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Committee on Finance
Trade Subcommittee
The U.S.-Korea Free Trade Agreement: Lessons Learned Two Years Later

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Chairwoman Stabenow, ranking member Isakson and members of the Senate Finance Trade Subcommittee, thank you for the invitation to discuss Ford Motor Company's views on the U.S.-Korea Free Trade Agreement (KORUS). On behalf of Ford, I also thank you for the strong commitment you have shown on trade issues that are hugely consequential to Ford Motor Company and our 72,000 U.S. employees – and our 5,500 U.S. suppliers and their employees across the country.

Since the global financial crisis in 2009, we have invested billions in the United States. This year, we will add more than 5,000 new U.S. jobs on top of more than 14,000 new hires in the past two years.

Ford has a strong and well-established trade pedigree. Henry Ford exported the sixth vehicle he assembled in 1903, and we have been building on his legacy ever since. In 2013, the automotive industry represented the single largest U.S. export sector, and Ford is the leading U.S. exporter of automobiles.

We are not philosophers of trade – we are practitioners. As a manufacturer, we see how trade allows Ford to create and leverage manufacturing scale to drive global competitiveness. Ford is among the nation's largest exporters and we are also among the nation's largest importers. That is why Ford has supported every free trade agreement ratified by the U.S. government.

In fact, the American auto industry provided the original impetus for U.S. trade initiatives when we successfully pushed for the U.S.-Canada Auto Pact in 1965. This free trade agreement, with our close ally and neighbor in Canada, became the foundation for the U.S.-Canada Free Trade Agreement, which itself soon expanded to become the North American Free Trade Agreement.

As a global company, it is our confirmed belief that the very best business conditions exist when trade barriers and tariffs are removed, allowing for the free flow of goods and services. These conditions permit the development of a healthy and efficient business, and they are proven to produce a customer base that is gainfully employed, upwardly mobile and able to make rational choices about purchases, such as the vehicle they will drive.

To that end, I am pleased to have the opportunity today to share some perspective on the implementation of KORUS. Despite our consistent support for opening markets, Ford had significant concerns with the original KORUS deal. We appreciated the advocacy by you, Senator Stabenow, and other members of this Committee, to urge the Administration to address its flaws. As a result, the KORUS, which was originally signed in 2007, was ultimately renegotiated before being approved by Congress in 2011.

Ford was grateful for the opportunity to participate in a broad stakeholder effort to ensure the final terms of the KORUS deal would result in real, meaningful market access for American-made cars and trucks. We believed the details provided that clarity, took a leap of faith and we stepped forward to support the deal, as did our UAW partners.

Despite the improvements made to KORUS and the commitments made by the Korean government, access to the Korean auto market has still fallen well short of the openness promised, and we are deeply disappointed by the results to date.

Since Korea came into force two years ago, U.S. vehicle exports have modestly increased by about 13,000 vehicles in a market expected to have 1.5 million vehicle sales this year. America's automotive trade deficit with Korea increased by nearly $4 billion and now stands at almost $19 billion. This amounts to 94 percent of the overall U.S. trade deficit with Korea.

Furthermore, overall U.S. exports to Korea are down over $1.9 billion, when compared to the year before KORUS. The overall U.S. trade deficit with Korea has increased by over $7 billion and now stands at a staggering $20 billion per year.

Outside the U.S., Korea represents one of the top 10 auto markets in the world by size, making it a very desirable market for U.S. automotive exports. It is an important market for global automakers, and Ford has invested sizable resources over two decades to expand our presence there.

Ford has been operating in Korea since 1995. We have worked closely with our dealers to expand our distribution network, and today, we have 31 showrooms and service centers in operation throughout Korea. Overall, Ford and its dealers have invested more than $70 million, including more than $10 million in 2013 alone. Additionally, millions more have been invested on product development to meet specific regulatory requirements in Korea.

The majority of vehicles sold by Ford in Korea are built in the United States. Our number one selling vehicle in Korea is the Ford Explorer, which is assembled at our Chicago assembly plant. We also sell the Ford Fusion, Taurus, Escape, Mustang, and Lincoln MKS and MKC – all of which are assembled in the U.S. While we also export vehicles from Canada and Europe, the majority of our volume in Korea is exported from the U.S.

Unfortunately, after 20 years of continuous effort and investment, Ford sells less than 10,000 vehicles a year in Korea. There is a reason for this. Despite free trade agreements with the U.S. <u>and</u> Europe, Korea's auto market remains among the world's most closed to imports.

For decades, the Korean government has followed a deliberate strategy to erect non-tariff barriers, or NTBs, to replace the previous tariffs eliminated under these trade agreements. Staffed by a bureaucracy that often fails to coordinate regulatory actions among the many ministries that regulate various aspects of the automotive industry, the Korean government has effectively ensured that no global manufacturer achieve a level of success in the Korean market that is commensurate with the performance of domestic brands.

Although the U.S. government has engaged actively to address NTBs in Korea, these NTBs have created a climate of regulatory uncertainty that has thwarted U.S. automakers' plans. U.S. producers are currently revising plans downward, recognizing that the continuation of the Korean government's pattern of NTBs has undermined the promise that was made to the U.S. to open the Korean auto market with the signing of KORUS.

<u>The Korean Government's Pattern of Shifting Regulatory Requirements</u>

Almost immediately after KORUS became effective, the Korean government launched a new round of regulatory requirements, denying U.S. automobile manufacturers the benefits they expected under the trade agreement.

In each instance of changing regulatory requirements, the same pattern persists:

- The Korean government announces a measure, frequently without advance consultation or with only a minimal effort at consultation.
- U.S. automakers assess the unexpected proposal, and determine that it poses significant risks to their Korean operations.
- Over a period of time – sometimes up to a year or more, the U.S. government raises the issue with the Korean government and either obtains a commitment to postpone its implementation, or to exempt U.S. automobile manufacturers.
- Sometimes this is done in confidential negotiations, with no clear public resolution of the issue.
- Sometimes the negotiation offers no clear cut solution, either continuing to impose significant burdens, or leaving legal uncertainty as to the scope of the measure.

U.S. auto manufacturers are not alone in facing these challenges. In March of this year, European manufacturers expressed their concern about Korean NTBs in a letter to the European Trade Commissioner, stating *"we consider that this is defeating the underlying purpose of the FTA to facilitate trade."*

Examples of NTBs include:

- **<u>Elimination of Table 4 – Korean Government Proposal to Remove Foreign Built Vehicle Standard Equivalency.</u>** On August 23, 2012, the Korean Ministry of Land, Transport and Maritime Affairs issued a proposal to delete Article 4 of the Enforcement Regulations of the Korean Motor Vehicle Safety Standards (KMVSS).

  The core element of Article 4 is a table ("Table 4") that aligns various U.S. Federal Motor Vehicle Safety Standards (FMVSS), UNECE directives and EC directives, and recognizes them as equivalent to corresponding KMVSS. Table 4 applies to vehicles manufactured in all countries. Thus, a vehicle assembled in Canada, which might not receive the protections of KORUS, could qualify under KMVSS by means of Table 4. Table 4 also applies to certain vehicle standards that are not closely tied to vehicle safety, such as radio frequency standards on vehicle systems.

  The announcement by the Korean government to eliminate Table 4 posed a grave threat to U.S. automakers' Korea operations because the majority of U.S. vehicles sold in Korea would not meet KMVSS without Table 4.

  For a full year after KORUS came into force, U.S. trade negotiators pressed for the Korean government's compliance with Table 4 commitments. Ultimately, the Korean government promised that Table 4 will remain in effect. Even with this assurance delivered to the U.S. government, no formal agreement has been made public and the Korean Government has taken no public action to formally withdraw its proposal. In fact, at various points in time, most recently in May of this year, Korean officials have re-introduced the notion that Table 4 should be eliminated.

  All of this continues to cast a considerable cloud of legal uncertainty over U.S. automobile manufacturers' Korean operations. In short, for a significant time, importers were unsure if it would be possible to legally import certain models into Korea.

- **<u>Bonus/Malus Program: Subsidies and Penalties Impacting Imported Vehicles</u>.** Korea's current environmental standards on fuel economy and greenhouse gas (GHG) emissions represent one of the world's most stringent regimes for controlling such emissions.

Under this regime, by 2015, the standard for the fleet average will be 140 g/km or 17 km/L. Under the February 10, 2011 KORUS "Agreed Minutes on Regulations Pertaining to Automotive Fuel Economy and Greenhouse Gas Emissions," U.S. automakers were granted a period of 19 percent leniency in meeting these fuel economy and GHG emissions targets. This margin was considered sufficient to permit U.S. producers to sell a full product line in Korea once the Korean market was fully open to imports.

Notwithstanding the introduction and phase-in of these new fuel economy and GHG regulations, the Korean government in 2012 took affirmative legislative and administrative steps to impose an entirely new "Bonus/Malus" system.

As initially proposed in 2012, the Bonus/Malus system was to go into effect in 2013-14, and would have imposed cash penalties on purchases of vehicles emitting more than 145 g/km of CO2 while providing cash subsidies to purchasers of vehicles emitting less than 131 g/km of CO2.

The subsidies and penalties were to be calculated based on emissions levels. At the extremes, purchasers of vehicles emitting less than 40 g/km would receive a subsidy of several thousand dollars, and purchasers of vehicles emitting more than 246 g/km would be charged as much as an additional $7,000.

In March 2013, after extensive discussions with U.S. officials, the Korean legislature passed the Atmospheric Environment Preservation Act ("AEPA"), which delays the effective date of the Bonus/Malus program to January 1, 2015. While the temporary postponement of the Bonus/Malus program is welcome, the measures are already having a significant adverse impact on the competitive conditions faced by U.S. vehicle exporters.

Foreign importers typically have little choice but to sell larger or premium automobiles with higher profit margins to offset the higher costs of doing business in Korea, including meeting Korea's unique regulatory requirements. Under the currently-proposed Bonus/Malus thresholds, most of the vehicles currently being imported from the United States would be penalized. This reduces the business case to import more vehicles into the market and inhibits the opportunity to invest in greater volumes and diversification of imported fleets in a manner that would improve fleet fuel economy. This also would discourage investment in the expansion of the overall business operations in Korea.

While Korean domestic producers have also raised objections to the scheme, virtually all locally-produced Korean cars are expected either to obtain a direct competitive advantage through bonus payments, or to be unaffected by the program. The Bonus/Malus system will significantly tip an already tilted field in favor of Korean producers.

Some steps can be taken to mitigate, but these steps come with significant costs. For example, U.S. vehicle producers may be able to import a greater proportion of diesel-powered vehicles. But shifts of this kind require significant additional investments in engineering, marketing, management and distribution costs. The lack of market access makes it difficult to justify the business case. Nevertheless, these steps are being explored now, and the Bonus/Malus system is already imposing unexpected costs on U.S. vehicle manufacturers that are not imposed on Korean manufacturers.

- **Self-Certification of Auto Parts and Equivalence**. This proposal, released in April, 2012, would have required U.S. automobile manufacturers to certify certain replacement parts shipped to the Korean market as compliant with KVMSS, and would not allow equivalence to U.S. FMVSS qualification. All of the parts involved satisfied FMVSS and all are shipped to Korea to replace original equipment parts on vehicles sold by U.S. manufacturer, vehicles that frequently are certified on the basis of equivalence with FMVSS. This measure threatened the workability of warranty and dealer service operations that are central to all manufacturers' product programs. In short, a manufacturer cannot sell a car in Korea if replacements parts are blocked from the same market. After strong engagement by the U.S. government, the Korean government ultimately agreed not to apply the policy. Even after this concession was made, disagreement with the Korean government continues on the issue of appropriate marking techniques for the parts.

- **Vehicle Identification Number (VIN) Stamping**. After KORUS became effective, the Korean government did not change its regulations to accept as equivalent VIN stamping that is consistent with FMVSS. Korean VIN stamping requirements are different and the refusal to align with FMVSS would create additional cost in special stamping of vehicles bound for the Korean market. The U.S. government again has become involved in the matter, seeking approval from the Korean government to accept VIN stamping that is compliant with FMVSS.

- **Fuel Economy Tailpipe Emissions Audits**. Korea's Ministry of Trade, Industry & Energy ("MOTIE") has introduced an "Improvement Plan for Motor Vehicle Fuel Economy Management System" ("Improvement Plan"). The details are still being worked out, but the MOTIE proposal appears to be inconsistent with the emission control policies of the Ministry of Environment (MOE). The MOE accepts in-house-testing by manufacturers without prior verification, while the Ministry of Land, Travel and Maritime Affairs administers the self-certification program for safety standards. The result is that vehicle manufacturers are facing conflicting requirements from multiple Korean agencies for validation of in-house testing facilities and for correlation tests between the manufacturers and testing agencies. It also appears that the measurement standards being applied for this purpose may not be consistent across ministries.

- **Currency Manipulation to Subsidize Exports.** Finally, currency plays a role in the continued challenges we face in the Korean market. Currency is the medium in which trade occurs, and exchange rates can be as important a determinant of trade outcomes as the qualities of the goods or services themselves. In the context of a free trade agreement, currency manipulation can negate the trade liberalizing effects of tariff reductions.

  Chairwoman Stabenow, we appreciate your recognition of this critical issue of currency manipulation, including your leadership in communicating the need for strong and enforceable currency disciplines in future trade agreements. Currency manipulation is the 21st century trade barrier and it is not surprising that 59 of your Senate colleagues joined you in a letter to the Administration stating this position, and that more than 230 U.S. House members also agree.

  You and the majority in the House and Senate reflect the view of the American people. A recent survey conducted by IPSOS found that nearly 90 percent of Americans believe including currency manipulation rules in international trade agreements is important. The survey also found that by a more than 2-1 margin, Americans believe Congress should oppose an international trade deal that does not prohibit currency manipulation.

  Since the signing of KORUS, the Korean government has intervened in currency markets to slow the appreciation of its Won versus the U.S. Dollar. This manipulation of currency has the effect of subsidizing Korean exports while creating a barrier to imports into the Korean market.

  Since January 2011, foreign exchange reserves in Korea have increased $70 billion or 24 percent and now stand at over $366 billion. The Bank of Korea has routinely intervened to slow the appreciation of the Won despite criticisms from the U.S. Department of Treasury and the International Monetary Fund.

Lessons for Future Trade Agreements

As a company operating in six continents, Ford sees real benefits of free trade policies. It lowers transaction costs, improves efficiency and enables us to build a strong business to meet the demands of our customers here in the U.S. and abroad. But free trade must not be encumbered by the layers of restrictions that are set up only to protect domestic industries.

That is why we were hopeful that KORUS would result in meaningful market access for our products into the Korean market. Unfortunately, it has fallen well short of expectations and will continue to, if the Korean government's pattern of non-tariff barriers persists.

The U.S. is among the most open markets in the world. The priority for the U.S. government should be to remove barriers to U.S. goods and services in other markets to an equivalent degree. As the U.S. pursues future free trade negotiations, there are many cautionary lessons offered by KORUS.

1. It is critical that the U.S. specifically address all trade-distorting impediments – especially the less visible non-tariff barriers.

2. It is critical to include strong and enforceable currency disciplines in all future U.S. trade agreements, beginning with TPP. Without these, we send the message that it is ok for countries to subsidize their exports abroad, and undermine manufacturing jobs here in America.

3. Finally, all future trade agreements need strong dispute resolution mechanisms and strong enforcement mechanisms, which include elimination of the FTAs benefits to violators.

Ford is proud of its investment in America. We are delivering product excellence with passion, driving the innovations of tomorrow and successfully competing around the world. Our goal is to succeed on our own. All we ask for is a level playing field on which to compete. We appreciate the Committee's focus on ensuring trade agreements benefit all, including American manufacturers and American workers.