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WORLD TRADE ORGANIZATION & REGIONAL TRADE AGREEMENTS

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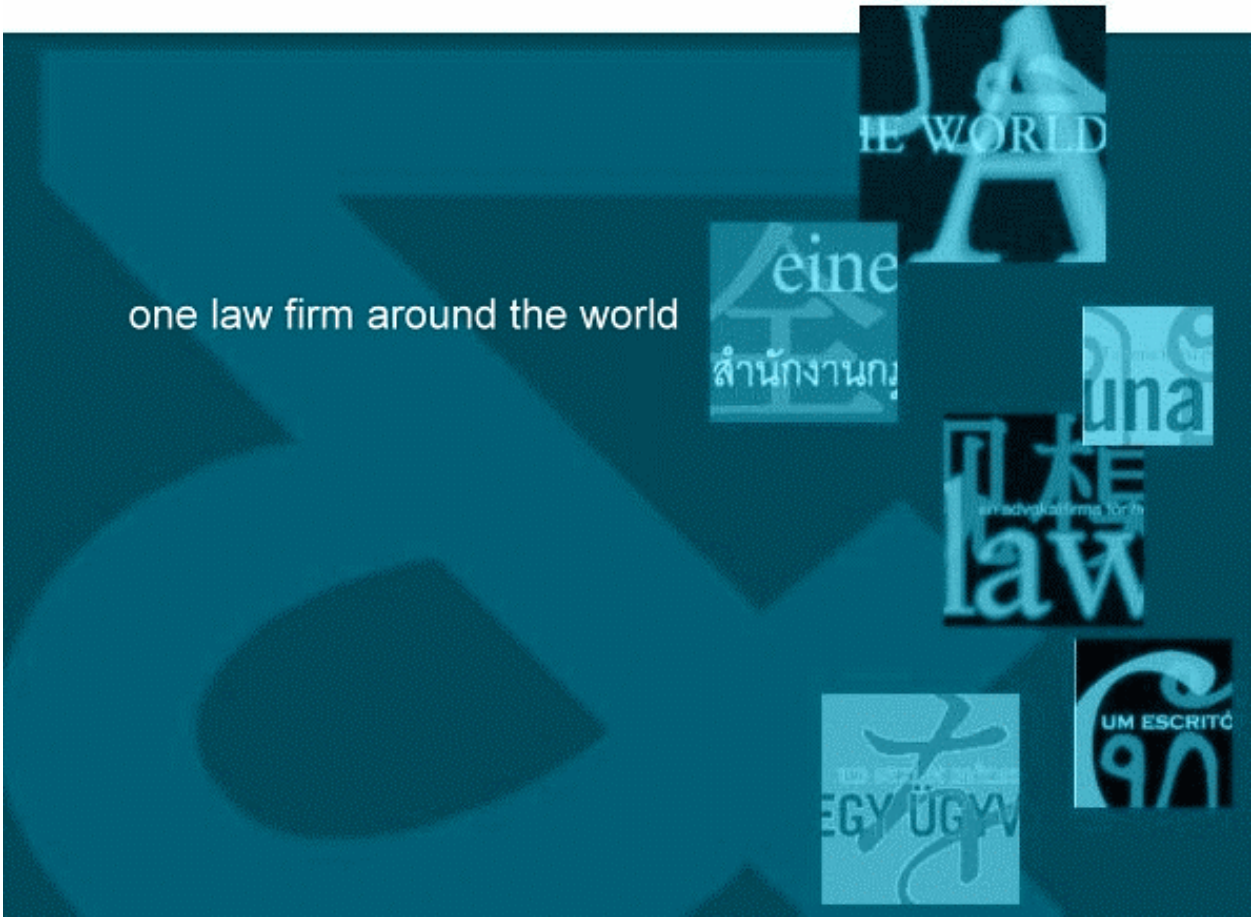

Due to the general nature of its contents, this newsletter is not and should not be regarded as legal advice.

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The most critical issue is that of deciding the non-preferential purposes to which the harmonized rules of origin would apply – including antidumping and countervailing duty purposes. Notwithstanding that the Agreement on Origin appears to provide for application of harmonized rules for all non-preferential purposes, the U.S. and some developing countries propose that application for all purposes is optional (such as for trade remedies). Developing countries argue that harmonization should be for all purposes including trade remedies, resulting in a split between developing and developed countries.

The 12 issues identified by the Committee for the General Council include assembly of machinery and vehicles and steel processing, as well as origin of food and agricultural processing operations. These issues illustrate the positions of the members, particularly that of the EU favoring a value-added test as the basic determinant of origin, versus that of the U.S. and most other countries generally favoring a test requiring change in tariff classification of a processed good.

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WTO Market Access Negotiations on Industrial Goods Launched

WTO Members on July 18, 2002 ended the impasse over establishment of the timeframe for market-access negotiations on non-agricultural, industrial goods. After much debate, Members agreed to set modalities (negotiating approaches) by May 31, 2003 – in order to conclude negotiations by the Doha mandate on January 1, 2005. Soon after, Members held their first substantive discussions on industrial goods negotiations on August 2, 2002. The meeting also set the timeframe for work until the end of 2002.

In addition, several Members have made proposals on market-access negotiations, including the he United States ("US"), European Communities ("EC") Japan, Korea and New Zealand. We summarize below the positions of these and other Members in the negotiations.

State of Play of TRIPS Negotiations on Compulsory Licensing in the Context of the Doha Declaration on TRIPS and Public Health

WTO Members are engaged in very active negotiations to make effective the use of compulsory licensing under the TRIPS Agreement by Members with insufficient or no manufacturing capacities in the pharmaceutical sector. Members must reach an agreement on this issue by the end of 2002, as provided for in the Doha Declaration on TRIPS and Public Health.

The discussion over the scope of the solution (i.e. products covered, Members' eligibility) along with the mechanism to be used to implement that solution seem to dominate the debate. There is an emerging consensus among Members that the solution should be expeditious; workable; transparent; sustainable; and legally secure. However, Members are facing difficulties over which of the proposed mechanisms will best meet those requirements.

On the one hand, research-based manufacturing countries such as the US and Switzerland favor a more restrictive approach, trying to ensure stringent safeguards to protect the rights conferred on the patent holder in the exporting country. On the other hand, generic-based manufacturing countries like India and developing countries without pharmaceutical production favor a more flexible solution, not only with regard to the scope of the mechanism but also with regard to the mechanism itself.

This report presents a brief overview of the main proposed mechanisms, highlighting the merits and defects, depending on the standpoint of stakeholders and contenders.

WTO Trade Policy Review Body Conducts Sixth EU Trade Policy Review

On July 24-26 the World Trade Organization Trade Policy Review (TPR) Body conducted its sixth Trade Policy Review of the EU. The review followed a framework established by a previously prepared report by the WTO Secretariat. This report among other issues raised the following:

(i) Trade liberalization issues

(ii) The status of EU internal integration;

(iii) Preferential access offered to other countries;

(iv) Trade remedy mechanisms used by the EU;

(v) European Company proposals, and

(vi) Protection of Intellectual Property Rights.

We summarize below the key findings of the TPR report on the EU as prepared by the WTO Secretariat.

WTO Dispute Settlement

WTO Arbitrator Rules in Favor of EC in FSC Dispute

After several delays, a WTO arbitration panel on August 30, 2002 consisting of the original panelists,[1] issued an award on the long-standing Foreign Sales Corporation (FSC) dispute between the US and the EU strongly in favor of the EC's claims.[2] In particular, the arbitrators ruled:

- The EC be permitted to retaliate to the amount of USD 4.043 billion - the exact amount requested by the EC.
- Rejected the U.S. argument that EC retaliation be limited strictly to the trade effect of the subsidy.

Once the EC secures authorization from the Dispute Settlement Body ("DSB") to retaliate, it can countermeasures of up to the maximum of USD 4.043 billion annually. The WTO decision is the largest arbitration award in the GATT/WTO's history and has provoked a contentious response from the US, especially among affected U.S. industries. According to the National Foreign Trade Council (NFTC), 3.5 million American jobs depend on the FSC/ETI regime at issue. Significant beneficiaries include Boeing, General Electric, Motorola, Caterpillar, and Cisco Systems.

Nevertheless, both the Clinton and Bush Administrations have urged Congress to bring tax policies in line with WTO rules in order to avoid EU retaliation. Despite the magnitude of possible EU retaliation, it is not in EU interests to provoke yet another trans-Atlantic trade war. The US-EU relationship is already under strain from the U.S. safeguards on steel, U.S. Farm Bill and outstanding U.S. retaliation over the EU's ban on hormone-treated beef. Strong US-EU leadership is essential to the success of post-Doha negotiations, and thus much is at stake over the resolution of the FSC/ETI dispute.

WTO Panel Finds Against U.S. Antidumping and Countervailing Measures on Steel Plate from India; Upholds U.S. Law

A World Trade Organization (WTO) dispute settlement panel validated U.S. law but held in favor of India on key issues in a recent dispute with the United States involving imports of steel plate. The dispute concerned the U.S. imposition of antidumping measures on imports of certain cut-to-length carbon steel plate ("steel plate") from India. The U.S. Department of Commerce (DOC) initiated the antidumping ("AD") duty investigation on March 8, 1999 and issued a final

[1] Panel Chairman - Crawford Falconer, Panel Members - Didier Chambovey, Seung Wha Chang

[2] United States - Tax Treatment for "Foreign Sales Corporations" ("US - FSC"), Recourse to Arbitration by the United States under Article 22.6 of the *DSU* and Article 4.11 of the *SCM Agreement* - Decision of the Arbitrator WT/DS108/ARB, 30 August 2002

determination of dumped sales on February 10, 2000, with a margin of 72.49 percent for the sole Indian respondent - the Steel Authority of India, Ltd. ("SAIL").

India challenged the AD order issued by the DOC under the WTO AD Agreement Articles 2.2, 2.4, 6.8, 9.3, 15 and Annex II paragraphs 3, 5, and 7 as well as GATT Articles VI:1 and VI:2. This report focuses on the substantive issues reviewed by the Panel under Articles 6.8 and Annex II(3) and (5) as well as Article 15. The report also briefly discusses the procedural complaint of India relating to the U.S. practice in the application of facts available.

The panel concluded that the U.S. measure was imposed inconsistently with certain provisions of the AD Agreement. In particular, the US violated Article 6.8 and Annex II(3) in finding that SAIL had failed to provide necessary information, thus basing its determination entirely on facts available.

The panel also rejected several Indian claims. In particular, the Panel concluded that Sections 776(a), 782(d) and 782(e) of the U.S. statute were not facially inconsistent with Article 6.8 and Annex II(3) of the AD Agreement.

WTO Appointments

On September 1, 2002, Dr Supachai Panitchpakdi, the former Deputy Prime Minister of Thailand, assumed his functions as Director- General of the World Trade Organization, replacing Mr. Mike Moore of New Zealand. Following the precedent established at the time of Mr. Moore's appointment in 1999, the rest of the senior management of the WTO will also change; Dr. Supachai has announced his appointment of four new Deputy Directors-General, who will replace the existing team on October 1, 2002.

Regional Trade Agreements

EC Proposes List of Issues to Discuss in Relation to Regional Trade Agreements; Australia Submits Concrete Proposal on Article XXIV of GATT94

The European Communities (EC) and Australia recently submitted communications on regional trade agreements (RTAs) in the context of the WTO Doha Round of Multilateral Negotiations.

In their respective submissions, both the EC and Australia highlight the need to clarify the WTO legal framework of RTAs. However, while the EC's proposal focuses on the issues that should be discussed during the negotiations (i.e. substantive and procedural issues), Australia has put forward a concrete proposal on one of the outstanding issues related to RTAs (i.e. the clarification of "substantially all trade" in Article XXIV:8 of GATT 94).

Japan-Mexico Joint Group Releases Final Report on FTA Feasibility

The Japan-Mexico Joint Group recently released a final report on a feasibility study regarding the potential benefits of an FTA between Mexico and Japan. The report includes the following issues:

- ***General Overview:*** Japan and Mexico are complementary economies and would benefit from a bilateral FTA.

- ***Trade and Investment Liberalization:*** Regarding trade in goods, Japanese representatives within the joint group highlighted some concerns about some Mexican customs procedures such as high import duties, PROSEC, *Regla Octava*, and the Automatic Importation Notice System. On their part, Mexican representatives expressed their concern about the uncertainty of the Japanese Generalized System of Preferences (GSP) program. The joint group agreed that a future FTA should also include provisions on investment and trade in services, government procurement, and trade remedies.

- ***Bilateral Cooperation and Dispute Resolution:*** The FTA negotiations shall include bilateral cooperation mechanisms on various issues such as customs procedures, technical standards, antitrust, intellectual property, business environment, as well as a dispute settlement mechanism.

According to some prominent Mexican government officials, negotiations could start by late October 2002 and possibly conclude by October 2003.

REPORTS IN DETAIL

WTO WORKING GROUPS

Work of WTO Harmonization of Non-Preferential Rules of Origin at Impasse Over Application to Trade Remedies

SUMMARY

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The 12 issues identified by the Committee for the General Council include assembly of machinery and vehicles and steel processing, as well as origin of food and agricultural processing operations. These issues illustrate the positions of the members, particularly that of the EU favoring a value-added test as the basic determinant of origin, versus that of the U.S. and most other countries generally favoring a test requiring change in tariff classification of a processed good.

The remaining issues, approximately 135 of 500 identified in 1999, are the most contentious and complex. The lack of a common understanding on the purposes for which the harmonized rules will apply makes meaningful negotiations difficult. Therefore, the Committee, even with the aid of the General Council, is unlikely to complete harmonization in the foreseeable future – which could result in yet another extension of the deadline.

ANALYSIS

I. Background

The WTO effort to harmonize non-preferential rules of origin is at a critical state. The WTO began work to harmonize non-preferential rules of origin in July 1995, with completion scheduled within 3 years. The work proved very difficult and contentious and the General Council of the WTO extended the deadline for completion several times. The current deadline, set by the Ministers at Doha last year, is the end of 2002.

Initially, the WTO Committee on Rules of Origin (CRO) in Geneva and the Technical Committee on Rules of Origin (TCRO) of the WCO Customs Cooperation Council in Brussels performed harmonization work. The TCRO completed the technical work in June of 1999, at which time it reported on the status of harmonization of rules of origin for about 5,000 lines of goods of the Harmonized Tariff Schedule (*i.e.,* about 5,000 product descriptions). The TCRO reported that about 500 product-specific issues remained unresolved. Since then, the CRO has resolved about 350 of these issues. However, because the most difficult, contentious issues remain, the CRO's pace has slowed during the past year and 138 issues remain unresolved.

At the end of 2001, the General Council of the WTO agreed that the CRO should hold two sessions in the first half of 2002 to attempt to resolve the remaining issues. The General Council also agreed that the CRO could identify a limited number of core-policy issues for discussion and decision by the General Council.

II. June 28, 2002 Meeting of CRO

At its June 28, 2002 meeting the CRO took up this offer by the WTO General Council. The CRO identified about 100 critical issues and recommended that the General Council focus its considerations on the following 12 crucial issues:

- Implication of implementation of the Harmonized Rules of Origin on other WTO Agreements;
- Dying and printing of textile products;
- Coating of steel products;
- Assembly of machinery;
- Assembly of vehicles;
- Refining of sugars;
- Roasting of coffee;
- Slaughtering of live animals;
- Refining of oils;
- Fish taken from the sea of the exclusive economic zone;
- Footwear; and
- Dairy Products.

III. Harmonization Work at Impasse Over Application to Trade Remedies

The first issue, basically the extent to which the harmonized rules of origin will apply to other WTO agreements, has been very controversial throughout the negotiation process. Article 9.1 of the WTO Agreement on Rules of Origin provides that the "[harmonized] rules of origin should be applied equally for all purposes set out in Article 1" of the Agreement. Article 1 sets out as purposes for which the rules of origin are to be used: most-favored-nation treatment, antidumping and countervailing duties, safeguard measures, origin requirements, discriminatory quantitative restrictions or tariff quotas, government procurement, and trade statistics.

The U.S. argues that the requirement to "apply rules of origin equally for all such purposes is not synonymous with a future obligation to use rules of origin for all such purposes." (See May 18, 2001 Submission of the U.S. on Implications of the Harmonized Rules of Origin on other WTO Agreements (G/RO/W/65).) The U.S. has opposed use of the harmonized rules of origin for antidumping and countervailing duties, just as the Department of Commerce, responsible for those functions in the U.S., declines to be bound by U.S. Customs' traditional substantial transformation origin determinations for antidumping and countervailing duty purposes.

Generally, developing countries argue that the harmonized rules of origin should apply for all purposes listed in Article I of the agreement, including antidumping and countervailing duty purposes. Developing countries are concerned about the lack of progress of harmonization, particularly in the agricultural and textile sectors.

Of course, if members do not know the effect of the harmonized rules, they will not agree on those rules. The CRO has held intensive discussions on application of the harmonized rules to other WTO Agreements. In the CRO meeting on June 28, 2002, the Chairman proposed resolution by a position near to that of the U.S., *i.e.*, that "[e]ach member … is to decide whether rules of origin are used in its non-preferential policy instruments." After "robust" discussions of the Chairman's proposal, the CRO submitted this issue to the General Council as an outstanding core policy issue.

IV. Other Critical Issues – Specific Processes and Products

The other crucial issues referred to the General Council concern specific processing operations on specific products. The Chairman recommended a rule for most of these issues, unlike the core-policy issue of applicability of the harmonized rules to other WTO Agreements, for which the Chairman did not make a recommendation. We examine illustrative crucial issues below:

A. Assembly of Machinery

This issue applies to machinery of Chapters 84 through 90 of the Harmonized Tariff Schedule. The EU and two other countries favor a value-added test, under which assembly of components or parts to produce machinery must equal at least 40 percent of the value of the finished machinery. Most countries, including the U.S., Japan, and China, favor an assembly

approach. Under this approach, if the assembled good is classified in a different heading than the heading in which the components or parts are classified, the country of assembly is the country of origin. If the assembled good is assembled from parts of the same heading, the assembly must involve at least 5 major parts in order to take its origin from the country of assembly.

The Chairman recommends a partial compromise. He favors the assembly approach if the parts used in the assembly operation are classified in a different heading than the assembled good. However, for parts assembled into a good of the same heading, he recommends a choice of the 5-part rule under the assembly approach or a 40 percent value added test.

B. Assembly of Vehicles

This issue is similar to the determination of origin of machinery. The EU and the same two other countries favor a value added approach, under which the increase in value in the country of assembly must represent at least 45 to 60 percent of the ex-works price of the product (the EU favors 60 percent). The U.S., Japan, China, and most other countries favor a simple change of classification rule, at the tariff heading level. The Chairman recommends delaying consideration of origin rules for vehicle assembly until resolution of the origin rules for assembly of other machinery.

Because motor vehicles are composed of so many parts and assembly is a complex operation, the problem of simple assembly (dealt with elsewhere by rules such as the 5-part rule) does not exist for motor vehicles. Formerly, some countries favored excluding processing of motor vehicle chassis fitted with engines of heading 8706 into completed motor vehicles of other headings. Now, no country favors this exclusion and the Chairman recommends elimination of that exclusion as an option.

C. Coating of Steel Products

This process involves plating steel products with zinc or other base metals. Most members consider this process to confer origin, so that hot-rolled steel products produced in one country and coated in a second country would be considered to originate in the second country. Those countries argue that: (1) coating the steel requires a multi-stage process consisting of pre-treatment, coating, baking and post-treatment; (2) the coated steel is considered a new product with special purposes as a result of the coating; and (3) the coating operation almost doubles the value of the uncoated steel products. Opponents of treating coating as origin-conferring argue that: (1) the process is a simple one, involving merely dipping steel in molten material or processing by electrolytic means; (2) the amount of material used in the coating is miniscule; and (3) the process does not meaningfully affect the steel's malleability, tensile strength, or other characteristics or its dimensions.

According to the July 15, 2002 Report of the Chairman (WTO Document G/RO/52), which describes the issues and positions, the U.S. supports both positions. This is consistent with U.S. Customs' positions on the effect on origin of steel coating. U.S. Customs' position is that galvanizing and other coating operations only confer origin if they are combined with heat treatment of the steel in which the steel is heated sufficiently to meaningfully affect the steel's

tensile strength, yield and ductility. Although the U.S. Department of Commerce's origin determinations are often more restrictive than those of U.S. Customs, in at least one case the Department of Commerce determined that galvanizing by itself substantially transformed cold-rolled steel for antidumping and countervailing duty purposes. This determination, which is inconsistent with the Customs position, resulted in inclusion of the galvanized steel in the scope of the investigation because the galvanizing occurred in the country subject to the antidumping and countervailing duty investigation.

D. Roasting of Coffee

This issue, involving processing green coffee beans by heating to produce roasted coffee, illustrates the potential effect of harmonization on other WTO Agreements. Most coffee producing countries argue that roasting coffee beans does not confer origin on the country of roasting, and that the country of origin of roasted coffee beans should be the country where the coffee was grown. These countries argue that the roasting process is a simple process, essentially consisting of heating green beans without adding any substance. According to these countries, the "complex biochemical reactions" responsible for flavor, aroma, bitterness and acidity occur in the country of cultivation.

Countries taking the position that coffee roasting confers origin on the country where the coffee beans are roasted include the U.S., Japan, and Canada. These countries argue that coffee must be roasted for use and that the aroma and flavor result from the roasting process.

The U.S. cites this issue as an example of the effect of application of the harmonized rules of origin to other WTO Agreements. The U.S. notes that the TRIPS Agreement provides for protection of "geographical indications" (GIs), indications identifying a good as originating in the territory of a member. The commercial trademark "100% Columbian Coffee" is such a GI. If the rules of origin apply for purposes of the TRIPS Agreement and the origin of coffee is the country where coffee beans are roasted, the U.S. questions whether the GI "100% Columbian Coffee" could be placed on the label of Columbian coffee roasted in another country.

OUTLOOK

Harmonization of non-preferential rules of origin is a laudable goal. It will give predictability to origin determinations and thus make planning of global manufacturing operations more effective. The current system is arbitrary and unpredictable, as illustrated by the differences between agencies within the U.S. Government over the origin of galvanized steel.

However, most observers are pessimistic about achievement of harmonization for all non-preferential purposes in the near future and certainly by the latest deadline of the end of 2002, as extended at the Doha Ministerial. Developing countries are impatient with the current lack of progress. The U.S. says it remains committed to harmonization of rules of origin. Developing countries question that commitment, particularly in regard to the position of the U.S. and some other developed countries on the "core policy issue" regarding the purposes to which the harmonized rules of origin should apply – namely to trade remedies. Opponents of the U.S.

position argue that the U.S. would make application of the harmonized rules optional for each member.

Nevertheless, the CRO has achieved a great deal in the past seven years, and has reached consensus on more than 350 very contentious, complicated origin issues. Unfortunately, the remaining issues are those on which agreement could not be reached; *i.e.*, they are even more contentious. In addition, the division between the EU, on the one hand, and the U.S. and most other countries, on the other hand, over use of tariff shift rules or value-added as the basic origin determining mechanism remains. The inability of member countries to agree on the very basic issue of the effect of the rules of origin, and the split over this issue between developing and developed countries, makes early harmonization doubtful. Thus, harmonization of the rules of origin remains unlikely for the foreseeable future – and the deadline will likely be extended yet again.

WTO Market Access Negotiations on Industrial Goods Launched

SUMMARY

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ANALYSIS

I. WTO Members Set Timeframe for Modalities; Launch Negotiations

A. Deadlock on Modalities Resolved

WTO Members on July 18, 2002 ended the impasse over the timeframe for negotiations on market access for non-agricultural, industrial goods by agreeing to set modalities by May 31, 2003. The debate over negotiating timeframes prevented substantive discussions on industrial goods and was finally overcome by senior officials attending the second meeting of the Trade Negotiations Committee ("TNC"). Negotiators can now proceed with work on tariff liberalization on industrial goods, including tariff peaks, tariff escalation, non-tariff barriers and special attention (including non-reciprocal access) to developing country priorities.

Swiss ambassador Pierre-Louis Girard, Chair of the Negotiating Group on Market Access, had originally proposed to hold four negotiating sessions over the next year in order to establish modalities by March 31, 2003 – which coincides with important deadline for negotiations on agriculture and services. Most developed country Members and especially the EC (which sought a single negotiating deadline for all sectors due to sensitivities in its agricultural sector) supported an earlier deadline. Several key developing Members including India and China, however, sought a much later deadline (even end-2003) as they felt pressured into reaching early decisions.

The first formal meeting of the Negotiating Group on Market Access was scheduled for July 11-12, 2002, but was cancelled pending a resolution of the deadline for establishing modalities. Members then left the decision up to senior officials visiting from capitals for the second meeting of the Trade Negotiations Committee ("TNC") on July 18-19. At the TNC meeting, the senior officials finally reached a compromise date of May 31, 2002. In a gesture to the EC, Members agreed to a two-stage deadline of reaching a "common understanding on the possible outline on modalities" by the end of March 2003 "with a view to reaching an agreement on modalities by May 31, 2002." In addition, the EC and others pressured Members to launch

substantive negotiations immediately, which led to the convening on August 2 of the previously postponed first meeting of the Negotiating Group on Market Access.

B. Negotiations Launched at August 2 Meeting

The WTO Negotiating Group on Market Access met on August 2, 2002 for the first time after being postponed from July 11-12, and after a painfully-negotiated agreement reached on July 18-19, of its work programme for the remainder of this year. Having settled, at least temporarily, the issue of the date by which modalities for the negotiations should be agreed, delegates were able for the first time to discuss more substantive issues raised in papers submitted to the Group by the EU, US, Korea, Japan, and New Zealand. Discussion of substantive issues will continue at the next meeting, on September 12-13, and at the meeting of December 2-3. The Group will also meet from November 4-6 to discuss again the modalities for the negotiations on tariffs and non-tariff barriers.

II. Submissions and Interventions by WTO Members

The submissions by the EC, US, Japan, Korea and New Zealand were general statements of opening positions on the negotiations as a whole; those of the EU and Japan being considerably more substantive.

A. EC Submission

The EC proposal (TN/MA/W/1) stressed in particular its readiness to commit to ambitious targets for reduction and elimination of tariffs and non-tariff barriers ("NTBs") if others would also make truly meaningful commitments. The EC proposed as a target the complete elimination of tariffs for selected products or sectors, while recognizing that developing and especially least-developed countries might not be able to go so far.

Regarding the modality for tariff negotiations, the EC suggested that a formula approach (similar to its approach in the Uruguay Round) would be best suited to achieve comprehensive reductions, and that there could be deeper than average cuts for some product groups, such as environmental goods. However, the EC's suggestion that environmental goods might include those whose sustainable materials or production characteristics were environmentally beneficial gave rise to controversy; it was attacked by some developing countries as introducing the possibility of discrimination between goods on the basis of production and process methods, which have long been a contentious issue.

Controversy also arose over a statement by the EC that the negotiations were not confined to barriers to North-South trade; liberalization of South-South trade flows was equally important. This was seen by some delegations as pointing towards differentiation between developing countries, particularly since the EC had mentioned with approval the levels of tariff commitments assumed by recently acceding countries. The EC promised to submit further proposals concerning all aspects of the negotiations.

B. U.S. Submissions

The US has made two submissions: (i) negotiation on environmental goods (TN/MA/W/3 which was described in our July report); and (ii) on the need for comprehensive tariff and trade data as a basis for the negotiations (TN/MA/W/2).

Regarding the U.S. paper on environmental goods, the US challenges the EC's proposal on the similar topic and seeks to clarify the definition on the characteristics of the product. For example, negotiations should establish a list of goods whose end-use is beneficial to the environment, such as solar power equipment.

The US questions whether processes and production methods should shape the definition of environmental goods as it could vary greatly due to Member's own environmental conditions, priorities, and values. The US and many developing countries believe that criteria based on process and production methods have the potential to establish new standards and customs classifications that could result in disguised restrictions on trade. The US also proposed that Members establish a mechanism for dealing with NTBs for environmental goods, including through bilateral negotiations.

Regarding the U.S. proposal on trade data, the US proposes that the Negotiating Group should set a deadline for submission of common trade data for the most recent period, e.g., for the year 2000, to include bound and applied tariff rate in addition to import data. The US asserts that updated data is necessary for governments to assess their interests, opportunities and priorities in negotiations.

The US also pointed out that although tariff schedules and trade data had been collected from many Members as part of their Trade Policy Review, some had failed to authorize the transfer of this material to the WTO's Integrated Database, which is the basis for the tariffs negotiations, despite requests to do so. The Chair should work with these Members to secure the transfer. Members should also agree to provide legal authorization for other organizations to release data to the WTO where it is available.

The US has yet to submit a proposal on modalities and is still working with U.S. industry groups in this regard, according to Deputy U.S. Trade Representative Peter Allgeier who attended the July TNC meeting.

C. Japan's Submission

Japan recently submitted its first paper on market access negotiations and asserted it is ready to engage actively in these negotiations.[3] Japan's proposal suggested the adoption of target tariff rates which would take into account Members' levels of development and their current trade-waited average tariff rate – pointing out that the Uruguay Round had produced a wide disparity of tariffs among Members. The proposal suggests that there would be differentiation

[3] Market Access for Non-Agricultural Products, Contribution Paper from Japan, TN/MA/W/5. 5 August 2002.

between developing and least-developed countries in setting target tariff rates. Japan will submit a proposal later including on setting variables relating to a certain targeted tariff rates.

Japan, like the EC, supported reduction of tariff peaks and high tariffs, but on tariff escalation said only that it "would be subject to consultation." Japan also envisaged combining the "zero-for-zero" and harmonization approaches used in the Uruguay Round (e.g. formula approach) in combination with the target tariff rate approach. Also, regarding modalities, Japan supports a formula approach due to the short time frame for negotiations.

Japan encouraged the following liberalization initiatives:

- Increase the number of participants in the ITA with a view to expanding trade in information communication products. Inclusion of digital home appliance products and globalized industries including the automotive sector;

- Increase the number of participants and harmonized tariff rates for chemical products;

- "Zero-for-Zero" approach for the following products on which adequate discussions were not held during the Uruguay Round: consumer electric products, bicycles, rubber and articles thereof, glass and articles thereof, ceramic products, cameras, watches, toys; and

- "Harmonization" approach for textiles and clothing sectors.

Regarding NTBs, Japan believes it is necessary to take up not only border measures on the importing side but also trade distorting measures on the exporting side such as export duties and export restrictions.

Regarding implementation periods for tariff reductions, Japan believes in principle the staging could be for five years "at the longest" if the period commences in January 2005. Consideration should be accorded to developing and least developed Members circumstances. In addition, GSP schemes could be reviewed taking into account the competitiveness of the products and improving the market access for LDC's products.

Regarding environmental goods, Japan states that it will participate in work on a list of environmental goods for their improved market access. Japan suggests that special consideration should be given "to the goods which have to be appropriately addressed in terms of global environment issues and the sustainable use of exhaustible natural resources" – which may also imply consideration of process and production methods (as advocated by the EC proposal). Japan intends to submit a more specific proposal at a later date.

D. New Zealand's Submission

New Zealand's submission (TN/MA/W4) dealt with the scope of negotiations of non-tariff barriers, and was well received. It quoted a recent study on the impact on non-tariff

barriers on New Zealand exporters, which had shown that the top seven categories of NTBs, in terms of their damaging impact, were the following:

- Standards and certification;
- Customs procedures;
- Food safety and health requirements;
- Import quotas and import prohibitions;
- Cargo handling and port procedures;
- High internal taxes and charges; and
- Non-scientific basis to quarantine restrictions

New Zealand also pointed out a procedural difficulty in negotiating on such issues – there are existing WTO rules which address many of these barriers, and many are also perfectly legal regulations, notwithstanding their trade impact. New Zealand suggested that a framework will be needed to determine where (in which committees) and how individual NTBs should be dealt with. Some barriers may be addressed in other negotiations under the Doha mandate. Moreover, New Zealand suggested an initial categorization of NTBs under the following headings:

- Issues that might be addressed in negotiations elsewhere under the Doha mandate;
- Issues or proposals involving substantial change to existing WTO agreements;
- Proposals involving clarification of existing rules;
- Issues involving disputed interpretation of rules;
- Issues open to bilateral resolution;
- Products of interests to developing countries;
- Capacity issues;
- Implementation issues; and
- Special and differential provisions

E. Korea's Submission

Korea submitted recently a paper on market access which supports and ambitious and timely elimination of tariffs and NTBs.[4] In general, Korea believes that definitions of the terms "tariff peak, high tariff and tariffs escalation" should be clarified. In particular, it is concerned with how tariff peaks or high tariffs are levied by way of non-*ad valorem* duties.

Regarding modalities, Korea prefers the formula approach as opposed to the request-offer approach (usually supported by the US) – stating that it would be difficult within the proposed time due to the large number of WTO Members. But, Korea is open to the "limited use of the request-offer approach, when necessary."

Regarding NTBs, Korea believes NTBs should be clearly defined and listed while ways to identify individual NTBs should be agreed on at the outset of the negotiations.

F. India's Statement at the August 2 Meeting

India has yet to make a formal substantive proposal to the Negotiating Group, but has been very active in the debate on modalities. At the August 2 meeting, India made preliminary comments on particular aspects of negotiations.

India cited the principle of less than full reciprocity in reduction commitments in the context of developing countries, as enshrined in the Doha mandate. India also referred to the Enabling Clause as laying down the principle that "developed countries do not expect developing countries, in the course of trade negotiations, to make contributions, which are inconsistent with their individual development, financial, and trade needs." India also believes it is too early to decide on modalities such as request-offer or formula approaches.

India also called on the WTO Secretariat to prepare a detailed paper on elements relevant to modalities, including guiding principles, base year, staging of reduction, autonomous liberalization principles, and factoring in special needs of developing countries.

Finally, India was highly critical of what it perceived as efforts by some countries to differentiate between developing countries on special and differential ("S&D") treatment. India believes such distinctions is undesirable would result in "large-scale fragmentation."

OUTLOOK

WTO Members after much contentious debate and delay have now set a date for determining modalities on industrial market access. The May 31, 2003 deadline reflects a reasonable compromise between developed and developing countries – which falls not far after the March 2003 deadlines on agriculture and services negotiations, but should provide adequate time to conclude negotiations on modalities prior to the September Cancun Ministerial.

[4] Market Access for Non-Agricultural Products, Contribution Paper from Korea, TN/MA/W/6. 5 August 2002.

Nevertheless, WTO work on modalities is prone to delays and agreement might not be reached until close to the Ministerial – a strategy favorable to developing countries, but detrimental to the EC in particular.

The recent passage of TPA ("trade promotion authority"/fast track) adds new momentum to negotiations and should expedite more substantive proposals from Members including the US. Industry groups in the US are encouraged by TPA renewal and the launch of industrial market access negotiations, and are stepping up efforts on zero-for-zero tariff liberalization, among other initiatives.

State of Play of TRIPS Negotiations on Compulsory Licensing in the Context of the Doha Declaration on TRIPS and Public Health

SUMMARY

WTO Members are engaged in very active negotiations to make effective the use of compulsory licensing under the TRIPS Agreement by Members with insufficient or no manufacturing capacities in the pharmaceutical sector. Members must reach an agreement on this issue by the end of 2002, as provided for in the Doha Declaration on TRIPS and Public Health.

The discussion over the scope of the solution (i.e. products covered, Members' eligibility) along with the mechanism to be used to implement that solution seem to dominate the debate. There is an emerging consensus among Members that the solution should be expeditious; workable; transparent; sustainable; and legally secure. However, Members are facing difficulties over which of the proposed mechanisms will best meet those requirements.

On the one hand, research-based manufacturing countries such as the US and Switzerland favor a more restrictive approach, trying to ensure stringent safeguards to protect the rights conferred on the patent holder in the exporting country. On the other hand, generic-based manufacturing countries like India and developing countries without pharmaceutical production favor a more flexible solution, not only with regard to the scope of the mechanism but also with regard to the mechanism itself.

This report presents a brief overview of the main proposed mechanisms, highlighting the merits and defects, depending on the standpoint of stakeholders and contenders.

ANALYSIS

On occasion of the Doha Ministerial Meeting, in November 2001, WTO Members instructed the Council for TRIPS to find an "expeditious solution" to the problem identified in Paragraph 6 of the Doha Declaration on TRIPS and Public Health (*i.e.* effective use of compulsory licensing provisions) and to report to the General Council before the end of 2002.[5] Negotiations in the TRIPS Council have been very active during the last months of 2002 in an effort by the Members to meet that ambitious deadline.[6]

I. Contention Over Effective Use of Compulsory Licensing Provisions

Paragraph 6 of the Doha Declaration provides: "We recognize that WTO Members with insufficient or no manufacturing capacities in the pharmaceutical sector could face difficulties in making effective use of compulsory licensing under the TRIPS Agreement."

[5] WT/MIN(01)/DEC/W/2, 14 November 2001.

[6] Two formal meetings have already taken place (March and June 2002) and several informal meetings.

A major limitation in compulsory licensing rules under Article 31 (f) of the TRIPS Agreement is the requirement that a product made under a compulsory license ***be supplied predominantly to the licensee's domestic market***, unless the license was issued to remedy anti-competitive practices (Article 31 (k) of the Agreement).

This means, in practical terms, that Members with large markets (i.e. India, the US, France, etc.) could easily grant compulsory licenses for the supply of patented medicines to meet public health needs. However, a large number of developing and least developed country Members cannot effectively grant such licenses because they lack or have an insufficient capacity to manufacture medicines on their own. At the same time, they cannot import generic medicines manufactured under a compulsory license in another Member, because of the Article 31(f) limitation (i.e. the production must be predominantly for the domestic market).

Developing countries raised this problem in 2001 during the special sessions on TRIPS and Health at the TRIPS Council. In relation to this problem, they argued at that time that "…the reading of Article 31 (f) should confirm that nothing in the TRIPS Agreement will prevent Members from granting compulsory licenses to supply foreign markets."

II. Clarifications on TRIPs and Doha Mandate

It is important to make some clarifications to assess the actual dimension of the problem.

- Many developing countries and least developed countries are not currently bound by the TRIPS Agreement.[7] Therefore, nothing in the TRIPS Agreement prevents those with manufacturing capacity from supplying generic drugs abroad at present.

- In 2005, pharmaceuticals will become subject to patent protection in all developing countries. The combination of a new patent regime for pharmaceuticals and the implementation of Article 31(f) of the TRIPS will modify the parameters of the problem.

- Although Article 31(f) contains in-built flexibility that allows Members to export products under compulsory license, the expression "predominantly" limits the extent of such exports.

- The Doha Round of Negotiations shall be concluded not later than January 1, 2005 and all negotiations, including the TRIPS agenda, will be treated as a "single undertaking."

[7] Developing countries that did not provide patent protection for pharmaceutical products on the date of application of the TRIPS Agreement for the Member (i.e. 2000) were granted an additional 5-year transitional period to apply the provisions on product patents (i.e. 2005). See Article 65:4 of the TRIPS Agreement.

III . Review of Proposals on Compulsory Licensing

Five communications from WTO Members containing proposals on the Paragraph 6 problem are on the table of negotiations of the TRIPS Council.[8] The following solutions have been proposed, so far:

Two Substantive-type Solutions

- An authoritative interpretation based on Article 30 ("Exceptions to Rights Conferred")
- An amendment to Article 31 ("Compulsory Licensing")

Two Procedural-type Solutions

- A waiver for non-compliance with Article 31 (f)
- A dispute settlement moratorium on disputes that could arise as a result of the non-compliance with Article 31(f).

There seems to be an emerging consensus among Members that the solution should meet the following requirements: it should be (i) expeditious; (ii) workable; (iii) transparent; (iv) sustainable; and (v) legally secure. In short, Members will assess each one of the proposals taking into consideration some key issues:

- Whether it is convenient or not to open the TRIPS Agreement to introduce an amendment, with the risk of opening the "Pandora's Box";
- Whether the approach should be flexible or not, with regards to the authorization to export pharmaceutical products manufactured under a compulsory license to Members with insufficient or no manufacturing capacities;
- The difficulties in reaching the necessary consensus or the required majorities in the most expeditious way, depending on the decision-making procedure for the adoption of each one of the possible solutions.
- The economic feasibility of the solution.

[8] At the June 2002 meeting of the TRIPS Council, the following Members submitted proposals: Kenya on behalf of the African Group (IP/C/W/351, 24 June 2002); the EC and its Member States (IP/C/W/352, 20 June 2002); United Arab Emirates (IP/C/W/354, 24 June 2002); Brazil on behalf of a group of developing countries (Bolivia, Brazil, Cuba, China, Dominican Republic, Ecuador, India, Indonesia, Pakistan, Peru, Sri Lanka, Thailand and Venezuela (IP/C/W/355, 24 June 2002); and the US (IP/C/W/358, 9 July 2002).

Each proposed solution has its own merits and defects, depending on the standpoint of the stakeholders and contenders. The moratorium is not seen as a solution *per se*, but as a complementary one. We provide below a quick overview of the three main proposed mechanisms and we highlight some elements that should be taken into account for the adoption of a position with regard to each one of the major proposals.

A. An Authoritative Interpretation of Article 30 of TRIPS

Brazil and a group of developing countries propose to issue an "authoritative interpretation" of Article 30 of TRIPS ("Exceptions to the right conferred") recognizing that WTO Members have the right to authorize third parties to make, sell and export patented pharmaceutical products without the consent of the patent holder to address public health needs in another country. Article 30 provides for certain limitations that the proponents claim to meet (i.e. "limited exception"; "not unreasonably conflict with a normal exploitation of the invention"; "not unreasonably prejudice the legitimate interests of the patent owner").

According to the proponents:

- By withdrawing the solution from the scope of Article 31, which provides for a very high standard for the issuing of compulsory licenses, this exception:
    - Would allow Members to avoid burdensome procedures related to the grant, case-by-case, of compulsory licenses in both the exporting and the importing countries.
    - Would allow the importing country in need of pharmaceutical products to avoid a dependency on the grant of a compulsory licenses in the exporting country;
    - Would avoid the double compensation issue;
    - Could be invoked at any time, and without time limit, by a third party.
- There is no need to open the TRIPS Agreement, and therefore, "Pandora's Box";
- An authoritative interpretation is binding on all Members, as compared to an amendment, which is binding only on those Members accepting it.

However, critics have pointed out, *inter alia*, that Article 30:

- Cannot be interpreted so as to weaken the provisions of Article 31, reducing it to inutility. Moreover, Article 30 was intended to apply to statutory exceptions already provided for in many countries' laws at the time the TRIPS Agreement was negotiated (i.e. prior use rights; non-commercial experimental use; etc).

- The unauthorized manufacture of patented products for export purposes would conflict with the normal exploitation of the patent and would unreasonably prejudice the legitimate rights of the patentee.

- Does not contain stringent safeguards to protect the rights conferred on the patent holder in the exporting country (i.e. no government decision in each case; no requirements for notifying a patent owner of use, for establishing particular terms and conditions, for expiration if circumstances change, or for remuneration to the patent holder).

B. An Amendment to Article 31 of TRIPS

The EC proposes to add a new paragraph to Article 31 (f) which would carve out a clearly circumscribed exception to the restriction imposed by Article 31 (f) with a view to facilitating the use of a patent, under a compulsory license, on a pharmaceutical product needed to address public health problems in another Member.

According to the EC, this solution would go to the root of the problem and would be a straightforward solution within the existing legal framework for the granting of compulsory licenses. The EC aims to strike the right balance between the call for overcoming the restriction by Article 31 (f) and the protection of patent holder's right in the exporting country.

However, critics have pointed out, *inter alia*, that:

- Agreement on an amendment is always very difficult to reach and further delay would be required for Members' formal acceptance.

- There is the risk of opening "Pandora's Box." Many Members may be reluctant to amend any part of the Agreement, because of the risk of stimulating the renegotiation of other provisions.

- Members proposing an authoritative interpretation consider the granting of compulsory licensing cumbersome. Instead, they propose to withdraw the solution from the scope of Article 31 and to place it under Article 30.

- An amendment (the same objection applies for the interpretation) will not deliver the legal certainty or security sought by many Members. The actions of Members that begin production for export, relying on the new legal standard, could still be challenged as being inconsistent with the amendment (or the interpretation).

C. A Waiver for Non-compliance with Article 31 (f)

The US (with the support of Canada, Australia, Korea and New Zealand) proposes to issue "waivers" to those developing country Members having sufficient manufacturing capacity in the pharmaceutical sector to export pharmaceuticals to a developing or least-developed

country that is afflicted by a public health crisis, and that lacks of manufacturing capacities. The EC considers this solution as a complementary one.

The proponent highlights the following advantages:

- A consensus or a large majority is easier to reach in the context of the adoption of a waiver, because it is subject to a later review and possible modification or termination. A waiver, unlike an amendment or an authoritative interpretation, does not permanently alter the balance of rights and obligation of the Members.

- This solution ensures an advance control by Members over the beneficiaries of the waiver. The decision to grant a waiver involves a specific request to the WTO by a Member wishing to be relieved of its obligation under Article 31 (f). Each decision shall state the exceptional circumstances justifying it, the terms and conditions governing it and the date on which the waiver shall terminate. This solution also ensures an annual review and the possibility to modify or terminate the waiver if the circumstances justifying it changed.

- An advance authorization through a waiver forecloses any possible challenge based on the legal provisions that were waived.

However, several Member countries see the waiver as a very restrictive solution, since it ensures a double control (*a priori* and *a posteriori*) over the decision to relieve a Member of its obligations. The Brazilian proposal stresses that "it would be unacceptable to consider safeguards or conditions that in a way would limit either the flexibilities of Members under the TRIPS Agreement or the clarifications established in the Doha Ministerial Declaration on the TRIPS and Public Health."

IV. Other Remaining Cross-cutting Issues

Whatever the legal mechanism the Members eventually agree upon for the implementation of the solution for the Paragraph 6 problem, Members need also negotiate different cross-cutting issues. Members have submitted many proposals regarding:

- The scope of the solution (product coverage);

- Members' eligibility as exporting or importing country;

- Assessment criteria of insufficient manufacturing capacity;

- Transparency and safeguards against trade diversion;

- Involvement of the right holder.

OUTLOOK

The next rounds of negotiations regarding Paragraph 6 on compulsory licensing provisions are set to take place in two formal meetings (September 17-19, 2002 and November 25-28, 2002) and in several informal meetings during the up-coming months. Members seem intransigent for the time being with regard to the major proposals on legal mechanisms and cross-cutting issues.

Thus, it appears unlikely that the TRIPS Council will find an "expeditious" solution before the end of 2002, as it is provided for in the Doha negotiating mandate. If current positions remain unchanged, Members will have to agree on an extension of that deadline. In any case, a final agreement on the Paragraph 6 problem will still be subject to the single-undertaking rule of the Doha mandate – which could mean further delays until the conclusion of the round.

WTO Trade Policy Review Body Conducts Sixth EU Trade Policy Review

SUMMARY

On July 24-26 the World Trade Organization Trade Policy Review (TPR) Body conducted its sixth Trade Policy Review of the EU. The review followed a framework established by a previously prepared report by the WTO Secretariat. This report among other issues raised the following:

(i) Trade liberalization issues

(ii) The status of EU internal integration;

(iii) Preferential access offered to other countries;

(iv) Trade remedy mechanisms used by the EU;

(v) European Company proposals, and

(vi) Protection of Intellectual Property Rights.

We summarize below the key findings of the TPR report on the EU as prepared by the WTO Secretariat.

ANALYSIS

I. Background

Under the WTO Agreements, the WTO TPR body periodically examines and evaluates trade and related policies of all WTO members. The basis for each of these reviews are two documents: (1) a report prepared by the WTO Secretariat, and (2) a policy statement by the WTO member under review -in this case, a policy statement by the European Commission ("the Commission"). These documents are subsequently discussed at the TPR body and are eventually published together with the minutes of the meetings of the TPR Body.

Besides the trade policies of all WTO members, the WTO Agreements provide "significant developments, which may have an impact on the global trading system." These developments are also subject to review and monitoring by the TPR Body. Since the establishment of the WTO in 1995, the TPR body has also monitored services and trade-related aspects of intellectual property rights.

II. WTO Secretariat Report on the EU

On June 26, the WTO Secretariat released its sixth report on the EU TPR. As explained above, this report subsequently served as the primary document for all discussions at the TPR Body. Below we have summarized some of the key findings:

1. The EU has done a lot to liberalize its markets except for textiles and agriculture

The report recognizes the EU's efforts to completely liberalize its markets through "multilateral, regional and bilateral initiatives." At the multilateral level, the report points out the EU's contribution towards the launching of the Doha Development Agenda. At the regional and bilateral level, the report states that during recent years the EU has signed a good deal of new arrangements and has also deepened old agreements as for example, those concluded with EU candidate countries.

The report highlights that there are only two sectors in which the EU is still not willing to liberalize - textiles and agriculture. It states that even though the EU market for non-agricultural products is largely open, the EU has only lifted restrictions on 20 percent of its textile and clothing products over the last ten years. The EU has scheduled to remove restrictions for the remaining 80 percent of imports by the end of 2004.

2. The EU has deepened its internal integration through the Euro

The report further praises the EU for its continuous efforts to complete its internal integration agenda. The report sees most of these efforts in the completion of the Internal Market, reform in the product and capital markets, the introduction of a common European currency "the Euro" and the strict enforcement of EU competition policy. Finally, the report recognizes the EU's success in maintaining strict control on public finances. With regard to the introduction of the Euro, the report points out that the new currency has done a great deal to facilitate "cross-country price comparisons, and thus strengthen the Internal Market." According to the report the Euro has also benefited non-member countries as it ensures lower costs of international transactions.

The report however also notes that progress in other areas of the internal market has been relatively slow and should attract more attention in the near future.

3. The EU extends preferential access to most trading partners

The report notes that the EU gives preferential access to almost all of its trading partners. Thus in 2002 nine of the EU's partners benefited from Most-Favored Nation ("MFN") treatment for all products: Australia; Canada; Chinese Taipei; Hong Kong, China; Japan; Republic of Korea; New Zealand; Singapore; and the United States. A large number of other countries benefited from a "most beneficial treatment" and the General System of Preferences ("GSP".)

The report points out that the overall simple average MFN tariff for 2002 is 6.4 percent. While the simple average applied tariff on non-agricultural products is 4.1 percent, the report shows that the tariff on agricultural products is 16.1 percent - four times bigger than the tariff on non-agricultural products. These high tariffs pertain in particular to processed products under the EU's Common Agricultural Policy ("CAP").

4. The EU is a frequent user of trade remedies

With regard to trade remedies, the Secretariat's report concludes that the after the United States, the EU is the most frequent user of various trade remedies. However, the report also states that although the EU has launched a good deal of antidumping investigation during the last several years, almost 40 percent of all antidumping investigations have resulted with no measures imposed. The report also underscores the recent safeguards investigation on steel initiated by the EU in response to the U.S. Section 201 case. It further points out that the EU continues to use the special safeguard tool under the WTO Agreement on Agriculture to impose "snap-back" tariffs.

The report raises the controversial issue pertaining to the EU's restrictive policy towards imports of genetically modified organisms (GMOs). During recent years, the EU has adopted certain regulations for these products, which constitute a considerable impediment for some of the EU's trading partners. Other WTO members have continuously complained against these rules and have even threatened to challenge this legislation at the WTO. This and other reasons have pushed the EU to consider amendments to these regulations, which would ensure compliance with WTO rules.

5. Proposals for European Companies

Another issues raised in the report surrounds the currently adopted proposal for a European company established in more than one Member State. The new legislation is scheduled to be in place by 2004 and is expected to reduce requirements and other burdensome procedures for companies established in more than one Member State. Under the proposal, foreign companies can also benefit from the new rules under certain conditions. The report points out that so far, the Commission has done a respectable job of enforcing Community antitrust law in addition to national antitrust legislations.

6. Intellectual property protection

With regard to intellectual property protection, the report refers to the recently adopted legislation introducing resale rights for the author of an original work of art, and copyright and other related rights for other cases pertaining to the digital environment. The report states that due to reasons such as translation as well as jurisdiction, Member States have not yet reached an agreement on the EC's proposal for a unitary Community patent.

OUTLOOK

The WTO Secretariat's report and review by Members of EU trade policies represented a fruitful dialogue between the EU and the other WTO members. The review addressed most of the WTO members' concerns about some aspects of EU trade policy such as agriculture, textiles and trade remedies. The review highlighted the strong interdependence between the EU and its trading partners, including the EU's many preferential trading agreements. Finally, many WTO Members realize that the EU is facing a controversial and challenging period in its creation – including greater pressures to liberalize sensitive sectors as part of post-Doha negotiations.

WTO DISPUTE SETTLEMENT

WTO Arbitrator Rules in Favor of EC in FSC Dispute

SUMMARY

After several delays, a WTO arbitration panel on August 30, 2002 consisting of the original panelists,[9] issued an award on the long-standing Foreign Sales Corporation (FSC) dispute between the US and the EU strongly in favor of the EC's claims.[10] In particular, the arbitrators ruled:

- The EC be permitted to retaliate to the amount of USD 4.043 billion - the exact amount requested by the EC.
- Rejected the U.S. argument that EC retaliation be limited strictly to the trade effect of the subsidy.

Once the EC secures authorization from the Dispute Settlement Body ("DSB") to retaliate, it can countermeasures of up to the maximum of USD 4.043 billion annually. The WTO decision is the largest arbitration award in the GATT/WTO's history and has provoked a contentious response from the US, especially among affected U.S. industries. According to the National Foreign Trade Council (NFTC), 3.5 million American jobs depend on the FSC/ETI regime at issue. Significant beneficiaries include Boeing, General Electric, Motorola, Caterpillar, and Cisco Systems.

Nevertheless, both the Clinton and Bush Administrations have urged Congress to bring tax policies in line with WTO rules in order to avoid EU retaliation. Despite the magnitude of possible EU retaliation, it is not in EU interests to provoke yet another trans-Atlantic trade war. The US-EU relationship is already under strain from the U.S. safeguards on steel, U.S. Farm Bill and outstanding U.S. retaliation over the EU's ban on hormone-treated beef. Strong US-EU leadership is essential to the success of post-Doha negotiations, and thus much is at stake over the resolution of the FSC/ETI dispute.

ANALYSIS

I. Background

The dispute over the U.S. FSC regime (and its successor the "ETI") has its origins in 1971 with the Domestic International Sales Corporation (DISC) scheme, which was declared an

[9] Panel Chairman - Crawford Falconer, Panel Members - Didier Chambovey, Seung Wha Chang

[10] United States - Tax Treatment for "Foreign Sales Corporations" ("US - FSC"), Recourse to Arbitration by the United States under Article 22.6 of the *DSU* and Article 4.11 of the *SCM Agreement* - Decision of the Arbitrator WT/DS108/ARB, 30 August 2002

illegal export subsidy by a GATT panel in 1976 (panel ruling adopted in 1981). The US replaced the DISC scheme with the FSC scheme in 1984. At the time the EC contested the legality of the FSC but did not pursue it due to the opening of the Uruguay Round trade negotiations.

A. Original Panel Findings on FSC

The WTO's Dispute Settlement Body (DSB) adopted, on 20 March 2000, the Panel and Appellate Body (AB) Reports in the US-FSC dispute[11]. The DSB found the FSC subsidies to be in violation with the US commitments under the *Agreement on Subsidies and Countervailing Measures* (SCM Agreement) and the *Agreement on Agriculture*. After a request from US (with approval by the EU), the DSB extended the initial deadline for the US to withdraw the FSC subsidies from 12 October 2000 to 1 November 2000[12]. On 15 November 2000, President CLinton signed what the US deemed as a WTO consistent substitute for the FSC into law - "FSC Repeal and Extraterritorial Income Exclusion Act of 2000"[13] ("ETI Act"). The ETI was considered by most as an effort to buy more time for compliance, and not an effective solution to the difficult dispute.

B. Compliance Panel Findings

Just two days after the enactment of the ETI, the EC sought a compliance panel under Article 21.5 of the DSU. Article 21.5 stipulates that, wherever possible, in case of disagreement over compliance, the parties should have recourse to the original panel. The EC claimed that the US had not withdrawn the subsidies pursuant to Article 4.7 of the SCM Agreement, and was still in violation of WTO findings. The EC also requested DSB authorization to apply countermeasures in the amount of US$4.043 billion annually.

The compliance panel, not surprisingly, found the ETI Act to violate the SCM Agreement, the Agreement on Agriculture and Article III:4 of the *GATT 1994*. The Appellate Body upheld these conclusions as expected. The compliance panel and AB reports were formally adopted by the DSB on 29 January 2002.

C. Arbitration Ruling

The 30 August 2002 WTO arbitration decision is based on an understanding on "Agreed Procedures under Articles 21 and 22 of the Dispute Settlement Understanding (DSU) and Article 4 of the SCM Agreement applicable in the follow-up to the United States - Tax Treatment for 'Foreign Sales Corporations' dispute"[14] reached by the parties on 29 September 2000. The arbitration clause was triggered by the EC's original 17 November 2000 request for retaliation.

[11] Panel Report, United States - Tax Treatment for "Foreign Sales Corporations" WT/DS108/R, adopted 20 March 2000 as modified by original Appellate Body Report, WT/DS108/AB/R, DSR 2000:IV, 1677, para. 8.8

[12] WT/DS108/11, 2 October 2000.

[13] United States Public Law 106-519, 114 Stat. 2423 (2000)

[14] WT/DS108/12, 5 October 2000.

The EC had reserved the right to request authorization to suspend concessions pursuant to Article 22.2 of the DSU and seek countermeasures if a "mutually acceptable compensation" was not reached.

The US had at the time indicated it would challenge the EU's estimate of the appropriate level of countermeasures. Thus, the parties submitted the matter to arbitration procedures as set out by Article 22.6 of the DSU. The mandate of the arbitrator is not to examine the nature of the concessions or other obligations to be suspended but chiefly to determine whether the level of such suspension is equivalent to the level of nullification or impairment. The parties also agreed that the course of the arbitration could be interrupted in the event the EC requested a compliance panel. The compliance panel and AB reports were adopted on 29 January 2002, and thus triggered the arbitration proceedings.

The US had argued that the level of the 'trade effects' of the prohibited subsidy be indicative of the scope and nature of the punitive countermeasures. Citing the term "appropriate countermeasures" in SCM Agreement Article 4.10, the US rested on a footnote in that same article that states (SCM Agreement Footnote 9): "This expression [appropriate countermeasures] is not meant to allow countermeasures that are disproportionate in light of the fact that the subsidies dealt with under these provisions are prohibited." In particular, US asserted that the effects of the FSC export subsidy were not felt, in their entirety, by the EC. Specifically, the US valued the EC's share of the total trade effects of FSC as being 26.9 percent, and thus valued at $1.1 billion[15] and that the $4 billion retaliation ceiling was disproportionate to the trade effects felt by the EC.[16]

The WTO arbitrator questioned the U.S. argument of unhinging the trade effects of the subsidy from its dollar value and ruled in favor of the EC's argument that damages be set at the actual amount of the subsidy – US$4.043 billion annually. The arbitrator reasoned, "…each dollar is, as it were, as much a breach of the obligations of the United States as any other. Certain dollars do not become any less so - or effectively "quarantined" from their legal status of breach of an obligation - by virtue of some other criteria (such as trade effects)… It [the illegal subsidy] cannot be considered "allocatable" across the Membership."[17]

II. EC Response: No Immediate Retaliation Anticipated

Although the WTO arbitration ruling greatly stengthens the EC's hand, it is unlikely that the EC will seek immediate retaliation due to the substantial effect that retaliation would have on

[15] US Exhibit 17, as referred to in United States - Tax Treatment for "Foreign Sales Corporations" - Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement, Decision of the Arbitrator WT/DS108/ARB 30 August 2002 Para. 3.1

[16] The US went so far as to suggest that, due to the circumstances of the case, the arbitrators not use any economic modeling.

[17] United States - Tax Treatment for "Foreign Sales Corporations" - Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement, Decision of the Arbitrator WT/DS108/ARB 30 August 2002 Para. 6.10

trans-Atlantic trade, among other issues. The ruling presents the EC with a significant bargaining chip, and could influence U.S. strategies in regards to other trade relations and disputes with the EC.

In order to pursue retaliation, the EC must first secure the WTO DSB formal authorization. DSB authorization is considered a matter of procedural formality. Even with DSB authorization, the EC will likely withhold from retaliation until bilateral solutions are exhausted. The EC response will likely hinge on progress by the U.S. Administration and Congress in repealing the ETI entirely, or modifying U.S. tax laws to remove the subsidy granted by the ETI. Thus, the final timetable for complying with the WTO ruling may overlap closely with the Congressional schedule. U.S. compliance efforts could be hindered after the adjournment of Congress in October 2002 since Congressional elections are scheduled for November 2002.

The EC is also not keen to retaliate since U.S.-EU trade would be negatively affected. U.S.-EU trade is vastly integrated - over half the trade is between transnational affiliates. Also, the EC will require support from its Member States in order to impose punitive tariffs. This support may prove difficult if the retaliation directly affects companies and industries within various Member States. A viable option for the EC could be the threat of limited and targeted retaliation of less than $4 billion. Such a retaliatory tariff-heading list will be easier for the EC to come up with domestically, and will make a point without unduly upsetting transatlantic economic relations.

III. U.S. Responses: No Surprises, But a Difficult Task Ahead

The initial response from the U.S. Administration and Congress has been remarkably tempered, and an indication that the ruling does not come as a surprise despite the magnitude of its implications. The ruling has been a long time coming after nearly three years and many efforts at seeking a resolution, both at the WTO and through bilateral discussions. Also, a strong reaction from the U.S. Congress could reinforce the EC's political victory.

Nevertheless, Congress will have a difficult task ahead in complying with an international ruling which has considerable implications for the ever sensitive issue of domestic taxation. House Ways & Means Committee Chairman Bill Thomas (R-CA) is eager to use the WTO arbitrator's ruling to repeal the ETI and seek broader reform of U.S. tax laws. Thomas also appears open to tax derogations for a limited number of companies. Nevertheless, Thomas' plan has met with criticism even from within Republican ranks. Both Democrats and Republicans who have constituents that benefit from the tax regime are not keen on forsaking these interests, particularly in an election year.

OUTLOOK

As a result of the WTO arbitrator's substantial award in the FSC/ETI dispute, the EC will likely proceed with requesting DSB authorization to suspend concessions, but is not likely to seek immediate retaliation nor for the full damages of up to $4 billion annually. EC retaliation

will be tempered by broader implications of the dispute to trans-Atlantic trade and the overall U.S.-EU trading relationship.

The EC must also determine a detailed list of products subject to retaliation – drawing upon the original indicative list submitted in November 2000, which could prove a lengthy and difficult exercise. The indicative list of November 2000 named broadly 95 sectors, ranging from live animals to toys, but did not provide product-specific subheadings. The EC will consult European industry for up to 60 days before submitting a definitive list to the WTO for approval. Still, the EC can impose countermeasures anytime after final DSB authorization has been granted.

Transatlantic trade relations, already shaky following the imposition of US steel tariffs, would come under further strain if the EC were to retaliate. Another contentious dispute between the US and EC could undermine efforts to conclude successfully the new round of trade negotiations launched at Doha.

Nevertheless, the EC will hinge its reaction on U.S. progress in compliance and thus attention is shifted back to Congressional efforts to reform domestic tax legislation. In this regard, the aftermath of September 11 events and U.S. corporate corruption scandals has had unintended effects in the EC's favor – U.S. public opinion has turned against perceived unpatriotic and unaccountable offshore corporations and tax havens.

WTO Panel Finds Against U.S. Antidumping and Countervailing Measures on Steel Plate from India; Upholds U.S. Law

SUMMARY

A World Trade Organization (WTO) dispute settlement panel validated U.S. law but held in favor of India on key issues in a recent dispute with the United States involving imports of steel plate. The dispute concerned the U.S. imposition of antidumping measures on imports of certain cut-to-length carbon steel plate ("steel plate") from India. The U.S. Department of Commerce (DOC) initiated the antidumping ("AD") duty investigation on March 8, 1999 and issued a final determination of dumped sales on February 10, 2000, with a margin of 72.49 percent for the sole Indian respondent - the Steel Authority of India, Ltd. ("SAIL").

India challenged the AD order issued by the DOC under the WTO AD Agreement Articles 2.2, 2.4, 6.8, 9.3, 15 and Annex II paragraphs 3, 5, and 7 as well as GATT Articles VI:1 and VI:2. This report focuses on the substantive issues reviewed by the Panel under Articles 6.8 and Annex II(3) and (5) as well as Article 15. The report also briefly discusses the procedural complaint of India relating to the U.S. practice in the application of facts available.

The panel concluded that the U.S. measure was imposed inconsistently with certain provisions of the AD Agreement. In particular, the US violated Article 6.8 and Annex II(3) in finding that SAIL had failed to provide necessary information, thus basing its determination entirely on facts available.

The panel also rejected several Indian claims. In particular, the Panel concluded that Sections 776(a), 782(d) and 782(e) of the U.S. statute were not facially inconsistent with Article 6.8 and Annex II(3) of the AD Agreement.

ANALYSIS

In *United States-Anti-Dumping and Countervailing Measures on Steel Plate from India ("Indian Steel Plate"),* the WTO Dispute Settlement Panel found that the US violated Article 6.8 and Annex II(3) when it found that SAIL had failed to provide necessary information and imposed an AD order based entirely on facts available. In contrast however, the Panel found that U.S. law did not violate the 'face value' of the AD agreement.

I. AD Agreement Article 6.8 and Annex II(3)

Although acknowledging that some information had not been provided to the DOC, India argued that the DOC should have accepted SAIL's U.S. sales price information because the information fully satisfied the requirements of Annex II(3). The DOC had rejected the U.S. sales information finding that "SAIL's data on the whole" was unreliable due to errors with the information as well as other "pervasive flaws in SAIL's data."

In finding a violation of Article 6.8 and Annex II(3) the Panel stated that Annex II guides the question of whether necessary information has been provided. Thus, if the provisions of

Annex II are applied and satisfied with respect to any information, then the investigating authority must use that information in its determination and may not resort to use of facts available with respect to that information. In sum, the Panel found that the provisions of Annex II are mandatory.

However, the Panel also stated that their finding did not require that "every element of information submitted which satisfies the criteria set out therein must be considered by the investigating authority when making its determinations." Yet, the Panel continued, for all information for which the investigating authority is not satisfied, it must determine if the information satisfies the criteria set out in Annex II(3). The Panel itself evaluated the U.S. Sales data provided by India and found that the information satisfied all four criteria of Annex II(3).

The Panel then rejected India's argument regarding Annex II(5). To India, Annex II(5) requires that the investigating authorities make "more concerted efforts" to use information even if it fails the disciplines of paragraph (3) if the respondent-country acted to the best of its ability in submitting that information. In rejecting India's argument, the Panel stated that investigations must be "based to the extent possible on facts" and India's approach would undermine this goal.

Finally, the Panel concluded that U.S. law was not facially violative of the WTO AD Agreement. India argued that Sections 776(a), 782(d) and 782(e) of the U.S. statute were facially violative of Article 6.8 and Annex II(3) of the AD Agreement in that they required the DOC to resort to total facts available. In its evaluation of the U.S. laws at issue, the Panel concluded that Section 776(a) was facially consistent with the AD Agreement and that Sections 782(d) and (e) were discretionary and did not require the DOC to resort facts available.

II. Article 15 of AD Agreement on Developing Countries

India argued that the United States had violated Article 15 of the AD Agreement contending that the US violated Article 15 by failing to give "special regard" to India's status as a developing country as well as by failing to explore the possibilities of "constructive remedies" before applying the duties.

The Panel noted India's acknowledgement that "there are no specific legal requirements for specific action set out in the first sentence of Article 15." Furthermore, the Panel disagreed with India's view that "this mandatory provision does create a general obligation, the precise parameters of which are to be determined based on the facts and circumstances of the particular case." Thus, the Panel concluded that the first sentence of Article 15 imposed "no specific or general obligation" on Members to undertake any particular action.

Moreover, referring to the panel report in *EC-Bed Linen*, the Panel stated that Article 15, second sentence does not impose any obligation to consider different choices of methodology for the investigation and calculation of antidumping margins where developing country Members are involved. The Panel then considered whether the United States had met the requirement that it "explore" "constructive remedies." The Panel again referred to *EC-Bed Linen* and stated that "explore" means to "investigate," "examine," or "scrutinize." Thus, the concept of "explore," to the Panel could not be understood to require any particular "outcome…" Thus, to the Panel, by

exploring the possibility of a suspension agreement, the US had met the requirement of exploring constructive remedies.

III. U.S. Practice in the Application of Facts Available

India claimed that U.S. "practice" in the application of facts available violated U.S. obligations under the WTO. The Panel disagreed. The Panel concluded that the U.S. practice concerning the application of total facts available is not a separate measure that can independently give rise to a WTO violation. Specifically, the Panel concluded that a "practice" was not within the scope of Article 18.4 that refers to "laws, regulations and administrative procedures" as measures that may be challenged. Moreover, prior WTO panels have found that statutes can only be challenged if they mandate a violation. To the Panel, a "practice" would not qualify because a "practice" is not mandatory given that administering authorities may change its "practice" if a rationale is provided for the change.

WTO APPOINTMENTS

Change of Regime at the WTO: Dr. Supachai and Deputies to Take Office

SUMMARY

On September 1, 2002, Dr Supachai Panitchpakdi, the former Deputy Prime Minister and Minister of Commerce of Thailand, assumed his functions as Director-General of the World Trade Organization, replacing Mr. Mike Moore of New Zealand. Following the precedent established at the time of Mr. Moore's appointment in 1999, the rest of the senior management of the WTO will also change; Dr. Supachai has announced his appointment of four new Deputy Directors-General, who will replace the existing team on October 1, 2002.

ANALYSIS

On September 1, 2002, Dr Supachai Panitchpakdi, the former Deputy Prime Minister of Thailand, assumed his functions as Director-General of the World Trade Organization, replacing Mr. Mike Moore of New Zealand. The rest of the senior management of the WTO will also change; Dr. Supachai has announced his appointment of four new Deputy Directors-General, who will replace the existing team on October 1, 2002.

The outgoing Deputies are Mr. Ablassé Ouedraogo, Mr. Paul-Henri Ravier, France, Mr. Miguel Rodriguez Mendoza of Venezuela and Mr. Andrew Stoler of the USA. The four new Deputies are: Mr. Roderick Abbott (UK), Dr. Kipkorir Aly Azad Rana (Kenya), Mr. Francisco Thompson-Flôres (Brazil) and Mr. Rufus H. Yerxa (USA). The four new DDGs will constitute a strong management team around the DG. All four have long experience as trade negotiators and three have served as Ambassadors in Geneva.

- **Roderick Abbott** was EU Ambassador in Geneva from 1996 to 2000 and since then has been Deputy Director-General of DG Trade in the European Commission. He has been directly involved in negotiations in the GATT and the WTO for over 30 years, first on behalf of the UK and since 1973 on behalf of the European Communities.

- **Kipkorir Aly Azad Rana** was Kenya's Ambassador in Geneva from 1998 to 2000, following appointments as Deputy Head of Mission in Tokyo and New York. He has represented Kenya at many international conferences and in recent years has been intensively involved in trade issues, notably as coordinator of African delegations to the WTO and as Senior Trade Policy Advisor to the Minister for Trade and Industry.

- **Francisco Thompson-Flôres** is currently Brazil's Ambassador to Uruguay. He has also served as Ambassador in Buenos Aires and Bonn, and to Holy See, in addition to diplomatic postings in London, Brussels and Washington. He too has long experience as a trade negotiator, notably on agricultural issues and in the negotiation of the Mercosur Agreement.

- **Rufus Yerxa** was US Ambassador to the GATT from 1989 to 1993, and the senior Deputy United States Trade Representative in Washington from 1993 to 1995. He had long previous experience of international trade issues as Staff Director of the Trade Sub-Committee of the Committee on Ways and Means, US House of Representatives. Since 1995 he has practiced law, first for a major US law firm and since 1998 for Monsanto Company.

OUTLOOK

It is perhaps unfortunate that the whole of the senior management of the WTO including the Director-General and Deputy Director-Generals should change in this way after only three years; the loss of continuity and of accumulated experience is very evident. However, the general reaction of Geneva Delegations to Dr. Supachai's appointments has been very positive, in recognition of the high quality of the people he has selected. In particular, Supachai's appointment of Stuart Harbinson, the former Ambassador of Hong-Kong and Chairman of the General Council as Director of the Director-General's Office, is considered a wise choice. Moreover, many Geneva delegations are encouraged by the start of Dr. Supachai's term – he is the first ever to head the GATT/WTO from a developing country – as many Members supported his candidacy originally. There is also a faction of Members that welcome a change in leadership after Michael Moore's three volatile years as Director-General – which were marked by both failure at Seattle and success in Doha.

REGIONAL TRADE AGREEMENTS

EC Proposes List of Issues to Discuss in Relation to Regional Trade Agreements; Australia Submits Concrete Proposal on Article XXIV of GATT94

SUMMARY

The European Communities (EC) and Australia recently submitted communications on regional trade agreements (RTAs) in the context of the WTO Doha Round of Multilateral Negotiations.

In their respective submissions, both the EC and Australia highlight the need to clarify the WTO legal framework of RTAs. However, while the EC's proposal focuses on the issues that should be discussed during the negotiations (i.e. substantive and procedural issues), Australia has put forward a concrete proposal on one of the outstanding issues related to RTAs (i.e. the clarification of "substantially all trade in Article XXIV:8 of GATT 94).

ANALYSIS

During the last meeting of the WTO Negotiating Group on Rules (July 8-10, 2002), the European Communities (EC) and Australia submitted communications on regional trade agreements (RTAs).

In the context of the WTO Doha Round of Multilateral Negotiations, Members agreed to hold "[…] *negotiations aimed at clarifying and improving disciplines and procedures under the existing WTO provisions applying to regional trade agreements. The negotiations shall take into account the developmental aspects of regional trade agreements."*[18]

The EC and Australia recall, in their respective submissions, that as a result of a large number of long-standing differences of interpretation associated with WTO rules on regional trade agreements, in particular Article XXIV of GATT94, GATT Contracting Parties and now WTO Members could only in very rare cases reach consensus on the conformity or otherwise of a particular RTA with GATT or WTO requirements.

We summarize below the main aspects of both submissions:

I. Submission by the European Communities and their Member States[19]

The EC submission provides for an "initial list" of issues that "merit discussion and analysis during the course of negotiations," in relation to Article XXIV of GATT 94, the 1979 Enabling Clause and Article V of GATS. This non-exhaustive list of issues includes, *inter alia*:

[18] Par. 29 Doha Ministerial Declaration.

[19] TN/RL/W/14, 9 July 2002.

A. Issues related to substantive aspects of the legal framework applicable to RTAs

a. The definition of key terms in Article XXIV of GATT94 (i.e. "substantially all the trade"; "regulations of commerce"; "restrictive regulations of commerce"; "applicable duties" and "major sector");

b. The treatment of non-tariff measures in trade between RTA partners, including rules of origin;

c. The relationship between the provisions of the Enabling Clause and Article XXIV;

d. The clarification of key concepts for the application of Article V of the GATS (i.e. "substantial sectoral coverage" and "substantially all discrimination"); and the definition of the "reasonable time frame" for the implementation of economic integration agreements;

e. The appropriate combination of elimination of discriminatory measures (roll-back) and prohibition of new or more discriminatory measures (standstill) in order to achieve the absence or elimination of substantially all discrimination (Article V:1(b)(i) and (ii);

f. The appropriate methodology to ensure that the overall level of barriers and restrictions to trade in services with respect to third parties is not raised in the creation or enlargement of economic integration agreements;

g. The examination of the extent to which WTO rules already take into account discrepancies in development levels between RTA parties.

B. Issues related to procedural aspects of the examination of RTAs in WTO bodies

With regard to the "development dimension" of RTAs of the Doha mandate, the EC also stresses the need for the Negotiating Group on Rules. This is to welcome any input to the discussions and eventual decisions relating to this issue from the WTO Committee on Trade and Development and the General Council (in charge of the work program on Small Economies).

The EC will come forward with further proposals and ideas as the negotiations progress.

II. Submission by Australia[20]

Australia has submitted a concrete proposal for the clarification of "substantially all the trade" (Article XXIV:8).

[20] TN/RL/W/15, 9 July 2002.

Article XXIV:8 of GATT94 requires that parties to a "custom union" or a "free trade area" must eliminate duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) with respect to "*substantially all the trade*" between the constituent territories in products originating in such territories. However, Members have never reached consensus on the interpretation of "substantially all the trade," a key term for examining the WTO-conformity of regional trade agreements.

A. The Proposal

- Australia rejects the criterion based on "the use of actual and potential trade flows." According to Australia, simply looking at trade flows does not take account of the dynamics at work before the conclusion of an arrangement, its implementation, and the situation prevailing once it has been fully implemented.

- "Substantially all the trade" should be defined in terms of coverage by a free trade agreement, or an agreement establishing a customs union, of a defined percentage of all the six-digit lines in the Harmonized System.

  Australia considers that this criterion should be established at a sufficiently high level to prevent the carving-out of any major sector, in terms of its near-complete exclusion of coverage.

- Particular attention would have to be given to the definition of what is covered by an agreement. According to Australia, coverage would have to be understood to mean that there are no tariffs or non-tariff measures in that product affecting the trade of products originating from Members, or that such measures would be eliminated during the agreed implementation timeframe.

B. Benefits of the Proposed Criterion

- Ensures sufficient flexibility to set aside product areas that for one reason or another cannot yet be traded between the partners free of restrictions.

- Allows also for a workable definition, easily verifiable without requiring complex econometric work.

- Allows assessment of the coverage of measures leading to the formation of an FTA or customs union over a number of years.

Japan-Mexico Joint Group Releases Final Report on FTA Feasibility

SUMMARY

The Japan-Mexico Joint Group recently released a final report on a feasibility study regarding the potential benefits of an FTA between Mexico and Japan. The report includes the following issues:

- ***General Overview:*** Japan and Mexico are complementary economies and would benefit from a bilateral FTA.

- ***Trade and Investment Liberalization:*** Regarding trade in goods, Japanese representatives within the joint group highlighted some concerns about some Mexican customs procedures such as high import duties, PROSEC, *Regla Octava,* and the Automatic Importation Notice System. On their part, Mexican representatives expressed their concern about the uncertainty of the Japanese Generalized System of Preferences (GSP) program. The joint group agreed that a future FTA should also include provisions on investment and trade in services, government procurement, and trade remedies.

- ***Bilateral Cooperation and Dispute Resolution:*** The FTA negotiations shall include bilateral cooperation mechanisms on various issues such as customs procedures, technical standards, antitrust, intellectual property, business environment, as well as a dispute settlement mechanism.

According to some prominent Mexican government officials, negotiations could start by late October 2002 and possibly conclude by October 2003.

ANALYSIS

Recently, the Mexican Ministry of Economy released the final report by the Mexico-Japan Joint Group, which analyzes the feasibility of a bilateral free trade agreement (FTA) between the two countries. The joint group presented its final report after concluding the seventh and final meeting in July. The joint group concluded that Japan and Mexico would benefit from an FTA. The two countries could formally launch negotiations by October 26-27, 2002 during the Asia Pacific Economic Cooperation (APEC) forum in Los Cabos, Mexico, and possibly conclude negotiations by October 2003 during the APEC forum in Thailand *(Please see W&C July monthly report).*

The final report of the joint group contains the following three parts: (i) general overview, (ii) trade and investment liberalization, and (iii) bilateral cooperation and dispute resolution.

I. General Overview

The report asserts that Japan and Mexico are complementary economies and that strengthening bilateral trade and investment relations should boost their respective economies.

Despite this fact, neither Japan nor Mexico has taken the lead to reap any potential benefits from the bilateral relationship. For instance, Japan's percentage in the total value of Mexican imports decreased from 6.1 percent in 1994 to 4.8 percent in 2001. In the same manner, the value of Mexican exports to Japan as percentage of Mexican total exports decreased from 1.6 percent in 1994 to 0.3 percent in 2001.

In addition, Japan's level of foreign direct investment (FDI) into Mexico only reached 3.3 percent from 1994 to 2001, while FDI from the United States reached 67.3 percent and that from the EU reached 18.6 percent during the same period.

The report notes that an FTA with Mexico is relevant to Japan for the following reasons:

- Mexico is one of the primary economies in Latin America and holds strategic importance as a gateway to North America, Latin America and Europe through its 32 FTAs. Mexico's FTA network would contribute to international development and improvement in managing supply chains for Japanese companies.

- Currently, Japanese companies face disadvantages, compared with those companies from countries having an FTA with Mexico, regarding preferential import duties, trade in services, investment, and government procurement.

In the same manner, the report notes that an FTA with Japan is relevant to Mexico for the following reasons:

- Japan is a very important source of FDI and technology and a large market for Mexican exports.

- An FTA with Japan would allow Mexico to continue its export diversification policy.

II. Trade and Investment Liberalization

A. Trade in Goods

Representatives from Japan within the joint group highlighted the following concerns regarding trade in goods:

- Mexican import duties are, in general, higher than those of other countries with a similar economic development level.[21] Also, Mexico is not a Party of the Information Technology Agreement (ITA), whose goal is to reduce import duties on information technology products. Furthermore, Japan faces a disadvantage regarding import duties compared with the NAFTA and the EU-

[21] The average bound rate of Mexico is 36.24 percent and the average applied rate is 16.23 percent. The average bound rate of Japan is 8.7 percent and the average applied rate is 8.1 percent.

Mexico FTA Partners. Some of the most affected sectors for these developments include electric equipment and inputs, inputs for electricity generation plants, and vehicles. Continuing amendments of Mexican import duties have resulted in reduced transparency and certainty in the business environment.

- Mexican Sector Promotion Programs (PROSEC) are only applicable to inputs and not to final products, while the scope and amount of import duty reductions under such PROSEC is not sufficient. PROSEC amendments are relatively easy and consequently, changes in the scope of PROSEC could have negative effects on the production costs of Japanese companies.

- The *Regla Octava* used for allowing imports under preferential duties such as PROSEC, has rigid procedures for receiving extensions every six months. Furthermore, the lack of certainty for renewing *Regla Octava* could create costs for companies.

- The Automatic Importation Notice (*Aviso Automático de Importación*) is a system designed to ensure that imports are being conducted at correct market prices. This system includes high reference prices for some products and as a result, Japanese companies importing such products must make a deposit, which Mexican authorities hold for a three-month period. This deposit corresponds to the difference between product prices and reference prices.

Representatives from Mexico highlighted the following concerns regarding trade in goods:

- Lack of certainty in the Japanese GSP program. Through GSP Japan grants preferential import duties to developing countries, including Mexico. Japan's GSP is suspended if the imports of certain products exceed a specific value or amount.

- Although Japan's import duties are relatively low, Japan maintains high import duties on some specific sectors such as agriculture.

Regarding rules of origin, the joint group agreed that the main criteria of these rules in a Japan-Mexico FTA should be tariff code changes. The joint group also agreed to use a regional value content system only for some specific cases.

The Fourth WTO Ministerial Conference held in November 2001 resulted in the agreement of establishing the modalities for agriculture negotiations by March 31, 2003 and concluding all negotiations by January 1, 2005. The WTO agreement will be applicable to all WTO members and thus can benefit Japanese companies in Mexico. Mexican representatives within the joint group highlighted that phase out of the Most Favored Nation (MFN) rates for some sensitive goods such as textiles, footwear, and steel will be negotiated bilaterally with Japan since multilateral negotiations could take longer. The joint group agrees that reaching an

FTA would be more favorable for Mexico and Japan than waiting for the conclusion of multilateral negotiations.

B. Government Procurement

While Japan is a member of the WTO Government Procurement Agreement (GPA), Mexico is not a Party. For this reason, Mexico only grants preferential treatment in government procurement issues to Mexican companies and to companies from Mexico's FTA partners. For the case of Japan both domestic and foreign companies have access to bid processes, but only members of the WTO GPA have access to the dispute settlement mechanisms provided for in this agreement.

The joint group agreed on the possibility of creating a government procurement agreement between Mexico and Japan within the FTA framework in order to grant non-discriminatory procedures for both Parties.

C. Trade Remedy Provisions

The joint group acknowledged that countervailing duties would be imposed against unfair trade practices, provided the FTA partners do not use these provisions as protective measures. Furthermore, such measures shall be applied according to WTO provisions. While Mexican representatives consider that the Parties could discuss transparency and fair competition procedures within the FTA framework, Japanese representatives argue that these issues shall be discussed within the WTO negotiating framework.

According to the joint group, the Parties shall consider including safeguard measures in the future FTA. Such measures will be WTO-consistent.

D. Services and Investment

Japanese representatives within the joint group expressed the following concerns regarding services:

- According to current Mexican legislation, foreign investors can own up to 49 percent of some companies engaged in activities such as storage, administration of ports, insurance and stock companies, finance commission companies, and non-banking financial institutions.

- Government approval is required for foreign ownership above 49 percent regarding maritime transportation.

- Mexican regulations have nationality requirements for the granting of professional services such as fiscal and auditing services and public notaries.

- There are some foreign investment restrictions in Mexico for various sectors such as energy, professional services, telecommunications, transportation, and construction.

- The Automotive Decree includes regional content and trade balance requirements as well as other performance requirements. Also, according to this Decree, only vehicle producers in Mexico may import vehicles. Nevertheless, the Mexican representatives argue that the Mexican Government expects to amend the Automotive Decree by year's end.

Most members of the joint group believe that concluding an FTA on trade in services is a more effective measure for improving bilateral economic relations, than a liberalization commitment under a new WTO negotiations round. They believe that multilateral negotiations would be lengthy and their scope more limited.

Mexico defends a negative-list-approach for trade in services, which allows for the liberalization of all sectors excluding only sensitive sectors. Japan, however, supports a positive-list approach, which only would include those sectors to be liberalized.

The joint group agrees that the FTA must include clear regulations regarding investment, specifically in issues of: (i) national treatment and most favored nation treatment; (ii) prohibition of imposing performance requirements; (iii) possibility of conducting transfers freely; and, (iv) clarification of expropriation and compensation procedures.

III. Bilateral Cooperation and Dispute Resolution

The joint group agreed that the following tasks are relevant to the proposed FTA regarding bilateral cooperation and dispute resolution:

- Simplifying and harmonizing customs procedures;

- Guaranteeing that the application of standardization norms and technical regulations to protect health, environment, consumer rights, or quality standards, does not obstruct bilateral trade;

- Establishing a cooperation mechanism on antitrust issues to ensure legal certainty and the facilitation of trade and investment;

- Strengthening the compliance of domestic intellectual property regulations and establishing cooperation procedures;

- Improving business environment, especially regarding (i) amendments to regulations that could negatively affect businesses; (ii) labor relations; (iii) security conditions; (iv) regulatory reforms; (v) energy and resources; and (vi) environment.

- Strengthening the input supply network in Mexico;
- Implementing trade and investment promotion programs;
- Cooperating in energy, agriculture and fishery, and science and technology initiatives; and
- Including a dispute settlement mechanism based on the regional and multilateral experiences from both countries. NAFTA includes three kinds of dispute settlement mechanisms: State-State, Private-State, and Investor-State disputes. Both the Mexico-EU FTA and the Japan-Singapore Economic Association Agreement include two dispute settlement mechanisms: State-State, and Investor-State disputes.

OUTLOOK

The joint group concluded that Japan and Mexico must advance FTA negotiations in strict accordance with the guidelines of WTO regulations (i.e. GATT Article XXIV) in areas such as trade, investment, trade in services, and government procurement. Still, during the negotiations, Mexico and Japan will have to take into account those sensitive sectors that could hamper talks. For both countries, agriculture remains one of the most sensitive sectors, and agriculture-related talks likely will be one of the most contentious during the negotiations, which could begin as early as October 2002.