

Management
Briefing Seminars
2007



Manufacturing

It's a Small World After All

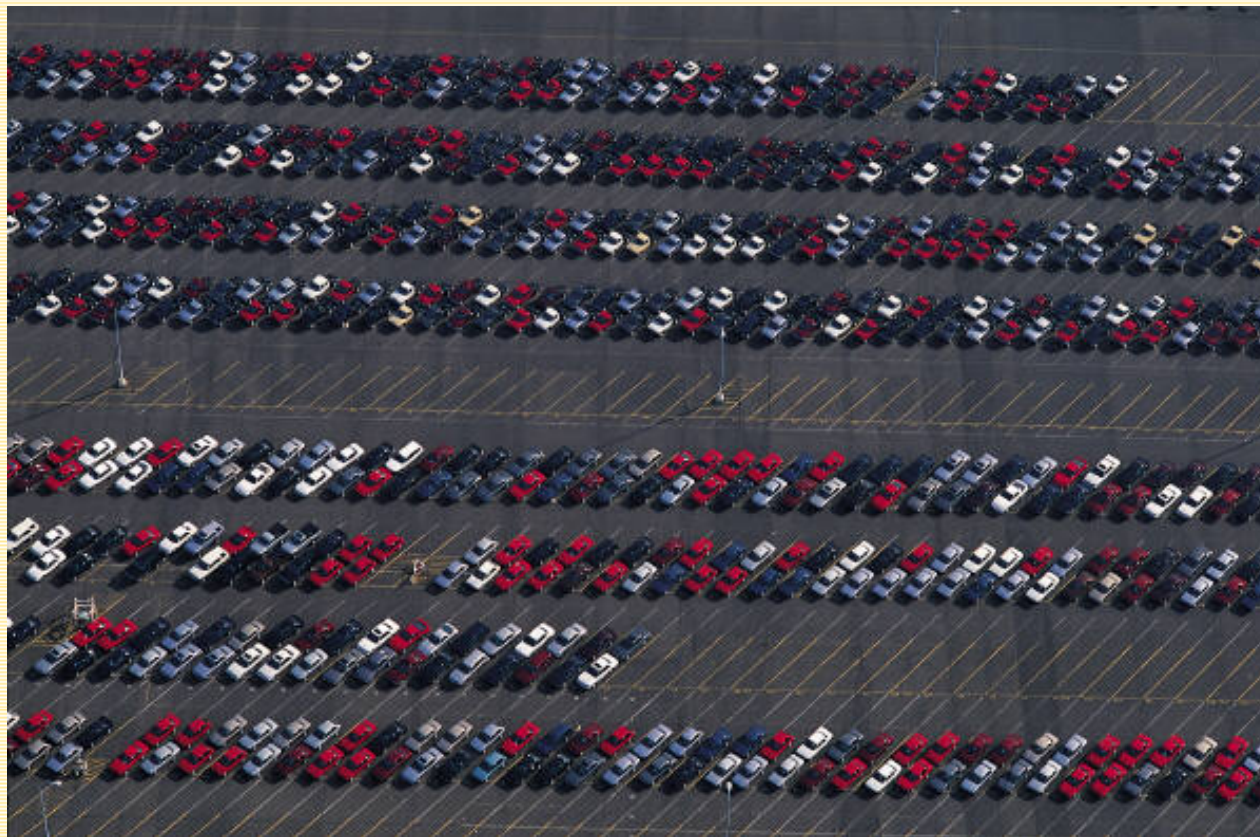
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Globalization, International Trade Policy, and the Automotive Industry: It's a Small World After All





The Automotive Industry in Washington's Sight: A Good Thing Or Bad?



- **FUEL ECONOMY:** Several proposals to increase CAFE, as well as to develop alternative power train sources. The Senate passed legislation requiring fleetwide 35 MPG by 2022. Two primary bills moving in the House: the Markey bill which would require 35 MPG for vehicles under 10,000 pounds by 2018 (152 co-sponsors); and the Hill-Terry bill which would require 35 MPG for cars, and 32 MPG for trucks and SUVs, by 2022 (125 co-sponsors).
- **EMPLOYEE FREE CHOICE ACT:** Would permit employee organization on the basis of authorization cards alone; establish stronger penalties for unfair labor practices; and provide for a first-contract mediation and arbitration. The legislation passed the House. In the Senate, supporters were unable to garner 60 votes to invoke cloture and end a filibuster.
- **HEALTH CARE LAWS:** Healthcare debate in the country, escalating in connection with the upcoming elections, also has a direct bearing on auto industry. Indeed, Messrs. Lasorda, Mulalley, and Wagoner have been to Washington several times in the past 10 months to discuss this, among other issues.
- **PRIVATE EQUITY/HEDGE FUND MANAGERS' TAX TREATMENT:** Washington is also entertaining raising the taxes paid by private-equity and hedge funds managers. Unclear at this time whether this may have an impact on these funds' substantial investments in the automotive sector.
- **TRADE RELATED ISSUES:** The focus of this presentation.

International Trade: Free Trade Agreements

DO WE NEED FREE TRADE?

- ABSOLUTE ADVANTAGE: If Country X produces a product cheaper than Country Y, it is economically advantageous for both nations if Country Y trades with X for that commodity.
- COMPARATIVE ADVANTAGE: If Country X is better at manufacturing cars than it is at milling lumber, it is economically better for X to put its resources into producing cars and use those cars to trade for lumber.



How Does the U.S. Enter into Free Trade Agreements?

- Constitutionally, the power to regulate trade is delegated to Congress. U.S. Const. Art. I, Sec. 8 and Sec. 10
- Beginning in 1975, Congress delegated to the President the authority to negotiate Free Trade Agreements. This delegation was known as “Fast Track Negotiating Authority” (now “Trade Promotion Authority”)
 - Canada-United States Auto Pact (1965)
 - Congress approves up or down; no amendments possible
 - Requirements of extensive reports, studies, hearings, etc.





Free Trade Agreements to Which United States Is a Party



- Between 1975-1994, the U.S. entered into bilateral FTA's with Israel and Canada, into NAFTA and into the Uruguay Round Amendments that created the WTO
 - Fast Track Authority "lapsed" in 1994 and was not renewed until 2002
 - Controversial gaveling of the vote in the House
- Since 2002, U.S. entered into FTA's with: Chile; Singapore; Morocco; Dominican Republic-Central America; Bahrain; and Oman
- Pending are the FTA's with Panama, Peru, Colombia, and South Korea
- Democrats in Congress mandated inclusion of labor and environmental protections in each of the four pending FTA's

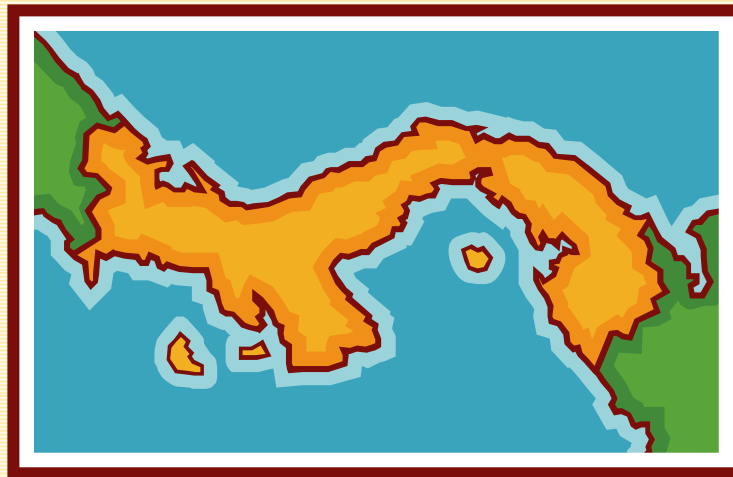
Status of the Four Pending Agreements: Peru



- Signed in April 2006, and overwhelmingly approved by Peru's Legislature in June 2006
- In and out of Congress, many believed Peru's labor laws were inefficient and poorly-enforced; in response, Peru agreed to adopt the five core labor standards set out in the 1998 International Labor Organization declaration
- Generally, out of the four agreements, Peru is considered the least troublesome and the most likely to pass. The Congressional hearings on this FTA are however not slated to take place until after the August recess

Status of the Four Pending Agreements: Panama

- The agreement was signed in June 2007
- While negotiations continue (the countries just concluded the second round of negotiations), overall, the agreement seems to be headed for the Congressional approval
- Approval is expected some time in September, immediately after the anticipated approval of the Peru-U.S. FTA



Status of the Four Pending Agreements: Colombia

- The parties signed the agreement in October 2006
- But the pact remains in legislative limbo because Colombia has a terrible history of killing labor activists
- Before Congress approves the agreement, Congress requests that the Uribe government expand its investigative efforts and improve its conviction rate
- Many congressmen do not support the Colombia FTA until there is concrete evidence of sustained results on the ground in Colombia
- Colombia agreement is more problematic than Peru and Panama FTA's



Status of the Four Pending Agreements: Korea

- Agreement was signed on June 30, 2007 (the last day of TPA), and is the largest free trade deal since NAFTA.
- Korea is the world's tenth-largest economy, with a GDP of nearly \$1 trillion, and America's seventh largest trading partner, with two-way goods trade in 2006 valued at approximately \$78 billion.
- South Korea is the world's ninth-largest car market, with 1 million vehicles purchased in 2006. Last year Korea imported fewer than 6,000 U.S.-made cars; the U.S. imported nearly 700,000 Korean-made cars.
- The KORUS FTA is the most politically problematic of the four and seemingly not slated for congressional approval any time soon.



KORUS: A Closer Look at the Automotive Provisions

- Korean Commitments:
 - Immediate reduction of the 8% auto tariff to zero
 - Immediate reduction of the truck tariffs to zero
 - Immediate reduction to zero on auto parts tariffs
 - Elimination of the discriminating aspects of Korea's Special Consumption and Vehicle Taxes, and reduction of existing tax rates
 - Establishment of a bilateral auto working group to identify potential regulatory issues
 - The agreement commits Korea to halving its sales taxes, rewriting its regulations and joining a dispute resolution panel that could restore U.S. tariffs to punish proven violations by South Korea
 - In exchange for accepting new obligations on labor and environment, Korea demands commitments on more visas for Korean professionals and a grace period before establishing a system of patent linkage
 - Agreement on non-tariff issues of ultra low emissions vehicles, on-board diagnostics, and safety self-certification

KORUS: A Closer Look at the Automotive Provisions (Cont.)

- U.S. Tariffs:
 - Immediate reduction of the 2.5% car tariff to zero for cars with engine up to 3.0 liters
 - Less linear phase-down to zero over 3 years of the 2.5% car tariff for Korean imports with engine sizes of 3.0 liter or more
 - Linear phase-down of the 25% truck tariffs to zero over 10 years
 - Immediate reduction to zero on auto parts tariffs

Auto Industry Response to KORUS

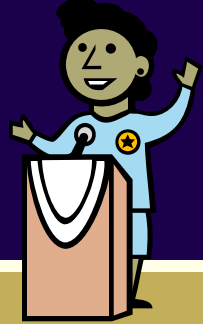
- Chrysler: “The agreement in its current form does not provide the Koreans with adequate incentives to open their market to increased U.S. automotive exports.”
 - Chrysler Group Statement in Response to Release of U.S.-Korea Free Trade Agreement Text, May 25, 2007, available at: www.marketwatch.com.

- Ford: “Ford is disappointed that ITAC’s negotiating advice and approach [to use leverage of preferential access for Korean automakers to the U.S. market as a means to ensure that the heavily restricted Korean auto market if fully opened] was not accepted. Ford is also disappointed with the lopsided benefit provided immediately to the Korean auto industry and the Korean economy resulting from U.S. concessions made on its vehicle tariffs, particularly in the absence of any benchmarks to track whether serious market opening progress is being made in Korea’s closed auto market.”
 - Ford Motor Company Assessment of the Automotive Provisions of the U.S.-Korea FTA, available at: www.ustr.gov

- General Motors: “GM believes that the KORUS Agreement concluded on April 1 has addressed the auto industry’s concerns.”
 - General Motors Corporation Assessment of the Automotive Provisions of the U.S.-Korea FTA, available at: www.ustr.gov

- Toyota: Toyota has not taken a public position on the FTA.

Response to KORUS from Politicians



- **“Our trade agreement [with Korea] is an opportunity to help a key democratic ally in a rapidly changing Asia to lock in economic reform and the rule of law. It is an opportunity to anchor our trans-Pacific vision of peace and prosperity for the 21st century.”**
-- Secretary of State Condoleezza Rice, May 9, 2007
- **“Unfortunately, the KFTA as currently negotiated is a missed opportunity. The agreement does not address in an effective manner the persistent problem of non-tariff barriers, particularly those blocking access of U.S. manufactured products in South Korea’s market.”**
-- Pelosi, Hoyer, Rangel, and Levin, *Statement on Trade*, July 2, 2007
- **“Whereas, the agreement will jeopardize thousands of automobile jobs because it opens the United States automobile market further while failing to address the barriers to the sale of United States automobiles in South Korea**

 . . . be it [r]esolved by the Senate (the House of Representatives concurring), [t]hat we urge the United States Congress to oppose the South Korea Trade Agreement.”
-- S. Con. Res. 11, 94th Leg., Reg. Sess. (Mich. 2007)
- **“[T]his FTA is not perfect – U.S. auto makers have raised serious concerns with tariff and non-tariff provisions they feel are not adequately addressed and that will continue to block meaningful access to Korea’s auto market. The NAM is encouraging continued discussions to address these legitimate concerns. Overall, though, this agreement will help U.S. manufacturing as we wrestle with how to deal with our trade position in Asia and how to maximize the prospects for increasing the competitiveness of manufacturing in the United States.”**
-- John Engler, NAM President, June 30, 2007

The Future of Free Trade: President's Fast Track Authority Expired

- The president's fast-track negotiating authority has expired yet again on July 1, 2007
- Democrats in control of Congress have shown no interest in a quick renewal of authority; White House knows renewal is not in its future
- Technically, the Administration does not need fast track to launch negotiations with another nation
- But many worry this will hurt U.S. in negotiations because partners will fear how Congress might alter an agreement

The Future of Free Trade: A Populist Sentiment in the Congress/Country?

- Many insist that trade should be free, but fair. . .
What does this really mean?
- Better job responding to displacement --
reauthorization/broadening of TAA
- Currently: a more skeptical view of free trade
- Democratic majority
 - Several newly elected Democrats ran on very a clear trade-
way platform
 - Labor and environmental concerns, as well as IP protection

Economic Impact of FTA's

- NAFTA, after which the current agreements are modeled, has reportedly increased the level of trade between the participating countries:
 - From 1994-2001, U.S. trade with NAFTA partners increased by 78 percent. U.S. trade with the rest of the world increased by 43 percent;
 - During the same period, U.S. exports to Canada and Mexico went up by 35 and 93 percent respectively. U.S. exports to the rest of the world went up 20 percent;
 - But these numbers can be deceptive, too:
 - Some of the increase in trade comes from parts leaving the U.S. for assembly and reimportation back into U.S.
- Other FTA's have also led to reported gains in U.S. exports:
 - In 2004, U.S. exports to Chile grew 33.5%, making America Chile's leading trade partner;
 - U.S. trade surplus with Singapore tripled after the first year of U.S.-Singapore FTA, reaching 4.3 billion;
 - In the first quarter since the U.S.-Australia FTA went into effect, the U.S. trade surplus with Australia grew 31.7% to 2.13 billion.

What Do Businesses and Politicians Think about TPA and FTA's?

- **“ . . . without trade promotion authority, the United States is sitting on the sidelines while our trading partners negotiate sweetheart deals with each other.”**
-- U.S. Trade Rep. Susan C. Schwab
- **“Our companies, workers and farmers cannot compete and win in the global marketplace if Congress does not grant [Trade Promotion] [A]uthority. Our trading partners will not negotiate agreements with the United States which are subject to change by the Congress after the deal is done.”**
-- Thomas Donohue, President and CEO of the U.S. Chamber of Commerce
- **“The Teamsters Union strongly opposes every current ‘free’ trade agreement in line for Congressional consideration – this includes the Peru, Panama, South Korea, and Colombia FTAs. There is something inherently wrong with trade agreements that weaken our economy and cost jobs, and that is exactly what each and every one of these FTAs will do.”**
-- James Hoffa, President of the Teamsters Union
- **“Our legislative priorities do not include the renewal of fast track authority. Before that debate can even begin, we must expand the benefits of globalization to all Americans. . . .”**
-- House Speaker Nancy Pelosi, Majority Leader Steny Hoyer, Ways and Means Committee Chairman Charles Rangel, and Ways and Means Trade Committee Chairman Sander Levin, in a Statement on Trade

What Do American People Think about Free Trade Agreements?

- On balance, FTA's are seen as a good thing for the Country, but Americans are divided over the impact of free trade agreements on their own personal financial situations
- 48% of Americans believe that free trade agreements lead to job losses in the U.S., while just 12% say that trade agreements have created jobs
- 44% say that free trade has led to lower wages for American workers, while only 11% believe it has increased wages
- 30% of people indicate that free trade agreements have raised prices on products, compared to 32% who say that they have led to lower prices
- Nearly six-in-ten Americans (57%) say that free trade is good for the people of developing countries, compared with just 19% who say it does not make a difference and 9% who think that free trade agreements are bad for developing countries

Source: The Pew Research Center, *Free Trade Agreements Get a Mixed Review*, Dec. 19, 2006

Different Opinions on Currency Manipulation

- **“Companies like mine, forced to lose business and lay off valuable employees because of the Chinese government’s manipulation of its currency, need action by Congress now. If U.S. companies and producers cannot compete fair and square, that’s just competition. But when we start off with a 40% disadvantage because of the Chinese government’s monetary manipulation, that is not free enterprise.”**
 - Doug Bartlett, Co-Chair of China Currency Coalition and President of Bartlett Manufacturing Company, Inc., June 29, 2007

- **“Some irresponsible Democrats in Congress would have you believe that China's economic success is simply the result of currency manipulation, unfair regulations and pirating American movies. It's true that China's currency is seriously undervalued. But places like Dongguan have thrived largely because of values we like to think of as American: ingenuity, diligence, entrepreneurship and respect for markets.”**
 - Nicholas D. Kristof, *Pirates and Sanctions*, N.Y. Times, May 24, 2007, at A27

- **“We recognized that some international currency exchange rate policies can be disruptive. We recognized that when a country’s policies keep its currency undervalued, those policies make that country’s products unfairly cheap here. And we recognized that those policies also make American products unduly expensive there. Today, China’s remninbi is the focus of our concerns. Tomorrow, other economy’s currency may threaten even more devastating effects.”**
 - Sen. Max Baucus (D-Mont), July 26, 2007, at the Markup of Currency Exchange Rate Oversight Reform Act of 2007

Present Framework for Dealing with Currency Manipulation

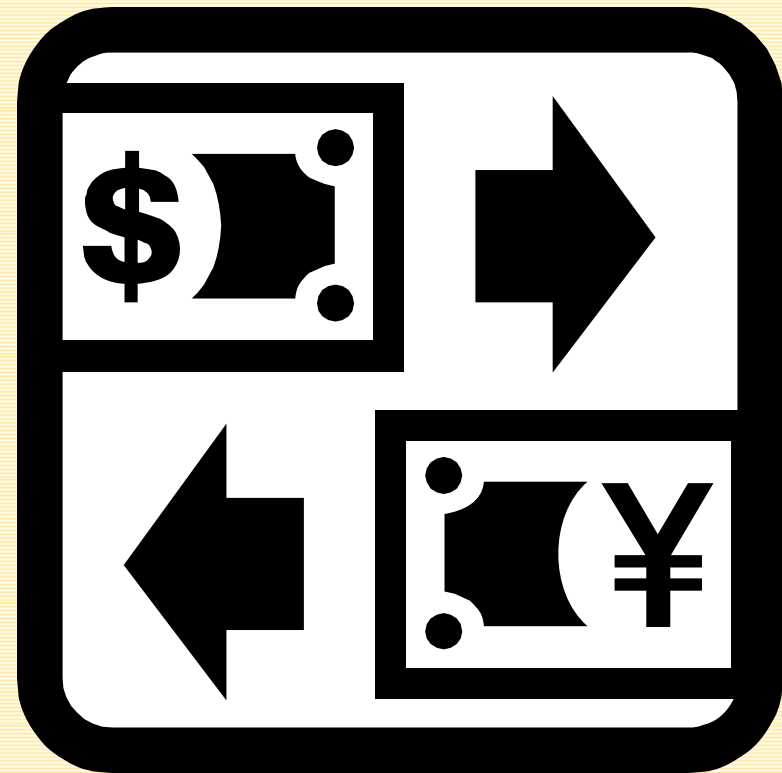
- Under the 1988 Omnibus Trade and Competitiveness Act, the Secretary of the Treasury, in conjunction with the IMF, is required to analyze countries' exchange rate policies to determine "whether countries manipulate the rate of exchange . . . for purposes of preventing effective balance of payments adjustments or gaining competitive advantage in international trade."
- The Secretary of the Treasury is required to undertake negotiations with those manipulating countries that have material global current account surpluses and significant bilateral trade surpluses with the United States, unless such negotiations would have a serious detrimental impact on vital national economic and security interests.
- The Treasury Department's semiannual report on June 13, 2007 found that, while China's yuan is undervalued, China is not intentionally manipulating its currency to gain a trade advantage. The Treasury Department did not find that China's exchange rate policy was carried out for the purpose of preventing effective balance of payments adjustment or gaining unfair competitive advantage in international trade.

Legislation to Address Currency Manipulation

- The most relevant bills to attack currency misalignment/manipulation are:
 - S. 1607—Currency Exchange Rate Oversight Reform Act of 2007 (Baucus-Grassley)
 - Requires Treasury to identify the “fundamentally misaligned currencies,” and provides for consultations with the offending nation and, in most egregious cases, by the legal action through the WTO. Addresses misaligned currencies with antidumping duties
 - Supported by Sen. Stabenow (D-MI), Carl Levin (D-MI), as well as Hillary Clinton (D-NY) and Barack Obama (D-III)
 - Approved in the Senate Finance Committee by a wide margin
 - S. 1677—Currency Reform and Financial Markets Access Act of 2007 (Dodd-Shelby)
 - Focus on whether or not a country is manipulating its currency, intentionally or not, to create advantage over the U.S.; the bill lacks the trade law changes of the other bills
 - Approved in the Senate Banking, Housing and Urban Affairs Committee
 - H.R. 1229—Nonmarket Economy Trade Remedy Act of 2007 (Davis-English)
 - Provides for application of CVD law to nonmarket economies, and outlines a methodology for calculating the additions to countervailing duties relative to unfair trade from China; no mention of dumping or exchange rate policy
 - H.R. 2942—Currency Reform for Fair Trade Act of 2007 (Ryan-Hunter)
 - The toughest of the four; calls for determining “fundamentally misaligned currencies” and those in need of priority action, and provides for antidumping remedies
 - In addition, provides that CVD laws will apply to nonmarket economies, and that currency misalignment should be considered a subsidy in calculating the CVD duty

Currency Legislation Targeting Japan

- The current legislation:
 - S. 1021—The Japan Currency Manipulation Act (Stabenow, D-MI) directs the U.S. Treasury and the Council of Economic Advisors to work with Japan to facilitate the proper alignment of yen and dollar. Also, the bill directs the Treasury to work with European trading partners and the IMF to address trade imbalances
 - H.R. 2886, introduced by Rep. Knollenberg, R-MI, is the House companion to the Senate bill and is similar to the Senate's version



Globalization and Import Safety

China executes food safety director

Official's death seen as sign
country wants to improve
quality control

"We should seriously reflect and learn lessons from these cases. We should step up our efforts to ensure food and drug safety, which is what we are doing now and what we will do in the future," Yan said about Zheng and a separate case involving Guo Wansheng, the administra-

- As the incidents involving mislabeled drug ingredients, lead-contaminated toys, pet food laced with deadly toxins, tainted toothpaste, or faulty tires increase, the questions of import safety become the focus of attention on Capitol Hill.
- Import safety transcends free-trade ideologies.
- Many of product defects are traced directly to China. Meanwhile, the share of U.S. imports from China has increased more than 300 percent since 1997, which tested the ability of Consumer Product Safety Commission to ensure safety of imported products.
- There are a number of proposals to increase imports safety, concentrating mainly on food and drugs safety:
 - John Edwards' proposal to increase food safety would require country-of-origin inspection and establishing safety systems abroad;
 - The Durbin/Brown Imported Food Security Act of 2007 would mandate that foreign imports meet the same or better standards than those of the U.S., and would give the FDA the authority to approve and disapprove of countries eligible to import.
- Responding to escalating public concern, President Bush created an Interagency Working Group on Import Safety chaired by Health and Human Services Secretary Michael Leavitt. The panel will review U.S. product safety procedures and methods, identify how to promote safety steps by U.S. importers, and survey federal, state, and local government authorities and practices regarding import safety.

Mexican Pilot Truck Program: New Legislation to Block the Administration's Plan



- The Administration's one-year pilot program would allow up to 100 trucking companies from Mexico full access to U.S. highways
- The U.S. Department of Transportation made clear that it wanted to permanently open the border to Mexican trucks upon completion of the program—without any analysis of its impact
- The pilot program does not ensure that Mexican trucking companies meet U.S. safety standards such as regulating hours of service, vehicle safety, licensing, drug testing, etc.
- In response, the House passed H.R. 1773, the Safe American Roads Act of 2007, which would extend the pilot program to 3 years and ensure that DOT analyzes the impact of allowing Mexican trucks in before opening the border
- In July 2007, Congressman Peter DeFazio (D-OR) offered an amendment to prohibit the use of federal funds to implement the pilot program
- The Amendment was offered to the 2008 Transportation-HUD Appropriations Act and was approved by a voice vote
- The Amendment is intended to slow down the process so that the DOT would place a priority on ensuring the safety and security of the roadways before they give Mexican trucks unfettered access

State and Local Incentives for Retaining and Expanding Jobs: Preventing Outsourcing

Michigan Wins Battle to Keep More Than 1,800 Federal-Mogul Jobs in State

Company to Invest \$6 Million in Greenville and St. Johns Plants

In a complete reversal of prior indications that Federal-Mogul would transfer jobs to Mexico or other locations from Greenville and St. Johns, Governor Jennifer M. Granholm today announced that the company will instead make new investments in the two plants and retain the company's 1,866 Michigan workers. Federal-Mogul's decision came as a result of the Governor's personal involvement and a new law she backed that allowed for a successful incentive offered by the Michigan Economic Development Corporation (MEDC).

The MEDC approved a Single Business Tax credit valued at more than \$65 million to help convince Federal-Mogul to remain in Greenville and St. Johns. The company is expected to invest approximately \$6 million in these two facilities.

Madison Precision to expand Jefferson County operations, awarded new Honda contract

MADISON, Ind. (July 26, 2006) Governor Mitch Daniels today joined executives from Madison Precision Products, a Japanese-owned automotive parts manufacturer located in Madison, Ind., to announce a \$16 million expansion and the creation of 66 new jobs at the Jefferson County facility. Governor Daniels and state economic development officials met with executives from Metts Corp., Madison Precision Products parent company, during a trade mission to Japan last month.

**INCENTIVES TO KEEP AUTO , RAIL SUPPLIER IN KENTUCKY
FRANKFORT BENDIX PLANT WILL HAVE TO CUT JOBS**

Herald-Leader Staff Report

The Kentucky Economic Development Finance Authority yesterday approved a \$3 million incentive package for a rail and auto supplier that will result in a loss of jobs but, apparently, keep the plant in Frankfort.

For More Information

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- This presentation was prepared with the help of Irina Kashcheyeva, one of Honigman's eleven summer associates.

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