Senate Commerce, Science and Transportation –
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Subcommittee Hearing

The Imbalance in U.S.-Korea Automobile Trade

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John T. Bozzella
Vice President, External Affairs and Public Policy (Americas)
Chrysler LLC
(Written Submission)

Thank you for the opportunity to provide Chrysler LLC's views on the imbalance in U.S.-Korea automobile trade. Chrysler LLC, headquartered in Auburn Hills, Michigan, is an indirect wholly owned subsidiary of Chrysler Holdings LLC, which in turn is owned 80.1 percent by Cerberus Capital Management LP and 19.9 percent by subsidiaries of Daimler AG. Chrysler LLC sells and services vehicles in roughly 120 countries around the world.

The Importance of Trade to Chrysler

International trade has become a defining characteristic of the automobile industry. Many people might already know that automotive is the largest import sector after oil for the United States ($231 billion or 12.5% of total imports), but maybe fewer recognize that it is also our largest export sector ($111 billion or 9.5% in 2007). Finished vehicles and parts are traded in massive volumes on a daily basis. Chrysler alone exported over 400,000 vehicles from the United States last year, or about 25% of our total U.S.-based production. The dramatic and often painful changes in recent years in the U.S. automotive market are emblematic of the immense forces that the global economy have had in our economy. But these changes and the recent economic turmoil in the U.S. also reinforces the need to have a global approach to your business. Chrysler believes that the U.S. continues to have the best workforce and most innovative environment for creating globally successfully products which are desired across the globe. We also believe in building partnerships with other automakers to forge new business opportunities both here and abroad.

Because of our history and philosophy, Chrysler has supported each free trade agreement negotiated by the U.S. We didn't do this blindly, rather we carefully reviewed the merits of each agreement. The very first "free trade agreement" negotiated by the U.S. was the 1965 Auto Pact between the U.S. and Canada, which still stands as a model of how free trade can build prosperity and grow jobs in both partner countries. Our industry was at the forefront of many agreements such as the North American Free Trade Agreement (NAFTA). Our exports have grown exponentially with our free trade partners. Two recent trade agreements provide just a quick example. Since the US-Chile Free Trade Agreement was implemented, Chrysler's U.S.-based exports to that country have grown by 365%. Similarly, Chrysler's U.S.-based exports to Australia have risen by over 115% since that FTA has been implemented.

Chrysler has made a commitment to grow sales outside North America, and has been successful in achieving significant sales growth for its international business. Key factors that contribute to this growth have been expanding the international dealer network, and the development of a vehicle portfolio that reflects the needs of global customers. In order to serve diverse international markets, over the last five years Chrysler has nearly tripled the number of right-hand-drive models (from 6 to 17), quadrupled the number of models with diesel powertrain options (from 4 to 17), and developed several vehicle packages specifically for our customers outside North America.

Unlike our American counterparts at GM and Ford, we do not have extensive production outside of North America. As a result, exports from North America remain a critical component of our business. This is evidenced by the fact that we remain one of the largest U.S.-based automotive exporters. For example, we exported over 40% of our production from our Belvidere, Illinois assembly plant last year, helping us maintain jobs that would otherwise have been lost due to the weakened U.S. market. We have also highlighted our intent to increase collaborative alliances with other manufacturers in the future, such as our cross-production arrangement announced this year with Nissan. Such alliances will allow us to deliver customer demanded vehicles in an even quicker fashion across the globe.

The U.S.-Korea Auto Trade Imbalance - Why Chrysler Can't Support the US-Korea FTA in its Current Form

The points I have highlighted make it clear that maintaining a system of open and fairly traded automotive products is vital to maintaining the strength of Chrysler's manufacturing base in the U.S. and to creating a business model for the company's future in a global automotive market. Now I would like to turn to the subject of today's hearing, the imbalance in U.S.-Korea auto trade. We will highlight the causes of the imbalance and explain why we simply cannot support the U.S.-Korea Free Trade Agreement in its current form. This is a difficult position for us, one that we do not take lightly. We are not promoting any form of protectionism nor do we believe in erecting any barriers to the growth of more open trade in the global economy. Far from it, we understand that an open and growing trading system is the future of our company and of the U.S. economy. We do believe that this agreement is flawed, and is an example of twisting the principles of free trade in a way that harms the interests of the U.S. economy and its workers. We see it as a classic example of why so many Americans have grown skeptical of the claims that such free trade agreements bring real benefit to American workers.

We do not believe the agreement as written will lead to a true free flow of goods. There is probably no greater example of huge and damaging one-sided trade than the flow of automotive trade between the U.S. and Korea. The U.S. auto industry simply cannot afford to lock in one-sided trade deals. In short, we believe that this FTA:

1) Rewards Korea's poor behavior for failing to honor two prior auto trade agreements with the U.S.
2) Narrows, but does not eliminate discrimination against U.S. importers
3) Eliminates the little U.S. leverage left to address Korean non-tariff barriers

4) Begins a process by which we will have to turn grievances over to lawyers when we should be hiring sales people to sell vehicles (the so-called gold standard dispute resolution mechanism)

Chrysler has a long and painful experience trying to operate normally in the South Korean market. We first entered the market in 1992. We currently sell more imported vehicles than GM and Ford combined (and more than the majority of foreign brands as well), and the 4,100 vehicles we sold in 2007 was a 53% increase from the previous year. However, we need to put these numbers in perspective. We sold almost twice as many vehicles in South Africa, a market which is about half the size of South Korea's. The hostility to imported autos is not directed just to U.S. manufacturers. In fact, total imports consisted of only 4% of the Korean market. More starkly, three local Hyundai dealers in the U.S. sold more cars through their individual dealerships in 2007 than Chrysler, Ford or GM sold in the entire Korean market last year. In fact, two of those dealers sold more than Chrysler in the Republic of Korea; nine dealers sold more than Ford; and more than 400 Hyundai dealers sold more vehicles than GM.

South Korea is recognized throughout the global automotive industry as having the most restrictive import market. Korea ranks 30th out of 30 among the OECD countries in terms of import market access. While the method for protecting the market has transitioned from a blatant ban on imports several decades ago, to a more nuanced but very effective approach of other forms of discrimination, make no mistake, the Korean government has systematically thwarted true competition in the Korean market.

The fortress the Koreans created for their domestic manufacturers has created an unnatural export powerhouse. While limiting imports to 4% of their home market, Korean automotive manufacturers exported 70% of their production in 2007. No, that is not a misprint. Over 16% of their production was exported to the United States. Now, if Chrysler could export 16% of our U.S. production to Korea, we'd be sending over 260,000 units over there instead of 4,000! Alright, you might say "let's get real." Well, if the U.S. share of the Korean market was similar to the Korean share of the U.S. market (4.2% as opposed to 0.5%), the U.S. would be exporting 50,000 vehicles valued at about $1 billion. This happens to be more than the value of the U.S. beef which was exported to Korea before they imposed the ban.

Speaking of beef, there has been great attention paid to the restrictions Korea has placed on imports of American beef. I can say that as a representative of a company that has faced the barrage of bans, regulations, and unfair restrictions on imports of our products, we understand the frustration of our colleagues in the beef industry. Yet, while the Administration has told the Koreans and the Congress repeatedly and unequivocally that this FTA cannot be approved until U.S. beef enters the Korean market, the Administration has not taken such a position when it comes to the auto industry, and we have to ask why.

While we have alluded to the inadequacies of this agreement, let us be a bit more specific. We would first like to point out that we work with the Administration in general and the office of the United State Trade Representative (USTR) in particular on many trade issues. We have the utmost respect for the bright, dedicated and hardworking individuals at USTR who work tirelessly on many different fronts in trade negotiations. In the vast majority of cases, we believe the U.S. negotiators achieve a result in which U.S. national interests are advanced in a proven effective way. However, we do not believe this was the case with the US-Korea FTA. The fact is, more should have been done.

Let's start with the fact that, because of its history of trade restrictions and discrimination, 80% of the $13 billion U.S. trade deficit with Korea is autos. That fact tells us that the first thing the U.S. should have negotiated with Korea in any agreement that confers on them the special status of a free trade 'partner' is an acknowledgement that confronts this directly, and ensures that this unacceptable one-sided trade in our largest traded product is decisively reversed. It seems to us that asking our negotiators to ensure that companies have a realistic and credible guarantee of true open and fair market access in Korea before granting Korea unconditional free market access here, doesn't seem, as the lead U.S. negotiator told us, to be a "bridge too far."

Our work with USTR on Korea did not begin with the U.S.-Korea FTA. In response to evidence of outrageous examples of Korean restrictions and downright harassment to keep U.S. auto imports out of Korea, in 1995 the U.S. negotiated and signed a Bilateral Trade Agreement (MOU) with South Korea in an attempt to address non-tariff trade barriers limiting U.S. exports. Within two years, it became clear that this agreement was a failure. The Koreans signed this agreement but did little to change their behavior, while simply exporting more and more cars to the U.S. In a rebuke to the Korean's behavior, the U.S. negotiated a second automotive trade agreement in 1998. The intent of both agreements was clear – there had to be unequivocal evidence that all evidence of discrimination and restrictions on imports of U.S. autos had stopped and that sales were increasing as evidence of a 'normal' mature market. But while making token changes, the Korean government simply crafted new barriers and certainly did not meet the spirit of the agreement as evidenced by the numbers. Fool me once, shame on you, fool me twice….

The history of Korean automotive non-tariff barriers which drive our concern with this agreement have been articulated publicly before on several occasions. I assume that the UAW will highlight some of them today as well. Unlike tariffs, non-tariff barriers are not easy to address. Korea has used a myriad of such non-tariff barriers ranging from outright bans to implementing complex regulatory requirements that upon first glance do not appear to be discriminatory but in practice are.

Today I would like to focus on the actions Korea has taken since the FTA was concluded last April. We would just like to point out that the Koreans have engaged in this activity knowing that the FTA is pending Congressional consideration. Given that they would engage in these activities now, we wonder what awaits us should the agreement enter into force as signed.

Non-Tariff Barriers Imposed Since the FTA Was Signed

The following are examples of Korean actions since the FTA negotiations started that have disrupted importers' operations in the Korean auto market.

<u>Korea's Auto Insurance Reform Proposal</u>

In March 2008, the Korea Insurance Development Institute (KIDI) released a reform package for automobile insurance calculations that was set to start in April 2007. The new methodology to determine the insurance rate was based on vehicle model brand (Chrysler) for imports, and vehicle model (Sonata) for domestics. The result is that the insurance rates increased for most imported vehicles compared to comparable domestic vehicles. Prior to the reform, the premium paid was determined by each individuals (insured) characteristics, not the model brand or source (domestic or import) of the insured vehicle. Under the reform, for example, a Chrysler 300C is about 28% more expensive to insure each year than a comparable Korean vehicle even through the prices are similar and the driver's profile is identical.

Regardless of KIDI's intensions, the result of the reform is customers that buy imported vehicles will pay higher auto insurance rates. As soon as they were made aware of this problem, the import industry objected stating that the rate should not be higher based on whether a vehicle is imported or not, and insurance should be allowed for all vehicle categories. Based on this pressure, and that of the U.S. government, Korea made some marginal changes that mitigated the worst effect of the insurance rate schedule, but the new schedule continues to result in higher insurance rates for imports vs. domestics.

FTC Korea Government Investigation of Importers

In early December 2007, the Korean Fair Trade Commission (FTC) arrived unannounced at the Korea Automobile Importers and Dealers Association (KAIDA) offices to investigate alleged unfair business practices (keep in mind that this is supposedly the anti-monopoly commission which is raiding an association representing 4% of the market). Some documents and files (meeting minutes, e-mails, agendas and letters) were seized in the raid. Several KAIDA members companies were also investigated/raided.

The reported purpose of the investigation was that KAIDA importers were allegedly colluding against grey market (parallel) auto importers, and price collusion in the import dealer network. The FTC claimed that it was supporting a law that protects unauthorized parallel importers in Korea. All major authorized auto importers, including Chrysler, are members of KAIDA. The result of the FTC investigation is still unknown, but the intimidating message it sent is clear.

Witness Testing

In February 2008, U.S. automakers certifying vehicles for sale in Korea were informed, by Korea's governing regulatory agencies, of a significant change to Korea's auto emissions testing/certification process—no longer allowing importers to certify by witness tests at the location of the automaker's test facilities. The Korean government claims that the change was a cost and a corruption reduction effort.

This change would have adversely affected the ability of U.S. automakers to introduce several new models into the Korean auto market in 2008, and going forward would also introduce unnecessary complexity and lack of consistency into an emissions testing process that has worked well to date.

U.S. automakers (Chrysler, Ford and GM) had scheduled witness tests for nine vehicle models in 2008. U.S. automakers requested that Korea's governing agencies continue to allow for auto emissions witness testing, which has been a successful and effective practice to date. After the U.S. government brought considerable pressure to bear on the Korean government, the Korean government agreed to back away from the change.

In June, 2008, the Korean government officially backed off of its plans to end witness testing and instead offered some alternative approaches. This ultimately ended up being a successful outcome, but demonstrates that Korea's longstanding habit of creating new non tariff barriers to auto imports has not ended.

These are just a few recent examples of the type of issues we face in Korea. As I mentioned, there are other long-existing non-tariff barriers which USTR tried to address in this agreement, but we believe the remedies are inadequate. I am happy to discuss these other non-tariff barriers, such as Korea's discriminatory tax practices, regulatory or certification issues or general anti-import bias.

How to "Fix" the Agreement

Members of the U.S. automotive industry, along with numerous Members of Congress, worked closely with USTR up to and including the day that the agreement was initialed in April 2007. After reviewing the agreement, we immediately called it unacceptable and not even close to what we and others in the industry had told the U.S. officials repeatedly was necessary to secure true change in the Korean market.

It quickly became clear that most of the U.S. industry and our workers, as well as many Members of Congress, including our Congressional Leadership, believed that the automotive provisions were inexcusably weak and ineffective and needed to be redrafted and expanded in order to obtain sufficient Congressional support.

The response so far? In more than a year since the signing of the agreement, the Korean government has not sought dialogue with our elected Representatives or anyone in our industry on how to address these concerns and inadequacies. Interestingly, they didn't seem to have a problem seeking alterations to the beef agreement their President just signed. I don's say this to be flip, but because it goes to our fundamental concern.

For its part, the U.S. Trade Representative has repeatedly made clear that the U.S. has no intention of asking the Koreans to sit down and improve on the automotive chapter of the FTA. However, the USTR has negotiated vigorously on the beef issue, which ironically isn't even part of the FTA. We find this frustrating and odd. Autos, unlike beef, is a pillar industry in Korea and requires a significant commitment on the part of the Administration for real change to occur.

And so there is a stalemate, not because there is a problem that can't be solved but because neither of the parties is willing to acknowledge that a critical part of the Agreement was perhaps rushed, and a more careful and deliberate set of proposals and agreements need to be hammered out.

The United States automotive market is by far the largest and most open in the world. This fact provided our government with substantial leverage in its negotiations with Korea. We clearly articulated the need for a robust agreement which would pry open a Korean automotive market that has been blatantly and pervasively protected for decades. We believe that the Administration miscalculated the dynamics in Korea. Their assumption was that the leadership in Korea was receptive to openness and we should therefore complete an agreement as quickly as possible to take advantage of this newfound, enlightened view in Korea.

Unfortunately, the longstanding and pervasive nature of the Korean government's protective meddling and nationalism cannot be undone overnight (note beef). While the leadership may commit to these changes, it is the Korean bureaucracy which would be responsible for implementing the agreement. And given their history, they have proven time and again that they are extremely adept at creating new barriers.

Changing this culture will not be easy. That is why we asked USTR to remove the existing U.S. barriers only after Korea had demonstrated that its auto market is open and that import access would be sustained. We believe that only this approach would provide the necessary incentive to the entire Korean bureaucracy to systemically eliminate the protectionist mentality and actions it has practiced for decades.

Similarly, Congressional leadership recognized the same concerns. In a March 1, 2007 letter to the President, House Leadership presented a Congressional Proposal to Open Korea's Automotive Market. There are two key components to the Congressional proposal. The first part addresses the phase-out of the U.S. passenger vehicle tariff and creates a positive incentive for Korea to open its market to U.S. vehicles. The second part addresses Korea's current non-tariff barriers and creates a "self-help" mechanism - available to all industries – for the United States to take action against future non-tariff barriers. Attached to our written testimony is a copy of that letter.

We are ready and willing to resume discussions with the Administration and the Korean government on how to improve the automotive provisions of the U.S.-Korea FTA. We appreciate the support we have received from both Senate and House members regarding this issue and once again thank Senator Dorgan for arranging this hearing and asking Chrysler to testify.