

COMMENTARY

The KORUS FTA and the U.S. automotive sector: Cause for optimism

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Winston Churchill once said that the pessimist sees difficulty in every opportunity and the optimist sees opportunity in every difficulty. The optimists prevailed throughout the long, difficult negotiations that culminated in the Korea-U.S. Free Trade Agreement, known as the KORUS FTA.

Beginning in February 2006 and following eight formal rounds of negotiations and countless other meetings, the U.S. and Korea signed the KORUS FTA June 30, 2007. Difficulties remained, however.

For a variety of reasons, including the negotiation of additional industry-specific commitments, the United States did not ratify the agreement until October 2011. The following month, the Korean National Assembly ratified the agreement, and the KORUS FTA took effect March 15, 2012 — after more than six years of sustained commitment by those involved on behalf of both nations.

The automotive industry is a key centerpiece to the KORUS FTA. At this juncture, U.S. automotive manufacturers and suppliers are continuing to assess how best to benefit from the agreement. The strategies will likely vary from one manufacturer to the other.

For example, years ago General Motors acquired Daewoo Motors and, as a result, has



A woman walks past a huge banner in support of the U.S.-South Korea free trade agreement in Seoul in 2008. REUTERS/Jo Yong hak

a well developed manufacturing and sales presence in Korea. GM changed the name of the company from GM Daewoo to GM Korea in 2011 and has been manufacturing vehicles under the Chevrolet brand ever since.

GM manufactured more than 800,000 vehicles in Korea in 2011, of which 141,000 were sold in Korea.

Ford Motor Co., on the other hand, while having a massive (and growing) manufacturing presence in China, currently has only a modest sales and service presence in Korea. The same goes for Chrysler, although both of these manufacturers have plans to expand in the Korean market now that the KORUS FTA is in place.

Undeniably, each manufacturer's Korean market strategy must fit within its global strategy (e.g., Brazil, China and Russia). Regardless of differences in company-specific strategies, the KORUS FTA raises the stakes in Korea — an economy that the International Money Fund projects to soon be larger than Japan's.

Many reasons exist why the Korean market, especially in light of the KORUS FTA, is potentially so important. As U.S. vehicle manufacturers and suppliers embrace life under KORUS FTA, each will want to make knowledgeable decisions about how best to proceed. Certain basic information exists that, if understood, should help companies in that regard.



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A TRADE IMBALANCE

To date, U.S. manufacturers have exported and sold small numbers of vehicles to Korea. At the same time, Korean exports to the U.S. market have been enormous by comparison. Several theories have been advanced regarding this disparity. No trade agreement will remedy this imbalance in the short term. Therefore, leveling the playing field will take some time and should not be measured simply in sheer sales volumes.

The KORUS FTA also immediately reduced the tariff on electric cars from 8 percent to 4 percent and will phase out the remaining tariffs in 2017. The agreement also immediately eliminated Korea's tariffs on most automotive parts and components and reduced long-standing taxes based on engine size.

A key complaint from the U.S. automotive industry has long been that Korea's safety standards are opaque and developed without sufficient input from foreign stakeholders.

regulations in this sector, which should give U.S. manufacturers an active role in the Korean automotive regulatory process.

The KORUS FTA also contains strict enforcement provisions that include a "snap back" to pre-agreement tariff levels for imports to the United States if Korea violates the automotive provisions of the agreement.

The agreement also creates an automotive working group that will meet at least annually and can serve as a good avenue to discuss issues of concern. As a result, sales should increase such that, in the short term, U.S. manufacturers should see large percentage increases, albeit to small overall numbers.

Eventually, in light of the tariff reductions, increased transparency and protections against market surges in the U.S., the KORUS FTA should contribute to an already growing overall acceptance of foreign vehicles in the Korean market. Marketing strategies, competitive pricing, good aftercare services and integrated international operations, among other things, will ultimately separate winners from losers.

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Several key components of the KORUS FTA specifically relate to the automotive sector. Some reduce tariffs on vehicles exported to Korea from the U.S. (*i.e.*, immediately reduce tariffs on cars from 8 percent to 4 percent, then eliminate the remaining 4 percent in 2017, and immediately eliminate the 10 percent tariff on trucks).

The KORUS FTA attempts to address this by allowing sales of up to 25,000 vehicles per manufacturer if they meet U.S. safety standards and allowing sales of more than 25,000 if a manufacturer meets certain environmental thresholds.

The agreement further requires Korea to provide early notice for any proposed new

Resources

English-language websites

- American Chamber of Commerce in Korea: <http://www.amchamkorea.org>
- U.S. Korea Connect: <http://www.uskoreaconnect.org>
- FCS Korea: <http://export.gov/southkorea/doingbusinessinskorea/traderegulationsstandards/index.asp>; U.S. government Web resource has been created with valuable information on the KORUS FTA, <http://export.gov/FTA/Korea>; Korea Country Commercial Guide 2012, prepared by the U.S. Embassy in Seoul on a yearly basis to highlight a wealth of information useful to US companies interested in doing business in the market), http://www.buyusainfo.net/docs/x_6114956.pdf
- FTA Tariff Tool (U.S. Department of Commerce): <http://export.gov/fta/ftatarifftool/ftamain.aspx> (includes industry-specific opportunities, an "FTA Tariff Tool" to look up tariff rates and how they are eliminated under the KORUS FTA, advice on "Rules of Origin" to determine if your products can benefit from the FTA)
- Office of the U.S. Trade Representative: <http://www.ustr.gov/trade-agreements/free-trade-agreements/korus-fta>
- U.S.-Korea FTA Business Council: <http://www.uskoreacouncil.org>
- ATO Seoul (branch of U.S. Agricultural Trade Office): http://www.atoseoul.com/fta/fta_page2_final.asp
- U.S. Customs and Border Protection: http://www.cbp.gov/xp/cgov/trade/trade_programs/international_agreements/free_trade/korea/

Korean-language websites

- FTA Support Website (Ministry of Strategy and Finance): <http://www.ftahub.go.kr/>
- FTA Website (Ministry of Foreign Affairs and Trade): <http://www.fta.go.kr/new/index.asp>
- FTA Information & Business Support Center (Korea International Trade Association): <http://www.okfta.org>
- Trade Navi (Ministry of Knowledge Economy, Korea International Trade Association): <http://www.tradenavi.or.kr>
- FTA Portal (Korea Customs Service): <http://fta.customs.go.kr>
- Trade Adjustment Support Center (Ministry of Knowledge Economy): <http://www.taa.go.kr>
- The Korea Commercial Arbitration Board: <http://kcab.or.kr>

BENEFITS FOR U.S. SUPPLIERS

The strategies among suppliers will likely be more varied and important. Historically, suppliers have globalized operations to meet the changing needs of customers (e.g., your customer expands and, in lock-step, you expand to meet your customer's needs).

In a sense, that is reactive expansion. While important, it should be only one of many reasons why a supplier should expand operations (whether manufacturing and/or a sales office) in a market like Korea. Indeed, virtually all of the world's top 50 automotive suppliers have a presence there currently.

The evolving industry model, which places more emphasis on suppliers developing differentiating technology, should motivate many more suppliers to be *proactive* in expanding. New markets and new customers wait, and the KORUS FTA opens a window of opportunity for suppliers who are well prepared and positioned. It virtually eliminates tariffs and affords suppliers many other procedural safeguards mentioned above.

In addition, technology transfer, research and development, innovative supply chain management, and other collaborative arrangements should abound. In that regard, General Motors, which has had on-the-ground manufacturing in Korea since 2002, already has more than 200 Korean suppliers.

U.S. automotive suppliers
could reap significant
benefits from the
KORUS FTA.

Overall, the KORUS FTA should benefit the automotive supply industries in both countries. While U.S. automotive supply companies can expect more access and protection in Korea, the Korean automotive supply companies will invariably benefit from additional outside investment in Korea's markets and an overall an "expanding of the pie" in the region.

It is also likely that, as U.S. investment and business interests in Korea mature, Korea could serve as a springboard for expanding to neighboring markets, too.

'JUST IN TIME' VS. 'JUST IN CASE'

In today's automotive industry, effective supply chain management is essential, especially in light of the myriad components in every vehicle. Moreover, vehicle manufacturers source the vast majority of those components from suppliers. They expect suppliers to design and validate differentiating technologies in addition to manufacturing and efficiently delivering inventories on a "just in time" basis.

While the costs of some supply chain logistics (e.g., uniformity, transportation, continual improvement) can be considerable, strategic location in Korea can materially facilitate engineering changes, production costs and, in particular, inventory costs.

Indeed, in a world where suppliers must strike a balance between "just in time" and "just in case" (e.g., supply chain interruptions caused by natural disasters, accidents and otherwise), localization is key.

The KORUS FTA provides a competitive advantage to suppliers that function as a truly global enterprise, particularly in a high-growth region like Asia. Those with differentiating technologies will pursue proactive global strategies that seek out new customers in addition to meeting the needs of current customers.

At this juncture, what region is more important to automotive than Asia? With its central location, democratic rule, capitalist economy, strong protection of intellectual property rights and commitment to free trade, Korea has already emerged as a global FTA hub.

Korea has free-trade agreements with the United States, European Union, Singapore, ASEAN, Chile, India, Peru and others. Furthermore, when one considers the strong political and military alliances that the United States has had with Korea, the KORUS FTA should make Korea an even more attractive market for U.S. manufacturers.

LOCALIZATION IS CRITICAL

During the past 30 years, Korea has had a meteoric rise in its economy. Historically self-contained, Korea has opened its borders considerably during that time. Because of Korea's rich history and reverence for culture and tradition, any company's successful expansion into the Korean market must recognize and respect those customs and traditions. Indeed, relationships are crucial.

In that sense, expansion into the Korean market, whether it includes manufacturing or not, involves a commitment to embrace some of Korea's unique ways of doing business and Korea's very demanding culture of customer service. Otherwise, expansion efforts will likely experience greater difficulty.

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UNINTENDED CONSEQUENCES

The KORUS FTA is a bilateral trade agreement. By its terms, however, manufacturers from other nations will benefit.

For example, Japanese manufacturers have been building cars in the United States for decades. Given the incredible strength of the yen, Toyota Motors and perhaps others will export vehicles made in the United States to Korea and benefit from the KORUS FTA.

In light of recent developments in Japan (e.g., natural disasters, energy sources, strength of yen), look for Japan's automotive companies to expand to Korea as well. While this development may not have been intended, it nonetheless benefits consumers by increasing competition and greater product selection at lower costs.

POTENTIAL CHALLENGES

The KORUS FTA is a potentially historic win/win agreement — if given a fair chance. As mentioned, it took six years to complete; and it met with political opposition in both nations along the way.

In addition, after only nine months, European automakers have already initiated efforts aimed at revising the Korea-EU Free Trade Agreement because of allegedly substantial increases in imports of Korean made vehicles.

The KORUS FTA contains special safeguard measures to address market surges should they occur. Potential political ramifications lie ahead as well. For example, both nations will hold presidential elections in 2012. To realize its considerable potential, industry needs to give the KORUS FTA adequate time to take effect.

DON'T GET LOST IN TRANSITION

IHS Global estimates that the global auto industry will offer roughly 35 to 45 new vehicle launches annually through 2020. Consumer choice will ultimately separate winners from losers.

But the KORUS FTA and the Korea-EU FTA will likely contribute to increasing acceptance of foreign vehicles in a market primed for growth. Currently, annual sales in Korea are approximately 1.5 million vehicles. In recent years, Koreans have demonstrated a willingness to purchase foreign vehicles, especially luxury models (e.g., BMW).

According to the Korean press, Korea ranks 12th in the world for annual number of car sales. But the Korean market for premium cars is ranked among the world's top five markets. Sales of premium brand imports soared from 29,000 to 60,000 last year. So potential growth awaits U.S. manufacturers that are prepared and positioned to seize the opportunity.

TIPS FOR BEST UTILIZING THE KORUS FTA

Several sources exist for practical, useful assistance on how to best utilize the KORUS FTA. These include agencies, associations and consultants, as well as the agreement itself.

Resources in Seoul that provide practical assistance to open doors in the Korean market

The U.S. Embassy: The Embassy Economic section is responsible for overall implementation of the KORUS FTA. Further, the Foreign Commercial Section, or FCS Korea, will help you access market research, connect with potential distributors and agents, promote your products and services to qualified buyers, and overcome challenges and trade barriers. U.S. companies interested in finding business partners in Korea may benefit from FCS Korea's Gold Key Service, which consists of a prearranged schedule of matchmaking meetings in Korea, the International Partner Search, which is a written report that FCS Korea offers on potential business partners, or its Single

Company Promotion, which typically consists of an event or a project launch organized by the U.S. Embassy.

The American Chamber of Commerce in Korea: AMCHAM Korea is 2,000 members strong and has a variety of committees (including an auto and automotive committee) and services that can assist U.S. companies on the ground in Korea.

Recruit the right team

A typical mistake made by a foreign direct investor is failing to assemble the appropriate team of advisers — legal, financial, business and market advisers — *beforehand*. Naturally, manufacturers are eager to get their operations underway. But myriad details should be identified and addressed first, especially in Korea. Doing so involves formulating strategies with the appropriate legal, financial and economic development advisers. Failure to do so can mean missed opportunities and avoidable, potentially costly, mistakes.

Look at all the relevant FTAs

The global landscape for FTAs is getting quite crowded. This can cause confusion as each has its own unique set of rules, including those related to rules of origin. But the growing number of FTAs can also provide a multinational company with new options for importing and exporting goods and supplies. So make sure you know that you are getting your inputs and sending your outputs in the most cost-effective way open to you.

Look for follow-through on the basic principles of the FTA

The KORUS FTA (like other trade agreements) is based on the principle of "national treatment." This simply means that foreign and domestic companies should be treated equally in the market.

Transparency: The FTA contains detailed commitments by Korea to ensure that there are no regulatory surprises in the automotive sector.

Use the many resources created by the agreement to raise issues of concern

If you experience difficulties in the Korean market that you believe are contrary to the commitments and basic principles of the

FTA, contact the U.S. Embassy in Seoul, the American Chamber of Commerce in Korea and/or the Office of the U.S. Trade Representative in Washington, and use the legal and other experts you have lined up to assist you in the Korean market. The earlier and more detailed (written) information you can give these representatives, the better chance you have at seeing the issue resolved before it becomes a real problem for you.

Collaborate with your local representatives

A growing number of U.S. Congress members, governors, and local public and private sector representatives are visiting Korea. Make sure they know your goals in Korea and how you intend to accomplish them! They can be very helpful in getting your name out and mentioning challenges and successes you are having in the Korean market.

CONCLUSION

For more than half a century the United States and Korea have worked hard to build strong military and political alliances. Clearly, trade has existed between the two nations during that time as well. But the KORUS FTA should open the door substantially to strengthen the economic bridge between the two nations.

If given time, the KORUS FTA will provide an all important "third pillar" that supports the long-standing and critical relationship between the two nations. In today's world, having such allies is more important than ever.

The KORUS FTA is a comprehensive trade agreement that now serves as a "gold standard" model for future trade agreements. Without question, representatives of both countries rose to the challenge, overcame adversity and achieved demonstrable success.

But beyond the challenges of negotiation and ratification, further difficulties remain. Who will find and seize the opportunities that lie within those difficulties? Expect optimists within the automotive industries of both nations to lead the charge. **WJ**

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