GLOBAL IMPACT

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GREAT AMERICAN INSURANCE GROUP

Dear Friends:

In order to remain competitive, shifting trends often require a reassessment of risk, a fresh perspective and a new strategy. And nowhere is this more true than in China. Changing times necessitate both a clear understanding of what's happening and a sound action plan (p1-2).

Oil spills create tremendous costs if not managed efficiently. Read about Great American's pollution policy and its spill management team that's worth its weight in gold (p3).

Future trade policy, to a large extent, will be dependent on who wins the American Presidency. But the makeup of the next Congress may have a larger impact. If the current Congress is any indication of what's to come, trade legislation may be limited (p4).

We hope you enjoy this issue and welcome your comments.

Sincerely,

John A. Rowney
Division President
Ocean Marine Division

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China is anticipated to overtake the United States in terms of job generation in 200 9 , according to Global Insights, a U.S. economic consultancy. China's growth, however, does not end there.

The World Bank says China surpassed Japan to become the world's largest importer of petroleum in 2005, and the world's second largest auto maker in 200 6 . And in 200 7 , China became the top producer of merchant ships. When one reviews port rankings published by Shipping Statistics Yearbook, this data is easily grasped. For example, measured by cargo volume, the Shanghai port ranks as the world's largest. And of the next seven largest, five are Chinese. Measured by container traffic, three of China's ports are in the top four. Rising prices, however, are changing China's trajectory.

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Due to rising prices, ò The era of China as a low-cost, manufacturing-for-export market has come to an end, ó says the management consulting firm of Booz & Company. How does this impact Chinese development ? As costs rise, China is moving up the value chain, producing more higher-technology goods and fewer low-tech goods. In fact, the Chinese government is using incentives to encourage local companies to innovate, while discouraging low-end manufacturers from operating in southern China, The New York Times reports. Many factors are responsible for rising costs. For example, from July 21, 2005 ñ when the Chinese government unpegged its currency from the U.S. dollar and allowed it to ÿ oat based on a managed basket of currencies ñ through August 2 7 , 200 8 , the renminbi, also known as the yuan, rose by 21 percent against the dollar.

Chinese labor rates for blue-collar workers and managerial staff alike, according to various sources, have risen about 5 to 15 percent per year. And tougher labor and environmental standards, as well as the termination of tax breaks for thousands of Chinese factories, have boosted costs. Foreign firms are not the only ones affected. A Pew Research Center survey of Chinese citizens released in July indicates ò 9 6 percent describe rising prices as a big problem for the country, and 7 2 percent say they are a very big problem. ó

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For U.S. manufacturers who have viewed China solely as a source of low cost production, rising costs have cut into their margins. In turn, a growing

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number are moving production and supply sources to lower cost countries, like ietnam, ndonesia, ndia, hailand, alaysia, angladesh and ra il. n fact, a survey of manufacturers among the members of mCham hanghai's anufacturing usiness Council found that "Nearly one in ve percent of these companies already has made the decision to move at least some China-based operations to other low-cost countries in sia and elsewhere."

ther factors pulling manufacturers away from China include attractive ta bene ts, the competitive landscape, intellectual property protection, and utility costs, the survey e plains. Plus, some countries are selling themselves more effectively.

or e ample, " ietnamese of cials have aggressively marketed their country as a lower cost alternative to manufacturing in China and have persuaded some . . customers to switch their outsourcing from China to ietnam. n turn, an increasing number of companies are looking south to ietnam to manufacture labor-intensive articles, such as toys and wood furniture," says alph Watkins, senior international trade analyst at the . . nternational rade Commission in Washington, .C.

ven though China is losing its competitive edge to other low-cost countries, oo llen amilton, a consultancy previously associated with oo Company and author of the mCham survey, says the iddle ingdom is still very much in the game. hat's why 3 percent of survey respondents have no plans to move capacity away from China. he biggest reason to remain there, the study says, is to access China's vast domestic market.

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or . . producers heavily invested in China and for those who prefer not to move elsewhere, a dual strategy may be in order. ccording to the mCham study, companies that pursue China for lower-cost labor and a source of supply, as well as a growth market for sales, and integrate these operationally, perform considerably better.

n fact, these companies "report an average pro tability rate two-thirds higher than those focused on ust one of those ob ectives 2 . percent compared with . percent . espite the returns that this approach can generate, only one out of four companies is able to combine a strong in-country market growth effort with its manufacturing and sourcing operations."

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il prices above a barrel have forced the cost of shipping a -foot container from China to the nited tates through the roof. his, plus rising Chinese prices, are causing some merican producers to relocate their facilities from China back to the . .

" scalating transportation costs have taken their toll on Chinese e porters of articles with a high ratio of weight to value. t least one Chinese producer of sian-style wood furniture has contracted with a manufacturer in ississippi to produce furniture for distribution in the North merican market," Watkins tells *Global Impact.*

How much U.S. production in China is likely to return to the United States ? ò Expecting the U.S. to recapture industries that already have gone to China may not be realistic. But the new cost equation likely will in ÿ uence many decisions about where to locate production in the future, ó says China Economic Review.

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U.S.-China trade, which totaled only $ 5 billion in 1 9 8 0, rose to $ 3 8 7 billion in 200 7 . Another figure that remains considerably high, as compared to all countries, is China's gross domestic product. It averaged 10 percent annually during the period 2000-200 6 . Can this growth rate continue over the next decade ? This is the trillion yuan question. ■

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n uly, a signi cant portion of the ississippi iver by New rleans was slick with black oil. barge, owned by merican Commercial ines nc., had collided with a tanker, splitting the barge nearly in half and spilling , barrels of No. fuel oil. he list of damages is growing. Cleanup costs are mounting, class action lawsuits have been led and hundreds of small boats have to be hauled and cleaned. usiness interruption claims from terminals up and down the river are climbing, and demurrage charges are also in store.

he incident is estimated to cost some 2 million. he response costs alone, which includes cleanup, total million. uch a staggering bill of damages can be mitigated. reat merican's *Pollution Cleanup Policy offers broad and seamless coverage for such accidents. ò We've always been a market leader in the breadth of the policy, ó said Capt. Ed Wilmot, vice president of the Ocean Marine division. ò Plus, we provide a spill management team that no one else can match. ó*

"Not one dime will come out of your pocket... We pay all costs directly... We've received nothing but rave reviews from those who have used our team."

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An oil spill usually triggers an incident command system that calls for cleanup crews, and handles planning, finance, and various other activities. A key plus of Great American's pollution policy is its spill management team. These professionals know what to look for, where oil will collect, what equipment is needed, who to contract, and much more. The spill management team has a singular focus: oil spills ñ and it manages several hundred oil spills a year.

ò When our spill management team is handling your spill, rest assured you've got well respected professionals who know how to deal with the Coast Guard and contractors. And best of all, not one dime will come out of your pocket, ó Wilmot said. ò We pay all costs directly... We've received nothing but rave reviews from those who have used our team. ó

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Great American's policy covers responsibilities under the Oil Pollution Act of 1 9 9 0 (OPA), the Comprehensive Environmental Response, Compensation and L iability Act (CERC L A), and state oil pollution liability and toxic waste laws. Response is initiated by an oil or CERC L A spill, or the threat of a spill. Responsibilities under OPA and CERC L A involve removal costs, including the expense of actions taken by any federal, state or local government agency to avert or lessen a spill.

With an effective response and cleanup plan, Great American can work to reduce losses. And when it comes to compensatory damages, which can be significant following a spill, the coverage applies to claims in six classes:

- *Natural resources.* *Damages can include injury to or loss of use of natural resources. Costs may involve steps taken to restore the impacted environment, such as restocking fish species or replanting wetlands.*
- *Real or personal use.* *This includes damages for injury to, or economic losses resulting from destruction of property.*

- *Subsistence.* *This may apply to a claimant who subsists on damaged natural resources, such as fishermen.*
- *Revenues.* *Federal, state and local governments are entitled to receive damages equal to net loss of taxes, royalties, rents, fees or net profit shares.*
- *Profits and earning capacity.* *This includes damages equal to the loss of profits or impairment of earning capacity from destruction or loss of use of property or natural resources.*
- *Public services.* *This includes damages for net costs of providing increased or additional public services resulting from removal activities, including fire, safety and health protection.*

Great American's policy coverage also includes advertising to help rebuild its client's image. The broad and seamless policy is offered as a stand alone item or as part of a package.

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H istory has shown how ignoring risks can be costly. Can one afford to be without extensive coverage ? ò Absolutely not, ó Wilmot said. ò Not in this day and age ñ particularly now that the Department of Justice is coming down very hard on anyone who spills oil. ó ■

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The first session of the 111th Congress begins in January 2009. What is likely to occur in terms of international trade policy, in large part, will be dependent on who wins the presidency: John McCain or Barack Obama.

Perhaps more importantly, the make-up of the new House of Representatives and Senate may have a larger impact, since Congress writes the bills, determines their voting schedule, and if they're considered and passed, sends them to the President for his signature or veto. But if the current Congress is any indication of the future, new trade legislation may be limited.

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Traditionally, during an election year Congress considers few bills that are controversial. And to an increasing extent, trade legislation has become more contentious. In addition, a growing number of Members of Congress have become less willing to support trade expansion. Consequently, several pieces of trade legislation have been put on the sidelines and will remain there at least until after the November election ñ and probably much longer.

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In July 2005, the Dominican Republic-Central American Free Trade Agreement (FTA) passed the House with the slimmest of margins: two votes. And although the U.S.-Peru FTA passed by a greater margin in late 2007, consideration of FTAs with Panama, Colombia and South Korea have been delayed. Plus, Trade Promotion Authority (TPA), which expired in July 2007, has been put on hold indefinitely.

TPA allows the president to submit trade deals to Congress for a yes or no vote without amendments. In the absence of TPA, many foreign countries will not negotiate agreements with the U.S. since Congress could change them. As a result, TPA is essential if the United States wishes to negotiate new agreements. ■

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For more information on how we can help your business stay profitable, contact your agent or Ed Wilmot at (212) 510-0135, ewilmot@gaic.com