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September 21, 2006

DELIVERY BY HAND

The Honorable John Engler
President and Chief Executive Officer
National Association of Manufacturers
1331 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-1790

Dear Governor Engler:

I and my fellow board members listed below have supported the resolution passed at the June 27, 2006 meeting of the NAM IEPC that will be reviewed at the meeting of the NAM Board of Directors next week.

This letter is prompted by your September 15th letter forwarding to NAM board members an opinion by Greenberg Traurig on the consistency of H.R. 1498, the Ryan-Hunter bill, with the obligations of the U.S. as a Member of the WTO. In your letter you state that the analysis by James Bacchus and Ira Shapiro of that law firm "shows that the provisions of HR 1498 appear incompatible with WTO obligations."

We respectfully disagree with that conclusion and feel it is only right that an alternative analysis is presented to the entire Board on this issue, especially since those of us who worked with the IEPC on this legislation for over a year and a half have repeatedly asked for specific legal issues with the bill and received none until this one at the last minute. We concur with you that WTO legality is critical to the NAM's support of any trade initiative. The Ryan-Hunter bill was written to achieve consistency with the WTO's agreements, and we believe that it succeeds in achieving that goal.

Indeed, in certain respects, the Greenberg Traurig letter is supportive of the Ryan-Hunter bill (for example, in finding that manipulative undervaluation of a foreign currency confers a "benefit" upon an exporter within the meaning of the WTO's Agreement on Subsidies and Countervailing Measures ("SCM")). In our judgment, however, the Greenberg Traurig letter is flawed in other fundamental aspects (as explained in more detail in the enclosed opinion by Kelley Drye Collier Shannon):

- Exchange-rate manipulation does involve a governmental "financial contribution" and is not a legitimate exercise of a country's "general regulatory powers" for purposes of the SCM Agreement.

- The governmental "financial contribution" can be seen as a direct transfer of funds or as a governmental provision of goods or services to exporters. While not strictly required by the SCM Agreement, there are real costs to the foreign government in making this "financial contribution" (such as the extensive costs entailed with "sterilizing" the foreign government's currency).

- Exchange-rate manipulation creates an incentive to export and clearly benefits only those who export, so that this subsidy is contingent upon exportation and prohibited under the SCM Agreement. There is no requirement expressed in the SCM Agreement that a subsidy must be exclusively tied to exportation in order to be export-contingent and prohibited.

H.R. 1498 is an important, carefully crafted, and well-reasoned effort to build on the clear intent and developing precedent of WTO law to eliminate trade-distorting subsidies. The currency policy now practiced by China and some other trading partners is the type of export subsidy WTO agreements are meant to prohibit and to provide a remedy against the resulting injury. We believe H.R. 1498 can be successfully defended against any potential challenge at the WTO.

NAM members and other U.S. companies have every right to benefit from trade with other countries and investment abroad. However, these benefits cannot outweigh the injury done to domestic manufacturers because of unfair trade advantages caused by prohibited currency manipulation. For this reason, while we would prefer to work by consensus, we value the NAM for providing an effective forum for U.S. manufacturers to act decisively on critical issues like this and we believe debate and voting are a healthy part of that process. The IEPC resolution was passed due to the active involvement by many smaller NAM members who have become activists because of the injury they are experiencing from the unfair practices of some of our trading partners and should be upheld by the NAM's Board.

Enclosed are two documents: (1) a legal memorandum from Kelley Drye Collier Shannon regarding WTO consistency of H.R. 1498 (Ryan-Hunter); and (2) a background memorandum about currency manipulation, the NAM's policy positions, and the reasons why H.R. 1498 is the best available policy response to currency manipulation.

We would appreciate your sending this letter with its enclosures to the NAM's Board of Directors in advance of next week's meetings. Thank you.

Very truly yours,

Richard L. Wilkey President Fisher Barton, Inc.	L. Patrick Hassey Chairman, President & Chief Executive Officer Allegheny Technologies Incorporated	M. Brian O'Shaughnessy President & Chief Executive Officer Revere Copper Products, Inc.

ENCLOSURE 1

CURRENCY UNDERVALUATION: WHAT IT DOES, HOW IT VIOLATES NAM PRINCIPLES, AND WHY H.R. 1498 IS THE BEST SOLUTION

As with other commodities, the value of a currency is a function of supply and demand. When market forces are free to determine the value, currencies move up and down as conditions change. However, when a government intervenes in currency markets to maintain an undervalued currency, it generates powerful and systematic advantages in its international trade.

With regard to its exports, an undervalued currency conveys a subsidy if and when a good is shipped across the border. As shown in the attachment, the government by its intervention decides how much extra domestic currency an exporter of goods or services (such as tourism) will receive for each dollar it earns. That bonus is a subsidy provided by the foreign government. Under WTO rules, a subsidy benefit that is received contingent on export is prohibited. The prohibition rests on the longstanding legal judgment that export subsidies are inherently distortive and destructive of free and fair competition.

With regard to the country's imports, an undervalued currency serves as a hidden tax on all imported goods and services. The attachment shows clearly that undervaluation creates the need for importers, or would-be importers, to pay extra in domestic currency to purchase each dollar of foreign goods. Whether viewed as a hidden tariff or a hidden tax, the undervalued currency undermines the level playing field for imported products and distorts free and fair competition.

The bottom line is that persistent currency undervaluation maintained by government intervention is incompatible with free trade and violates the letter as well as the spirit of the WTO agreements.

Currency Undervaluation Violates NAM Principles

In 2005, the Board approved two specific sets of priorities for NAM -- one an overall trade agenda; the other, a China-specific agenda. The principles and specific objectives in those documents provide a strong basis for condemning persistent currency undervaluation.

Specifically, NAM's established policy objectives include:

- **Eliminate trade-distorting subsidies & defend, preserve and enhance the effectiveness of WTO-consistent U.S. trade law.** As noted above, export subsidies are prohibited because they are the most distortive of free trade.
- **Elimination of artificially created and maintained competitive advantages through WTO-inconsistent subsidization or other means.**

As shown in the attachment, currency undervaluation creates powerful advantages for a country's exports as well as for domestic producers competing with imports.

- **Revalue the Chinese Yuan to Reflect Economic Fundamentals.** The Board agreed that this step is viewed as "essential to creating more balanced and sustainable trade flows," "giving U.S. companies a more stable period to adjust to changing economic relationships," and "enabling other countries to free their [undervalued] currencies to better reflect market conditions."
- **Immediate Revaluation of the Yuan by up to 40 Percent.** This objective was ratified by the Board in early 2005. Since then, the yuan has strengthened vis-à-vis the dollar by only 4.46 percent through September 20, 2006, according to figures published by NAM. In fact, this very modest, nominal appreciation has been exceeded by China's inflation during this same period, so that the yuan is actually weaker in real terms than it was in July 2005.
- **Apply Countervailing Duty Laws to China to Offset the Effects of Chinese Subsidies.** The Board agreed that "[t]he size of China's industrial sector and its huge foreign exchange reserves should dictate that greater subsidy discipline be applied." The need for such legislation has been heightened by China's failure to fulfill its commitment to eliminate all export subsidies by the time of its accession to the WTO on December 11, 2001.

Supporting a WTO-consistent remedy against persistently undervalued currencies is a logical next step in NAM's traditional support for free and fair trade, the rule of law in international trade, and the elimination of trade-distorting subsidies. It would validate NAM's leadership role on currency issues that led to the establishment of the Coalition for a Sound Dollar and the Fair Currency Alliance. It would underscore that WTO-consistent responses to mercantilism and protectionism by our trading partners is a key step in strengthening support in the United States for further trade liberalization.

Why H.R. 1498 is the Best Approach

H.R. 1498, introduced by Rep. Tim Ryan (D-OH) and Armed Services Chairman Duncan Hunter (R-CA), is the only bipartisan, WTO-consistent legislation that provides a remedy to persistent currency undervaluation. Thus far, 176 House members have cosponsored the bill, including 85 Republicans. As the 109th Congress draws to a close, H.R. 1498 stands out from all other currency legislation because:

- Consistent with the anti-subsidy rules of the WTO, it makes "currency manipulation" – undervaluation maintained by government intervention in any country – an export subsidy actionable under the U.S. countervailing duty law. The statute would apply in a nondiscriminatory way to all countries. The legislation addresses an unfair, mercantilist practice as a

matter of principle and does not single out any foreign country for discriminatory treatment.

- Consistent with the International Monetary Fund's standards, a temporarily undervalued currency resulting not from government interference but from an imbalance in market forces would not be liable to CVD duties.
- Consistent with established national trade law, domestic producers would be required to prove material injury caused by the subsidized imports to obtain offsetting duties. Frivolous cases would be screened out.
- Application of CVD remedies would be contingent on the exporting country's continued intervention to maintain an undervalued currency. Once the practice stops, the remedy stops. Thus, good behavior is rewarded.
- Enactment of H.R. 1498 would provide an avenue of relief for injured industries, encourage foreign governments to desist in the market interference to suppress the value of their currencies, and act as a deterrent to this unfair practice in the future.

H.R. 1498 is good policy and deserves NAM's endorsement.

The Simple Arithmetic of Currency Undervaluation: The Chinese Example

Assume:

- A market value for RBM of \$1 = 5 RMB
- An administered value for RMB of \$1 = 8 RMB
- An identical product is produced in the US and China at a cost of US\$ 100 or 500 RMB

A would-be Chinese buyer of the US good would have to be able and willing to pay:

500 RMB – market value of good
\+ 300 RMB – currency penalty

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800 RMB

Result: HUGE COST DISADVANTAGE FOR US EXPORTER

A would-be Chinese seller to the US would be able to sell it at:

500 RMB – market value of good
\+ 300 RMB – currency bonus

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800 RMB

Result: HUGE COST ADVANTAGE FOR CHINESE EXPORTER

ENCLOSURE 2

KELLEY DRYE
COLLIER SHANNON

MEMORANDUM

September 21, 2006

TO: **GOVERNOR JOHN ENGLER**

FROM: **DAVID A. HARTQUIST**
JEFFREY S. BECKINGTON

RE: **THE WTO-CONSISTENCY OF H.R. 1498, THE RYAN-HUNTER BILL**

This memorandum is being sent to you on behalf of the China Currency Coalition ("CCC") and responds to an analysis provided to Mr. Jim Jarrett in a letter dated September 12, 2006, by Messrs. James Bacchus and Ira Shapiro of Greenberg Traurig, LLP. In their opinion, H.R. 1498's treatment of manipulative undervaluation of a foreign currency as a countervailable, prohibited export subsidy would likely be found in dispute settlement to be WTO-inconsistent. The CCC respectfully disagrees.

We would like to note at the outset that the Ryan-Hunter bill has been crafted to comply with the rights and obligations of the United States under the WTO's various agreements, including particularly the Agreement on Subsidies and Countervailing Measures ("SCM Agreement"). It also should be observed that any legal contest at the WTO on this matter would be a case of first impression, so it cannot be known with absolute certainty what the final result of such proceedings would be. Nonetheless, H.R. 1498 has been scrutinized repeatedly since its introduction in April 2005, and 176 Members of the House of Representatives, virtually evenly split by party, have signed on as co-sponsors.

Under the circumstances, having now been able to read Greenberg Traurig's letter, we continue to believe that H.R. 1498 is WTO-consistent. Indeed, Greenberg Traurig's letter in significant respects supports or concurs with the reasoning that underlies the CCC's position. In the limited areas of disagreement that exist and in its outcome, Greenberg Traurig's evaluation is very much open to challenge. On balance, by far the better view is that the Ryan-Hunter bill is WTO-consistent. The CCC's further points follow.[1]

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[1] Importantly, at page 2 of Greenberg Traurig's September 12th letter, H.R. 1498's definition of "exchange-rate manipulation" for purposes of amending the U.S. countervailing duty statute has been misquoted in a way that wrongly suggests that amendment would apply only to China. In actuality, Section 3 of H.R. 1498 defines "exchange-rate manipulation" as a countervailable,

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- The CCC agrees that a measure constitutes a "subsidy" under the SCM Agreement only if (a) there is a governmental "financial contribution" involved and (b) a "benefit" to the recipient is thereby conferred.

- Greenberg Traurig's evaluation acknowledges that exchange-rate manipulation likely would be found in dispute settlement to confer a "benefit." The CCC concurs. When a country's currency is manipulatively undervalued in relation to the United States dollar, goods from that country that are sold in the United States will realize for the exporter – upon conversion of the dollars into the exporter's home currency – more of that country's currency than if that currency were valued realistically in accordance with market forces. That difference, resulting in additional funds for the exporter, assuredly yields a "benefit" for the exporter.

- Greenberg Traurig's opinion is that exchange-rate manipulation would likely not be considered to be a governmental "financial contribution" and so would not be a "subsidy" under the SCM Agreement. To the contrary, the CCC submits that exchange-rate manipulation does constitute or produce a governmental "financial contribution" either as a direct transfer of funds by the foreign government to the exporter or as a governmental provision of goods or services to the exporter in which the foreign government is selling its currency and buying U.S. dollars. The foreign government prints the money and decides how much to give to each exporter.

- In Greenberg Traurig's view, a governmental "financial contribution" is not likely to be found (a) because the foreign government's manipulative undervaluation of its currency is an exercise of its "general regulatory powers" and (b) because there is no "real cost" to the foreign government from a transfer of economic resources, as there is with an outright grant of governmental funds or a loan at below-market rates. But these attempted claims should fail. The vague yardstick of whether a measure is an exercise of "general regulatory powers" would wrongly excuse many measures like grants and preferential loans that already are recognized as governmental "financial contributions." Moreover, not only is the notion of a "real cost" to the foreign government not articulated or defined in the SCM Agreement as a prerequisite for a governmental "financial contribution," but exchange-rate manipulation does actually entail substantial costs for the foreign government. Such manipulation requires an extensive and costly regulatory system by the foreign government to maintain, not

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prohibited export subsidy so as to apply in countervailing duty proceedings to <u>any</u> foreign country (not just China) engaged in manipulative undervaluation of its currency. The definition of "exchange-rate manipulation" cited by Greenberg Traurig's letter concerns Section 4 of H.R. 1498, which deals with the China-specific market disruption provisions in U.S. law based upon China's Accession Agreement with the WTO. Any implication that H.R. 1498 singles out China for discriminatory treatment under the U.S. countervailing duty statute is erroneous.

least the process of "sterilizing" the foreign government's currency to avoid inflation. Again, there are solid grounds to treat exchange-rate manipulation as a "subsidy" under the SCM Agreement that involves both a governmental "financial contribution" and a "benefit" for the recipient.

- Greenberg Traurig's analysis also argues that the third criterion under the SCM Agreement for a prohibited export subsidy would not be met and that payments to an exporter by a foreign government's exchange-rate manipulation are not "contingent" upon export performance, if the exchange rate is available to anyone who has U.S. dollars to be exchanged into the manipulatively undervalued foreign currency. But the fact remains that the foreign country's exporters can only receive their home currency at the subsidized, advantageous rate by exporting and obtaining U.S. dollars. Availability of the subsidized rate to other groups, such as foreign investors or tourists (who are importers of services, such as lodging and transportation, as well as purchasers of goods to carry home), does not at all dictate a conclusion that the subsidy is not export-contingent. There is no requirement expressed in the SCM Agreement that a subsidy must be exclusively tied to exports in order to be export-contingent and prohibited. This distinction has been recognized and prohibited export subsidization has been found in dispute settlement at the WTO in similar situations. The fundamental issue is whether the subsidy creates an incentive to export; an undervalued currency clearly benefits only those who export.

In summary, the CCC continues to believe that exchange-rate manipulation is a countervailable, prohibited export subsidy and would be considered as such in a dispute settlement at the WTO.