

Tax Rates	KOREA	HONG KONG	SINGAPORE
Individual	39.6% *a flat rate of 18.7% is available for foreign workers (from 2004)	15.0%	15.0%
Corporate	27.5%	16.0%	26.0%
Tax Base	Global Income	Territorial	Remittance Base

are provided. The following are some examples of specific taxes where reforms and consolidation would be beneficial:

- **Investment Products:** At present, gains on investment products are split into both dividend and interest income and are subject to both dividend and interest income taxes. However, it is not logical to levy interest income tax on gains from investment products. Taxation should be reformed so that interest income tax is only levied on products earning a fixed rate of interest and investment products are only subject to dividend income tax. The tax rate on dividend income should be lowered to attract more investment.
- **Education Tax:** Financial institutions are required to pay education tax on their income, a burden that other industries do not have.
- **Introduce consolidated tax returns.** Filing consolidated tax returns is a long-running practice in the United States and was introduced in Japan several years ago.

- **Improve predictability in tax administration.** Businesses often find Korean tax laws to be subjective in terms of the appropriate level of taxes for a particular transaction or activity. Auditors may use arbitrary and inconsistent interpretations of tax laws and regulations and are also often reluctant to accept reasonable and legal counterarguments from taxpayers. Advisors observe inconsistencies in tax rulings and regulations dealing with issues such as classification of income and tax treatment on stock option income. In this regard, more specific detail in the Korean tax codes that remove ambiguity and reduce the scope of interpretation would contribute positively to Korea's business climate.

More detailed and practical guidelines are also needed in dealing with transfer pricing issues. Most multinational banks, securities firms, and insurance companies use sophisticated methods for allocating income and expenses among their divisions and subsidiaries in various countries. Korean tax authorities insist on auditing the underlying data for the

allocation bases, rather than trying to understand the methodologies.

Similarly, under current Korean tax laws, the definition for entertainment expenses is broad. Many cases are deemed as entertainment for categories such as promotional, advertising, and commissions, even when paid on an appropriate business basis with a direct relationship to premium income and revenues. The current tax environment leaves too much room for subjectivity by on-site tax inspectors.

POLICY RECOMMENDATIONS

The Korean government should take the following actions to enhance the competitiveness of its financial services sector and advance its regional financial hub goals:

- **Move toward a more open universal model for the financial system in Korea.**
- **Ensure fair competition and a level playing field by making Korea Post, quasi-governmental insurance companies, and other government-owned entities subject to the same regulations, taxes, and standards as private sector financial services entities.**
- **Move to a “negative list” regulatory environment where regulations specify activities that are prohibited or excluded, and permit all unspecified activities.**
- **Move to more open, global operating standards by revising laws that serve as**

barriers to foreign companies doing business in Korea, including offshore data processing. In particular, promote the role of the Financial Supervisory Service in managing at a macro level, with focus on proper disclosure and the financial viability of insurance providers, rather than in micro-managing products.

- **Simplify Korea’s taxation system, bring Korea’s tax rates in-line with those of regional financial centers, and improve predictability in tax administration.**

REGULATORY REFORM, TRANSPARENCY, AND MARKET ACCESS

Regulatory reform, transparency, and market access are cross-cutting issues impacting foreign investors in all sectors of the Korean economy. U.S.-Korea Business Council and AMCHAM Korea member companies have long cited Korea's regulatory regime as one of the largest barriers to doing business there, most significantly the lack of transparency in the regulatory process. Moreover, Korean regulatory policies intended to promote the domestic market risk being counterproductive, especially in areas such as new technologies in which Korean firms are increasingly global leaders. The Korean government has made substantial improvements in recent years, both in promoting deregulation and in increasing regulatory transparency. However, it is our organizations' position that continued progress is crucial to further enhancing Korea's global economic competitiveness.

Transparency-related issues in particular present difficulties to U.S. and other foreign investors across several sectors of the Korean market. A short list of these issues would include insufficient public comment periods, lack of predictability and consistency in applying regulations, constantly shifting interpretations of regulations, and implementation of regulations in a nontransparent manner without advance

consultation. Also, the lack of specificity in some Korean laws and regulations, and the broad discretion available to Korean authorities in interpreting and applying these rules in practice, create uncertainty for outside investors in how to comply with these rules. For these reasons, establishing a formal mechanism for foreign expertise to be included in the policymaking process would help Korea in its efforts to attract greater foreign investment, as investors would have confidence that their concerns would be heard and taken into consideration.

Our two organizations recognize that the Korean government is working to improve transparency through the Regulatory Reform Commission, the Corporate Difficulties Resolution Center, and the Deregulation Taskforce Team, each of which is tasked with reviewing and reducing regulations. These entities are a model for future efforts to incorporate foreign and industry expertise as Korea moves forward with regulatory reform. On another positive note, we welcome recent administrative guidelines issued by the Korean Ministry of Government and Home Affairs (MOGAHA) regarding how individual ministries and agencies should implement the Administration Procedures Act. Under these guidelines, Korean government agencies and local autonomous bodies are to give a

pre-notice period of a minimum of 60 days from the stage of drafting laws and regulations related to economics and trade, in order for foreign investors and multinational companies to submit comments. Follow through by MOGAHA and by individual agency officials to ensure these new guidelines are followed will help enhance the transparency of Korea's regulatory system.

In this section we highlight some examples across several sectors of the Korean market where regulatory reform, greater transparency, and a more open environment will improve Korea's business climate and attract greater investment: energy, pharmaceuticals, customs, automobiles, heavy machinery, broadcasting, telecommunications and technology standards, and tobacco.

Energy: Stable and predictable legal and regulatory frameworks are among the best ways to attract foreign direct investment. Particularly in the energy field, facilities such as gas terminals and pipelines are highly capital intensive, long-lived, geographically immobile, and generally incapable of being used for purposes other than those for which they were designed. Developing this type of infrastructure using private capital is a challenge in even the most advanced and well-functioning markets. Success requires a commitment to reasonably assure investors that the risks associated with their investments have been minimized to the greatest extent possible.

Korea is in the process of restructuring its gas industry and has promised to move from a market with just one integrated gas company with a natural monopoly to a more

competitive market. Plans for the restructuring were publicly announced in 1999, but progress has been slow. In addition, concerns remain about the possibility for cross-subsidization between the Korea Gas Corporation (KOGAS) import/wholesale subsidiary and its transmission/storage subsidiary. Expedited restructuring will provide benefits to the Korean market and Korean consumers and will create a more attractive environment for foreign investment.

Over the past few years, it has become clear that it will take the Korean government longer than expected to pass the KOGAS reforms. In the case of the electric power reforms, even after the reforms were identified and agreed to, it took a year for the National Assembly to pass the reform legislation. In restructuring the gas sector, it is not clear whether the appropriate reforms have been identified. For example, four years ago, the Ministry of Commerce, Industry, and Energy (MOCIE) announced plans to split its gas import and wholesale units of KOGAS into three affiliated companies by the end of 2001, with two of the three units to be sold to private investors by the end of 2002. This has not yet happened.

Among the elements critical to enhancing competition in the Korean gas market are enabling legislation to redesign the market, which includes unbundling and third-party access. Legislation is needed to ensure, for example, unbundling segments of the industry to create a more level playing field for competition to thrive. Specifically, the importation of gas can be separated from functions that are more akin to natural monopolies, such as transmission and

distribution. Combined with third-party access to the transmission and distribution facilities, such unbundling can help prevent market limitations that currently exist. This third-party access should be at a transparent tariff rate that is equal and nondiscriminatory.

Pharmaceuticals: U.S. companies in the pharmaceutical sector encounter significant transparency issues that serve as a major market access barrier in Korea and merit special attention. For example, Korea's Health Insurance Reimbursement Agency (HIRA) develops and imposes in a nontransparent manner restrictive reimbursement guidelines for many innovative foreign drugs. The Korea Food and Drug Administration (KFDA) approves indications of a drug, but HIRA can ignore, limit, or modify them through a nontransparent process that also lacks opportunities for consultation with substantial independent appeals by foreign companies. With pricing issues, imposing restrictive reimbursement guidelines not based on scientific data has caused a serious issue of access for Korean patients.

Lack of transparency and predictability have also hindered Korea's implementation of the A7 pricing regulation. Under this regulation, the Korean Ministry of Health and Welfare (MOHW) committed to provide a price for new innovative products equal to an average of the prices in seven industrialized countries (A7), but MOHW has never publicly disclosed the criteria upon which they are making pricing decisions, resulting in decisions that are arbitrary. Complicating this situation is the lack of an independent appeals process under the MOHW system. HIRA's Pricing Expert Committee determines which drugs will be

classified as "innovative." However, since 2000 only a few products have received this classification because the committee appears to evaluate innovation as it relates to economic considerations and improvements in cost, rather than on the basis of scientific data or quality. Consequently, several new innovative products have not been introduced in Korea due to unacceptable prices. Greater transparency and predictability in the implementation of A7 that reduces the subjectivity in determining what is "innovative" will improve access of Korean physicians and patients to beneficial drugs and medical treatments.

Enforcement of Actual Transaction Pricing (ATP) is another significant problem for U.S. pharmaceutical companies. Under ATP, the reimbursement price is supposed to be the same as the actual manufacturer price to medical institutions, rather than an inflated official reimbursement price. However, implementation of ATP is plagued by the lack of clear guidelines on operational details, lack of disclosure of data investigated in determining price reductions, and the absence of an independent appeals system. Consequently, some local companies in Korea continue to provide illegal discounts that are not captured in ATP accounting, leaving the majority of price reductions on primarily foreign, research-based companies. This has resulted in discriminatory cost-containment proposals directed toward innovative products, including lowest transaction price and triennial repricing. A recent decision by HIRA requiring written justification for pricing decisions could be a positive step toward resolving this issue. It is nevertheless disappointing to see that a written reply by

HIRA has not yet provided meaningful justification.

Another serious issue in the industry is unethical market practices. These occur mostly in the form of hospital donations and clinic rebates and create inefficiencies while disturbing industry development. Recent efforts by the Korean government, especially the Korea Independent Commission Against Corruption, to fight these market practices are encouraging; multinational companies in the industry fully support their activities. Our two organizations urge the Korean government to continue these efforts.

Customs: The Korea Customs Service (KCS) has made excellent progress over the past few years in speeding customs clearance by improving customs procedures. Nonetheless, more needs to be done to expedite the release of packages from customs, including separating the physical release from the filing of paperwork and the payment of duties and taxes. Appropriate risk-management procedures should be adopted so that low-risk shipments are cleared quickly and customs resources are focused on higher-risk shipments. More automation is needed to achieve these and other goals. At \$100, the de minimus level (under which goods are imported duty free) is too low for an advanced economy such as Korea, as is the \$2,000 low-value threshold (under which goods may be imported with simplified procedures).

KCS has also announced specific plans to enact a new rule requiring export manifests to be submitted prior to the loading of aircraft by October 2005. To that end, KCS is in the process of amending the related internal rules and

regulations. This advance manifest requirement will have a deleterious impact on Korean exporters of high value-added and urgently needed products, who rely on fast, reliable express shipping. Express delivery firms and their customers frequently do not know what products will be going on an aircraft so far in advance of the aircraft's departure. KCS has taken steps to consult with the industry, but the best solution would be not to implement a self-defeating advance manifest policy.

Automobiles: Korea's auto market remains one of the most closed in the world to U.S. automakers. While the Korean government has made some progress in reducing access barriers for U.S. motor vehicles under a 1998 Memorandum of Understanding (MOU) between the U.S. and Korean governments, high tariffs and tax rates on imported autos, unique and excessively burdensome standards and certification requirements, and continued anti-import bias continue to present challenges. The Korean government has simplified and reduced some taxes and implemented a self-certification system for automotive safety standards, but it has not been transparent about how it will meet the long-term goals of the MOU. Korea continues to devise and attempt to implement auto standards unique to Korea that threaten to reverse the gains U.S. auto manufacturers have made in the Korean market. Given the continued success of Korean automobiles in the U.S. market, it is important for the Korean government to follow through with the MOU and create a fair playing field for U.S. and other foreign motor vehicles in the Korean market.

Heavy Machinery: The Korean government subjects companies importing new or updated

versions of machines to an emissions witness testing process. This is a burden on foreign manufacturers because it requires them to run every model through the witness testing process and incurs costs in the hundreds of thousands of dollars. This contrasts with U.S. regulations that allow manufacturers to do self-certification using emissions testing that has already been done by the manufacturer at another stage in the process. Moreover, it is unfair and contrary to the intentions, if not the letter, of Korea's WTO obligations.

Broadcasting: The Korean broadcasting sector remains an important area where removing market barriers to outside investors would enhance the competitiveness of the industry for both foreign and Korean businesses. Korea's United Broadcasting Law (UBL) places a 20% quota on the number of foreign channel retransmissions permitted. While this is an improvement over the 10% restriction in place until 2004, the current quota represents only a small step forward, and further reduction is encouraged. Moreover, only 10% of total channel capacity on a given cable system can be allocated to foreign networks, which creates tremendous competition for limited shelf space.

Currently the UBL places a 30% mandatory local content programming quota on movie channels, and a 35% local content quota on animation channels. This animation quota—while improved from its previous level mandating 40% local content—remains an impediment to foreign media companies investing in and establishing a local animation channel because of the insufficient Korean content currently available that meets these

companies' standards. Such a channel would give foreign companies a business platform from which to invest in Korean animation and market it globally. The current quota is a disincentive to investment. By lowering or removing the quota, it is likely that the amount of Korean content on air would grow over time on the basis of market dynamics to exceed the current quotas—also benefiting the Korean animation industry.

Dubbing is restricted by the Korean Broadcasting Commission (KBC), which only allows subtitling as a form of language localization. The KBC justifies this rule by arguing that foreign channels are not subject to censorship oversight like domestic Korean channels are. However, foreign channels are all delivered by Korean service providers, either cable or satellite services, and these platform operators could be held accountable for ensuring that foreign broadcasters meet local censorship requirements. In addition, the KBC restricts local advertisement insertions for foreign channel retransmissions, which is unreasonable given that the government already imposes the 20% quota on foreign channel retransmissions. These provisions create double barriers for media companies that have led to the temporary suspension of localization of prominent cable networks. A more open market where consumers dictate the competitive balance would benefit Korean consumers in addition to domestic and foreign broadcasters.

Given the relation of issues in this sector to the ongoing services negotiations under the WTO Doha Development Agenda, our two organizations hope that the Korean government will be forthcoming in this area.

Telecommunications and Technology

Standards: The Korean government should serve as a facilitator, rather than as a leader, of market-driven technological development. Technology neutrality in standards-setting processes is important to fostering global competitiveness, and government-mandated standards in technology-related sectors inevitably shut some companies and their innovative technologies out of the market. Not only are mandated standards a protectionist policy increasingly out of step with Korea's WTO agreements, but they also deprive consumers of technology choices and limit the opportunity for the market to determine what standards will be commercialized. As Korean companies become global market leaders on the basis of their technological innovations, standards-setting proposals by the Korean government send an unwelcome signal to foreign businesses and could put at risk the long-term competitiveness of Korean firms.

In the telecommunications sector, proposals for Korea-specific standards are of strong concern to our two organizations. Korean government influence in choices of equipment and technology sources—both direct and indirect through industry associations and quasi-governmental commissions—has been observed in the licensing process for operators and in localization policies for procurement. Some U.S. firms with new technologies encounter resistance to their attempts to introduce new software and technologies to the market.

The Korean government's decision in 2004 to allow competing U.S. systems to co-exist in the Korean market with Korea's Wireless Internet Protocol for Interoperability (WIPI) standard

was a positive step toward letting the market determine technology standards. Previously, the Korean government had indicated its intention to implement WIPI as a mandatory telecommunications standard in Korea for downloading content from the Internet to mobile phones, which could have blocked market access to a competing U.S. system with several million current Korean subscribers. However, the Korean government's plans to reallocate the 2.3-gigahertz spectrum to a new wireless broadband Internet service within which it will allow only one technology to be deployed could present a significant barrier to technology choice and is potentially in conflict with Korea's WTO commitments. While the Korean government selected an International Institute of Electrical and Electronics Engineers (IEEE) standard as the technology standard for use in this spectrum, the selection of this standard still restricts access for several commercialized technologies. We urge the Korean government to let the market determine standards in order to promote a competitive local market and to position its domestic industry to compete at a global level.

Korean regulations maintain a limit of 49% foreign ownership of Korean telecommunication companies. By raising this limit to allow foreign control, Korea would boost the competitiveness of its telecommunications sector, drawing in new foreign investment and benefiting Korean consumers.

Tobacco: Korea's tobacco industry ceased to be a monopoly in 1988, but certain barriers and obstacles still exist that in practice serve primarily to benefit the former monopoly holder, KT&G Co., Ltd. (KT&G). For example, under the Tobacco Business Act (TBA),

retailers who wish to sell cigarettes must obtain a cigarette retail license from the relevant local government authority. Before a license can be issued, however, the TBA requires a site investigation inspection, a task which has been delegated to the Korea Cigarette Retailers' Association (KCRA). Even though the KCRA must act independently, according to certain sources in the market, it is believed that KT&G maintains influence over the KCRA as well as over certain aspects of the KCRA's operations, such as determining the qualifications of the cigarette retail license applicants. Concern has also been raised that retailers who have obtained a cigarette retail license continue to face tactics employed by KT&G to discriminate against foreign cigarettes, such as the replacement of foreign brand cigarettes with KT&G brand cigarettes and arrangements with retailers to exclusively sell or display KT&G brand cigarettes.

KT&G appears to continue to use its influence to restrict free competition in the tobacco market despite a previous corrective order by the Fair Trade Commission against KT&G for its unfair trade practices over its competitors. By creating a level playing field for foreign cigarette companies and an open and competitive market in Korea, KT&G would also benefit as it increases its international business presence.

POLICY RECOMMENDATIONS:

The Korean government should take the following actions to improve its regulatory climate, increase market access in key sectors, and enhance its global competitiveness:

- **Continue efforts to improve transparency in the rulemaking process**

and eliminate regulations presenting unnecessary obstacles to competition and growth.

- **Establish a formal process for foreign expertise to be included in the policymaking process as appropriate and ensure that foreign companies have equal opportunities to participate in dialogues regarding market practices and industry issues.**
- **Adopt licensing requirements, qualification requirements, and technical standards across all sectors of the Korean market that do not serve as unnecessary barriers to trade.**
- **Eliminate unique, redundant, and excessively burdensome approval tests and certification procedures across all market sectors.**
- **Ensure WTO compliance with tax laws, tariffs, and subsidies affecting imported products.**
- **Promote technology neutrality in standards and allow greater international participation in current and future standards-setting efforts.**

U.S. VISA POLICY

The U.S.-Korea Business Council and AMCHAM Korea recognize that there are areas where the U.S. government must be proactive in improving the U.S.-Korea business relationship. Our two organizations advocate facilitating nonimmigrant visa issuance for Korean citizens and are concerned that overly burdensome visa restrictions on legitimate travel by Koreans are having a negative impact on two-way trade and investment between the United States and Korea. In addition, ease of travel for Koreans to other countries—over 100 of which do not require visas for Korean travelers—is diverting Korean visitors away from U.S. tourist destinations, with significant impact on the U.S. tourism and hospitality industry. Most importantly, these restrictions risk hurting perceptions of the United States in Korea, a close ally and a strong supporter of U.S. anti-terrorism efforts.

Korea was among the top five origin countries for visitors to the United States in 2004. The U.S. Embassy in Seoul is the largest nonimmigrant U.S. visa issuance post in the world, handling more than 2,500 applications a day. Korea plays an important role in sending visitors to the United States for business, tourism, and academic study. Tightened U.S. entry rules implemented following the 2001 terrorist attacks have strained the capacity of

the U.S. visa-issuing system, significantly impacting Korean business, student, and other travelers to the United States. Because Korea has not yet qualified for the Visa Waiver Program, nearly all Korean applicants for U.S. visas must go to the U.S. Embassy in Seoul—currently the only U.S. visa issuance post in Korea—for a personal interview. This results in long waits for an interview appointment; in the first half of 2005, the average wait was 60 days. Moreover, limited physical plant and personnel resources available to the consular post have affected the ability of the U.S. Embassy to address the logistical challenges presented by stricter visa rules.

Our two organizations are encouraged by U.S. government actions to increase consular resources and simplify the visa application process for Korean citizens. In February 2005, the U.S. Embassy announced that it would simplify procedures to make the visa application process more efficient and user-friendly for Korean travelers to the United States. The U.S. Embassy is also increasing the number of personnel in the consular section and has expanded the number of intake windows at the consular post to help reduce the long waiting lines for visa applicants. These measures are increasing the number of applicants taken each day and should and are reducing delays.

VISA REFERRAL PROGRAMS

The U.S. Embassy in Korea makes use of a number of referral programs that permit it to process the visas for Korean business and student travelers without individual interviews. In particular, the U.S. Embassy has established a Business Registration Program (BRP) under which Korean companies can apply to participate and get expedited visa interview appointments. AMCHAM Korea administers a BRP for nonimmigrant B1 and B2 visas for its member companies and their employees and immediate families; it reports that it gets appointments for its applicants in three to five days and passports with visas returned in the same time period. In addition, the U.S. Embassy reinstated its University Referral Program to expedite the visa application process for faculty members and professional staff of large Korean universities. Our two organizations encourage the U.S. Embassy to facilitate and expand opportunities for Korean visitors to the United States through these programs.

VISA WAIVER PROGRAM

A long-term priority of our two organizations is the addition of Korea to the U.S. Visa Waiver Program. Korea's visa application rejection rate is currently just over the 3% threshold required for consideration for this program; however, this rate continues to decline. Our organizations welcome efforts by the U.S. government to work with the Korean government in addressing security issues with Korean passports—including cracking down on the high number of lost and stolen

Korean passports—that must be resolved for Korea to meet other requirements for Visa Waiver Program eligibility. In addition, AMCHAM Korea works closely with the Korean business community to educate Koreans about the visa application process—particularly the cultural differences that make this process challenging—to lower the rejection rate.

Our organizations will advocate for Korea's inclusion in the Visa Waiver Program once it meets the requirements for the program, and when the U.S. Congress has indicated its willingness to include new countries in this program. To facilitate this, we urge the U.S. and Korean governments to continue their dialogue on visa policy issues and to bring Korea's application rejection rate down through education and outreach efforts.

POLICY RECOMMENDATIONS

The U.S. government should take the following actions to facilitate the entry of Korean business travelers, students, and other visitors to the United States in order to promote greater trade and overall bilateral relations:

- **Increase transparency and predictability in the U.S. visa issuance process.**
- **Provide additional personnel and physical plant resources to allow the consular post at the U.S. Embassy in Seoul to comply with new U.S. government requirements while minimizing delays.**

CONCLUSION

The U.S.-Korea Business Council and AMCHAM Korea hope that Korean policymakers will consider our *2005 Policy Paper* a useful resource as they prioritize and develop policies to support Korea's regional hub ambitions. We urge the Korean government to continue its constructive dialogue with the U.S. business community—both in Seoul and in Washington—so that we can collectively identify opportunities to work together to promote Korea's economic growth.

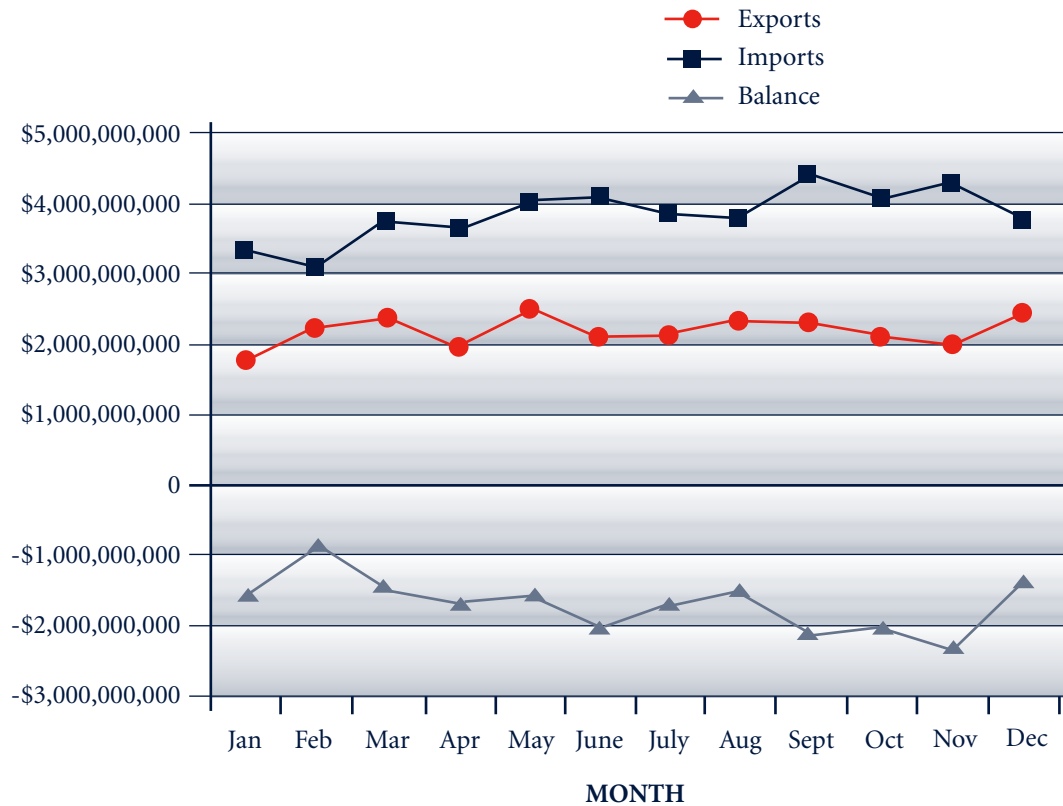
Likewise, our two organizations hope that U.S. policymakers find this paper a constructive assessment of one of our most important international economic and trade relationships. We urge the U.S. government to ensure that security precautions in U.S. visa policies do not adversely impact bilateral trade but instead enhance the flow of goods and people. In addition, we encourage U.S. policymakers to urge their Korean counterparts to make progress on the issues outlined in this paper in order for our two countries to move forward with FTA negotiations.

The Council and AMCHAM Korea are eager to work together with our counterparts in the Korea-U.S. Business Council to further build upon our important relationships, and to explore new opportunities for promoting our shared agendas and greater cooperation

between our business communities, as we look ahead to APEC 2005 and beyond.

APPENDIX A: U.S.-KOREA TRADE STATISTICS

U.S.-Korea Trade Statistics (2004)



Source: U.S. Census Bureau
<http://www.census.gov/foreign-trade/balance/c5800.html#2004>

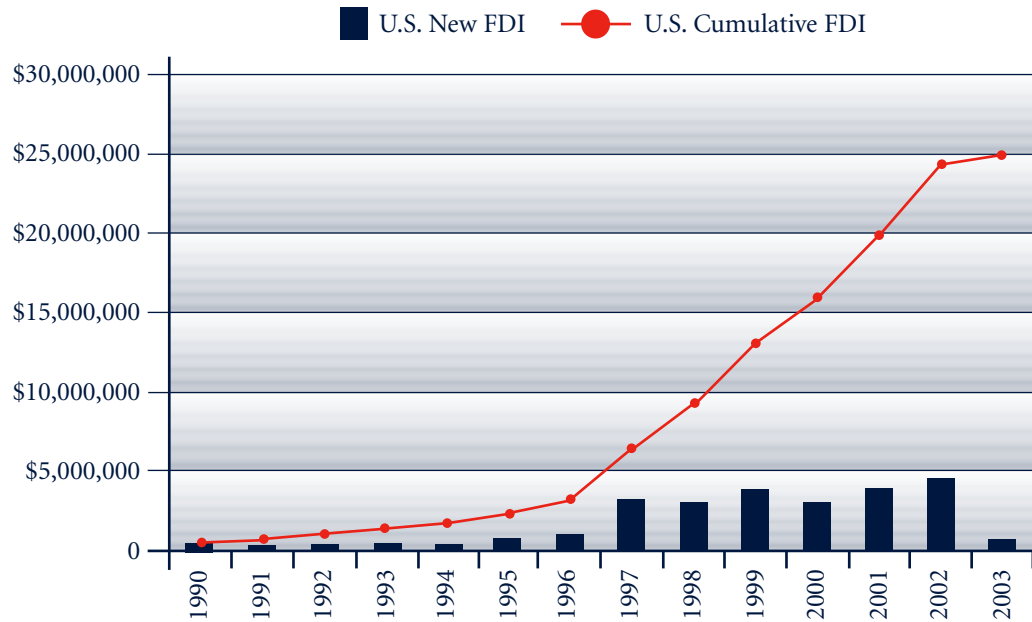
U.S.-Korea Trade Statistics (2000-2004)

Year	Exports	Imports	Balance
2000	\$27,830,000,000	\$40,307,700,000	-\$12,477,700,000
2001	\$22,180,700,000	\$35,181,500,000	-\$13,000,800,000
2002	\$22,575,700,000	\$35,571,700,000	-\$12,996,000,000
2003	\$24,072,600,000	\$37,229,400,000	-\$13,156,800,000
2004	\$26,412,500,000	\$46,167,900,000	-\$19,755,500,000

Source: U.S. Census Bureau
<http://www.census.gov/foreign-trade/balance/c5800.html#2004>

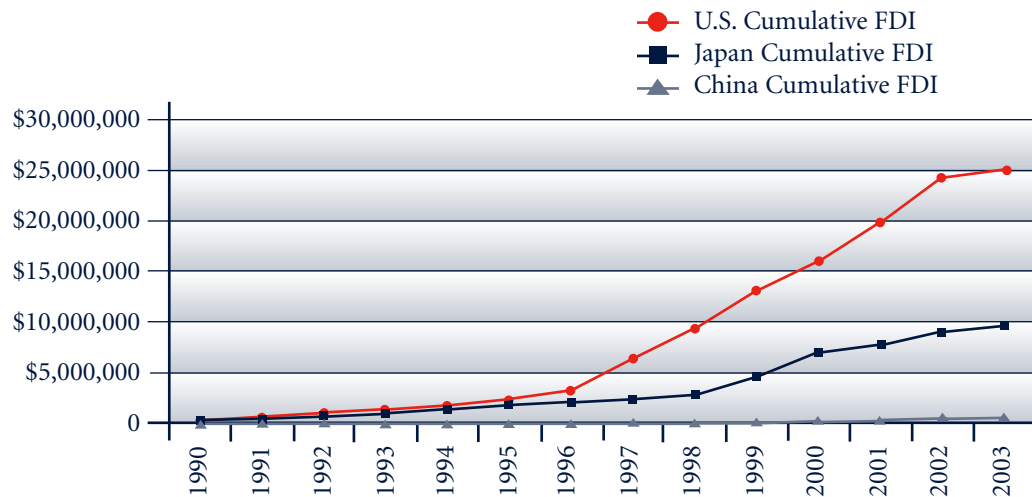
APPENDIX B: FOREIGN DIRECT INVESTMENT IN KOREA

Foreign Direct Investment from the U.S.



Source: U.S. Embassy, Republic of Korea
<http://usembassy.state.gov/seoul/wwwfe75305.pdf>

Cumulative Foreign Direct Investment by Country



Source: U.S. Embassy, Republic of Korea
<http://usembassy.state.gov/seoul/wwwfe75305.pdf>

APPENDIX B: FOREIGN DIRECT INVESTMENT IN KOREA

Inbound Foreign Direct Investment by Country

Year	Total		U.S.		Japan		China	
	New	Cumulative	New	Cumulative	New	Cumulative	New	Cumulative
1990	\$802,635	\$802,635	\$317,830	\$317,830	\$235,530	\$235,530	\$100	\$100
1991	1,395,996	2,198,631	296,620	614,450	225,918	461,448	690	790
1992	894,476	3,093,107	379,182	993,632	155,161	616,609	1,056	1,846
1993	1,044,274	4,137,381	340,669	1,334,301	286,006	902,615	6,864	8,710
1994	1,316,505	5,453,886	311,016	1,645,317	428,407	1,331,022	6,145	14,855
1995	1,947,229	7,401,115	642,776	2,288,093	424,094	1,755,116	10,892	25,747
1996	3,202,580	10,603,695	875,004	3,163,097	254,676	2,009,792	5,578	31,325
1997	6,970,916	17,574,611	3,189,524	6,352,621	265,380	2,275,172	6,518	37,843
1998	8,852,566	26,427,177	2,970,752	9,323,373	504,158	2,779,330	8,381	46,224
1999	15,541,547	41,968,724	3,738,999	13,062,372	1,749,206	4,528,536	26,586	72,810
2000	15,216,711	57,185,435	2,921,306	15,983,678	2,448,222	6,976,758	76,496	149,306
2001	11,291,844	68,477,279	3,889,094	19,872,772	772,184	7,748,942	70,422	219,728
2002	9,101,324	77,578,603	4,499,552	24,372,324	1,403,542	9,152,484	249,357	469,085
2003	2,660,339	80,238,942	582,187	24,954,511	366,514	9,518,998	26,237	495,322

Source: U.S. Embassy, Republic of Korea
(<http://usembassy.state.gov/seoul/wwwfe75305.pdf>)

NOTES

- 1 United States International Trade Commission. U.S.-Korea FTA: The Economic Impact of Establishing a Free Trade Agreement Between the United States and the Republic of Korea. Investigation No. 332-425. USITC Publication 3452 (September 2001). Washington, D.C.: USITC, 2001. pp. ix-xi.
- 2 Korean Ministry of Labor.
- 3 OECD. “Broadband Subscribers per 100 Inhabitants in OECD Countries,” June 2004. Posted at: www.oecd.org/dataoecd/19/42/34082810.xls. Viewed 4/3/05.
- 4 International Intellectual Property Alliance. “2005 Special 301 Report: South Korea.” p. 236. Posted at: www.iipa.com/rbc/2005/2005SPEC301SOUTH_KOREArev.pdf. Viewed 4/4/05.
- 5 Soribada was fined 19 million won (U.S.\$18,500) in damages under a civil court order issued in January 2005. International Intellectual Property Alliance. “2005 Special 301 Report: South Korea.” p. 238. Posted at: www.iipa.com/rbc/2005/2005SPEC301SOUTH_KOREArev.pdf. Viewed 4/4/05.
- 6 International Intellectual Property Alliance. “2005 Special 301 Report: South Korea.” pp. 237-241. Posted at: www.iipa.com/rbc/2005/2005SPEC301SOUTH_KOREArev.pdf. Viewed 4/4/05.
- 7 Motion Picture Association of America. “Worldwide Internet Piracy Study.” July 2004. Posted at: www.mpa.org/MPAAPress/index.htm. Viewed 4/4/05.





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