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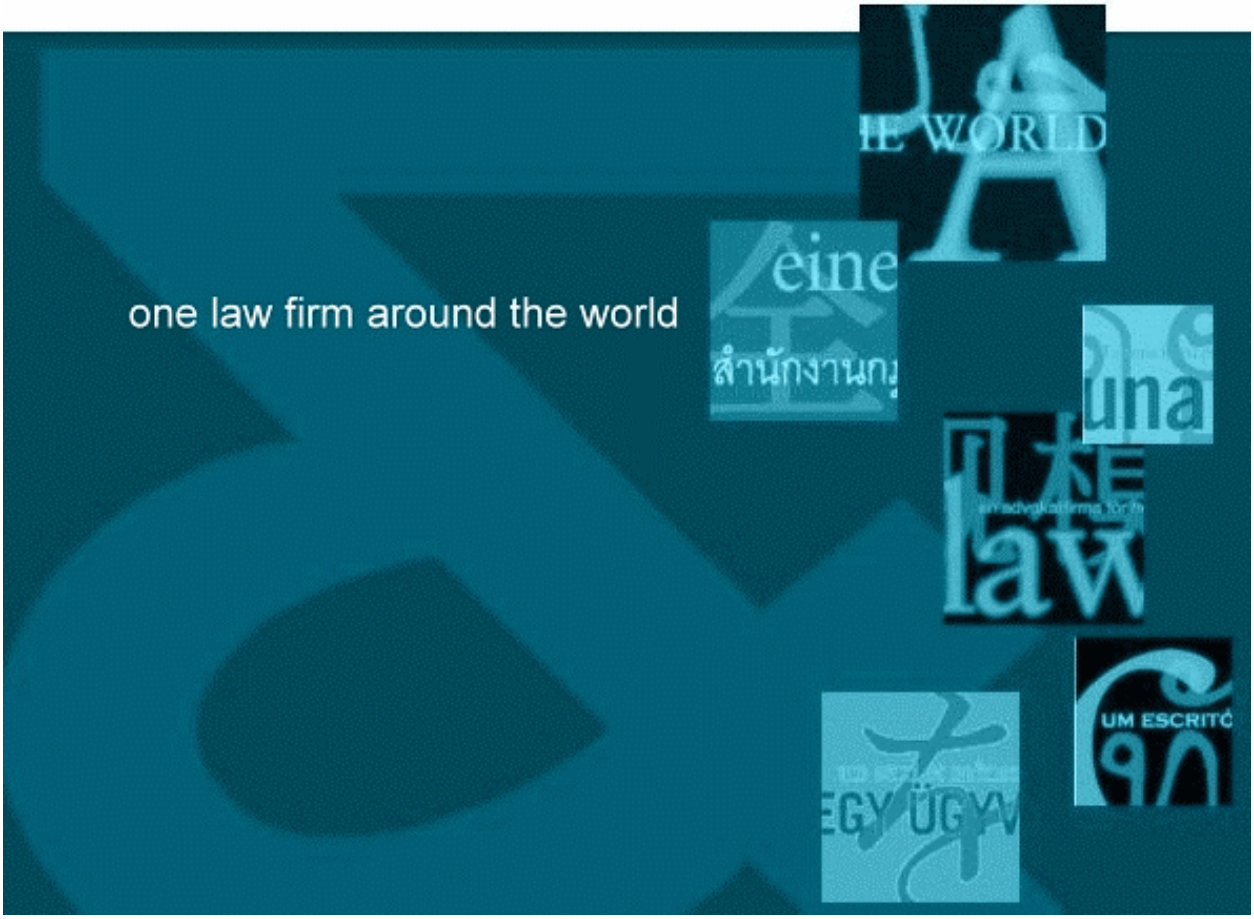
WORLD TRADE ORGANIZATION & REGIONAL TRADE AGREEMENTS

October 2002



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SUMMARY OF REPORTS

U.S. PERSPECTIVES

Effects of 2002 Congressional Elections on U.S. Trade Policy

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U.S. First Submissions in the Context of WTO Antidumping Negotiations

The United States recently made its first submissions to the Negotiating Group on Rules ("Rules Group") in the context of negotiations of the Antidumping and SCM Agreements. The primary submission consisted of two papers: a concept paper entitled "Basic Concepts and Principles of the Trade Remedy Rules" ("U.S. Concept Paper")[1] and a paper that the U.S. submitted to the Organization for Economic Co-operation and Development ("OECD") entitled "Addressing Market Distortions in the Global Steel Sector." ("U.S. OECD Paper")[2] Both papers are broad in scope, and the U.S. has indicated that it will table a more specific set of proposals in November. In addition, the U.S. submitted a response ("U.S. Response") to the first proposal made by the "Friends of Antidumping" ("AD Friends Group") and to proposals by India and Brazil made to the Rules Group.[3]

The U.S. papers are important because they seek to re-cast the Rules Group's purpose towards maintaining the *status quo*, and away from further renegotiation of the Antidumping Agreement's substantive disciplines. The U.S. does this by emphasizing paragraph 28 of the Doha Ministerial Declaration's mandate of "preserving the basic concepts" and makes no mention of the accompanying language of paragraph 28 on "clarifying and improving"

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The U.S. Response to the first "AD Friends Group" paper scores numerous "debating points" by exploiting superficial deficiencies in the proposals, but the U.S. fails to engage many of the issues in a constructive manner. The introduction to the U.S. Response leaves little doubt about the U.S. approach by repeatedly mentioning the importance of disciplines on "trade-distorting" or "unfair" practices.

Overall, the substantive discussions and questions posed in the U.S. first submission demonstrate the ease with which one influential Member might be able to block a consensus on the more conceptual elements of the Antidumping and SCM Agreements.

USTR Hearing on Doha Agenda Negotiations on Industrial Market Access

The Trade Policy Staff Committee ("TPSC"), chaired by the Office of the United States Trade Representative ("USTR"), held a hearing October 18, 2002 on non-agricultural market access issues arising from the Doha Development Agenda. Officials from USTR, International Trade Commission, and the departments of Commerce, Labor, and State heard testimony from witnesses and asked questions on how to best represent their interests in WTO negotiations.

Industry groups that gave testimony include the National Association of Manufacturers (NAM), Walmart, and industry representatives from the textiles and footwear, chemistry, electronics, fisheries and other industries.

GAO Report Concludes Trade Policy Advisory System Should Be Updated

On October 23, 2002, the General Accounting Office (GAO) released a report entitled "Advisory Committee Should Be Updated to Better Serve U.S. Policy Needs." The report concludes that the trade policy advisory committee system needs to be updated to reflect changes in the U.S. economy and trade policy.

Various U.S. agencies involved in the formation of trade policy received the report. Some of the agencies have indicated that they will implement some of the GAO's recommendations to strengthen the system.

We summarize the report below. The full report is available at www.gao.gov.

Baucus Calls for "Partnership of Equals" between Congress and Administration

In a recent speech to the full Senate, Finance Committee Chairman Max Baucus (D-Montana) proposed several specific guidelines on consultations between Congress and the United States Trade Representative (USTR) regarding trade policy. The Trade Act of 2002 mandates that USTR, in consultation with Congress, develop the guidelines by December 4, 2002.

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Baucus' proposals include (i) access to negotiating documents, (ii) access to regularly scheduled negotiating sessions, (iii) clear schedules for consultations relating to negotiating sessions, and (iv) consultations regarding monitoring and enforcement of trade agreements. Baucus believes that the relationship between Congress and the Executive with regard to trade should be "a partnership of equals" and that the guidelines will be the first opportunity "to memorialize this new, interdependent relationship." Some in the Administration, however, oppose what they consider a more intrusive role by Congress in bilateral, regional and WTO negotiations and policy.

McDermott Calls for New Consensus on Trade; Speakers Discuss Future of U.S. Trade Policy Following TPA Passage

Representative Jim McDermott (D-Washington) recently joined the dispute brewing on Capitol Hill over the interpretation and implementation of the Trade Promotion Authority (TPA) provisions contained in the Trade Act of 2002. McDermott believes that the current lack of consensus on the TPA provisions is a direct result of the failure of the TPA architects to address the most contentious issues in drafting the bill. In his remarks at the annual Washington Trade Expo on October 10, 2002, McDermott called for a new consensus on trade and outlined steps he believes that the US must take to change the current trade debate.

During a panel discussion at the same event, Greg Mastel and Angela Ellard, trade staff for the Senate Finance Committee and House Ways and Means Committee, respectively, discussed the future of U.S. trade policy following passage of TPA. Mastel outlined Senate Finance Committee Chairman Max Baucus' (D-Montana) priorities for trade, and Ellard discussed some of the lessons learned from the TPA debate. Mastel and Ellard disagreed on the role of Congress in negotiations as well as the interpretation of labor and environmental provisions in TPA.

WTO WORKING BODIES

US, EC and Japan Submissions on China WTO Compliance; Meeting of the Import Licensing Committee on China's TRM

The United States, European Communities and Japan submitted comments and questions to China on its import licensing regime on August 12, 28 and 29, respectively, in the context of China's Transitional Review Mechanism held in the Committee on Import Licensing, which met on September 24, 2002. After the meeting, the US submitted a statement and additional questions to China on September 30.

The US, EC and Japan's main concerns on China's import licensing system are:

- ***Transparency*** — Failure to notify all rules, information and changes concerning import licensing procedures.

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- ***Import quotas on automobiles*** — Discrepancy between quotas allocated and actual imports; priority consideration for new entrants in quota allocation; and quota reallocation.

- ***Separate licensing*** — Requirement of separate license applications beside quota applications, and different licenses depending on the modes of trade.

- ***AQSIQ import inspection certificate*** — Requirement that applicants obtain a quarantine inspection certificate before importation.

China submitted its notification and initial responses to Members on September 20 and 23. China responded to some questions on licensing administration; administration for processing trade; allocated quotas vs. actual imports; information on quota value; and transparency. During the September 24 committee meeting, China again rejected the request for written responses to questions from Members and asserted that these requests had no legal basis in China's Accession Protocol. China also insisted that further questions from Members concerning China's trade policies will receive due responses, but not in the context of this TRM. The Chairman finally decided to prepare a factual report on China's TRM, and further discussion on specific questions raised in the TRM would be addressed outside the TRM.

GATS "Services Week" 21 October to 1 November Focus on Requests for Market Access Improvements

On 1 November, services negotiators in the WTO completed the latest period of intensive negotiations under the Doha Round. Though referred to as a services "week", this period ran from 21 October to 1 November. The negotiations will continue to be organized in this manner, which is intended to facilitate the presence of capital-based experts in Geneva; the next "week" is scheduled for 2-10 December. The process is therefore intense, and it is making good progress.

Update on WTO Electronic Commerce: October Meeting and U.S. Proposal on E-Commerce

We provide here an update on the work programme on electronic commerce in the WTO. In particular, we discuss the recent deliberations at the 25 October meeting in Geneva at which WTO Members engaged in a further "dedicated discussion" of horizontal issues arising in the ongoing work programme. The last such meeting was held on 6 May. The discussion provides an occasion to review the state of work in the WTO on this subject, which has sometimes given rise to confusion and is still not well understood.

We also discuss the recent paper on electronic commerce submitted by the United States on "Proposed Goals for E-Commerce in the WTO."

Update on Negotiations of a Emergency Safeguard Mechanism

This note analyses the current state of the negotiations under Article X of the General Agreement on Trade in Services (GATS) on the question of an emergency safeguard mechanism ("ESM"),

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in the light of the most recent meeting, on 25 October, of the Working Group on GATS Rules, which is carrying out the negotiations. The prospects for a successful outcome, in the sense of an agreement on safeguard disciplines within the time-frame of the Doha Round of negotiations, are poor. Moreover, the lack of progress on the ESM could have negative effects on negotiations in other areas.

WTO DISPUTE SETTLEMENT

Proposals by the United States and Developing Countries on Reform of the WTO Dispute Settlement Understanding

Three new submissions have been made by developing countries on the revision of the WTO's dispute settlement system, in the context of the review of the Dispute Settlement Understanding ("DSU") which is to be completed by May 2003 for submission to the Fifth Ministerial Conference in Cancun, Mexico, in September 2003.

The main issues treated in the proposals are:

(i) *Panel procedures and role of the WTO Secretariat* – Suggest more flexible time frames, provision for dissenting opinions; and a strengthened role for the WTO Secretariat as legal counsel to developing countries on disputes;

(ii) *Retaliation for failure in compliance* – Assert need for more effective compliance procedures, including cross-retaliation, collective retaliation and monetary compensation;

(iii) *Special and differential treatment* – Argue for more flexible provisions in treatment of developing and least-developed countries, including revision of existing provisions and time frames for consultations and submissions; and

(iv) *Costs of litigation and access to legal services* – Believe that litigation costs are too high, and some suggest developed countries should reimburse developing countries for litigation costs if claims are rejected.

This report summarizes the proposals and initial reactions to them by WTO Members in the Special Session of the Dispute Settlement Body ("DSB"), which met from October 14, 2002. In addition, we discuss the U.S. proposal on transparency in dispute settlement, which was discussed at a special session of the DSB on September 10-11, 2002.

Panel Discussion and Deputy Treasury Secretary Speech on U.S. Implementation of WTO Findings Against FSC/ETI Regime

The Washington International Trade Association ("WITA") and Women in International Trade ("WIIT") held their annual Trade Expo on October 9, 2002, which included a panel discussion –

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off the record – on U.S. approaches to implementation of the WTO findings against the U.S. Extraterritorial Income Act/Foreign Sales Corporations ("ETI/FSC") regime.

Panelists included representatives from the U.S. Treasury Department, National Foreign Trade Council – which coordinates the industry coalition on the matter; European-American Business Counsel; and the tax counsel to Chairman Bill Thomas of the House Ways and Means Committee. Panelists agreed generally on the need to change the current ETI/FSC regime, but differed on taking either a legislative or negotiated approach, or a combination of both.

In addition, Deputy Secretary of Treasury Kenneth Dam spoke recently on the need for a serious fix of the ETI/FSC regime. Dam warned that a solution will result in some "winners and losers," as the ETI/FSC will not be replicated.

U.S. Presents First Written Submission in WTO Dispute on Mexico – Telecommunications Services

On October 3, 2002 the United States filed its first written submission in the dispute against Mexico on Measures Affecting Telecommunication Services. The U.S. claims that Mexico has failed to honor its obligations both under the "Reference Paper" incorporated to its additional commitments and the GATS Annex on Telecommunications. The dispute is also the first in WTO jurisprudence to deal exclusively with the GATS and on telecommunications services.

The next steps in the panel proceedings will be the first written submission from Mexico, initially due on December 7, as well as from third parties to the dispute due on December 14. Mexico recently requested an extension for its first submission, which will postpone all dates by at least one week.

REGIONAL TRADE AGREEMENTS

US Launches FTA Initiative with ASEAN and Trade Facilitation and Security Initiative with APEC at APEC Leaders' Meeting

Larry Greenwood, U.S. Senior Official for APEC, recently briefed the Asia Society in Washington, DC, regarding the results of the Tenth APEC Leaders' Meeting held in Los Cabos, Mexico, on October 21-27, 2002. Greenwood discussed the general results of the meeting as well as the U.S.-led trade initiatives.

The US launched the Secure Trade in the APEC Region ("STAR") initiative with APEC to enhance security while increasing trade facilitation. The US also launched the Enterprise for ASEAN Initiative (EAI), a new U.S. plan with ASEAN that provides a "roadmap" for closer trade relations between the United States and the ASEAN region. The EAI offers the "prospect" of bilateral free trade agreements (FTAs) to selected ASEAN countries.

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In related news, China joined the U.S. Customs Service Container Security Initiative (CSI) "in principle" on the eve of the APEC Leaders' Meeting. Greenwood noted the historical significance of China's membership in CSI.

ITC Report Finds Possible U.S.-Taiwan FTA Would Increase Bilateral Trade; Taiwan Cautiously Optimistic

The United States International Trade Commission recently released a report "U.S.-Taiwan FTA: Likely Economic Impact of a Free Trade Agreement Between the United States and Taiwan," which finds that a U.S.-Taiwan FTA would increase bilateral trade but not significantly. Taiwan was disappointed with the report's findings but remains cautiously optimistic.

Taiwan's Minister of Economic Affairs Yi-Fu Lin has stated that he will aggressively seek support from both the U.S. Congress and private sectors so that the United States will place an FTA with Taiwan among its top trade priorities. Analysts, however, note that the US is currently involved in a number of other FTA negotiations, and an FTA with the Taiwan is not among U.S. trade priorities at the moment.

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REPORTS IN DETAIL

U.S. PERSPECTIVES

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SUMMARY

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As for its implications on U.S. international trade policy, Republicans will control the two committees with jurisdiction over trade, *i.e.* Senate Finance and House Ways and Means, and will probably attempt to promote a more trade-friendly agenda, including seeking resolution to bilateral and WTO trade disputes, support for the Doha Development Agenda negotiations and free trade agreements.

ANALYSIS

I. Senate Results: Republicans Regain Control

Rather than widening their narrow margin of control, Senate Democrats lost their majority to Republicans. As it stands now, Republicans are certain to hold at least 51 seats. Two seats are still undecided. In South Dakota, only a few hundred votes separate incumbent Sen. Timothy Johnson (D) and challenger Rep. John Thune (R). With all of the precincts there reporting, Sen. Johnson appears to be the winner by just 527 votes. But a recount will almost certainly be conducted, meaning an official winner may not be known for days. In Louisiana, Sen. Mary Landrieu (D) failed to capture the 50 percent of the vote she needed to avoid a runoff election. Five Republicans vied for the Louisiana Senate seat in yesterday's election. Sen. Landrieu now must face the top Republican vote getter, Suzanne Terrell, in a head-to-head race on December 7, 2002.

A Republican Majority in the next Congress will return Sen. Trent Lott (R-Mississippi) to the post of Majority Leader. At a press conference today, he pledged to take up next year many of the issues left unfinished in the current Senate. A Department of Homeland Security bill, energy reform legislation and a pension reform bill were among the items he mentioned as legislative priorities.

II. Senate Trade Leadership Returns to Grassley

Sen. Charles Grassley (R-Iowa), a strong supporter of pro-trade initiatives, will return as Chairman of the trade and tax-writing Finance Committee in the next Congress. Four of the panel's current members are retiring: Sens. Phil Gramm (R-Texas), Fred Thompson (R-

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Tennessee), Frank Murkowski (R-Alaska), and Bob Torricelli (D-NJ). It remains unclear who will take these open seats on the committee.

Sen. Grassley started the last Congress as Chairman but had to hand over his gavel to Sen. Max Baucus (D-Montana) when Sen. Jim Jeffords (I-Vermont) left the Republican Party and turned control of the Senate over to Democrats in mid 2001. Senator Baucus, a traditional supporter of trade initiatives, has become increasingly critical of WTO findings against U.S. laws and practices, and has been a supporter of the labor and environment agenda.

Sen. Grassley first ascended to the top spot in Finance after Sen. William Roth (R-Delaware), another pro-trade Senator, was defeated in 2000. He has worked for a strong trade liberalization agenda, including support for renewal of trade promotion authority; the bilateral agreement on China's WTO accession; trade agreements with Jordan and Vietnam and the launch of new FTAs; compliance with WTO findings against U.S. laws and practices; and support for the Doha Development Agenda negotiations. Nevertheless, Grassley comes from a traditional agriculture state and has supported the Farm Bill that increases subsidies to farmers over the next 10 years.

Recently, Sen. Grassley has worked closely with Sen. Baucus on legislation to end corporate inversions and to crack down on corporate tax shelters as a result of WTO findings against the U.S. FSC/ETI regime; these legislative initiatives will likely resurface in the next Congress. Baucus had stalled FSC/ETI compliance efforts, but Grassley will likely attempt to move efforts forward, including possible review of the Thomas Bill, which would repeal the ETI regime. Grassley and Baucus also collaborated on the President's successful effort to renew Trade Promotion Authority and many other trade initiatives. Their cordial, collaborative relationship should continue, even as they again trade positions as Chairman and Ranking Member.

III. House Results: Majority Solidified

The elections solidified Republican control of the House. With all 435 seats up for grabs, Republicans actually widened their majority by as many as 12 seats. House Republicans will hold at least 226 seats. Four House races are still undecided in Colorado, Louisiana, New Mexico and Texas. The poor showing for Democrats called into question whether Minority Leader Richard Gephardt (a strong opponent of trade liberalizing initiatives) would continue to lead the Democratic caucus. Rep. Harold Ford (D-Tennessee) is one of what may be a growing number of Democrats calling for new leadership.

Today Gephardt will announce that he will not seek re-election as leader of the Democrats in the House. Among those who may seek to replace Rep. Gephardt as Minority Leader are Rep. Nancy Pelosi (D-California) and Rep. Martin Frost (D-Texas). Rep. Pelosi is the second-ranking Democrat in the House leadership. As Minority Whip, she is responsible for counting and delivering votes for Democratic initiatives. Rep. Frost holds the post of Caucus Chairman.

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House Republicans will make a few leadership changes as well. The departure of Rep. Richard Armey (R-Texas), who did not seek re-election this year, leaves open his position as Majority Leader. House Republican Majority Whip Tom DeLay (R-Texas) will likely seek the position as Majority Leader. Also departing is House Republican Conference Chairman J.C. Watts. Rep. Chris Cox (R-California), who chairs the Republican Policy Committee, may seek to move up in the leadership ranks by running for either of these open posts.

IV. House Trade Leadership: Thomas Remains Chairman

The House Ways and Means Committee, where all trade legislation starts, will remain under the chairmanship of Rep. Bill Thomas (R-California), while three of its current Committee members will depart. Reps. Wes Watkins (R-Oklahoma) and Bill Coyne (D-Pennsylvania) are retiring; and Rep. Karen Thurman (D-Florida) lost her bid for re-election. Replacements for these seats on the panel have not yet been named.

Chairman Thomas is a strong supporter of trade liberalization and was critical to securing renewal of Trade Promotion Authority for the President this year.

Recently, Rep. Thomas took the lead in finding a legislative response to the WTO decision against the FSC/ETI regime. In doing so, he proposed a holistic approach, arguing that the larger issue of international tax reform must be addressed as part of any response to the ETI. He introduced a major bill that would replace the ETI regime with nearly 20 international tax incentives, crack down on corporate tax shelters, and tighten the tax treatment of corporate inversions and earning stripping. The bill ran aground and never saw a hearing or markup this year. It also faced strong opposition from Max Baucus on the Senate side. Even with Grassley taking the chairmanship of the Finance Committee, it is uncertain whether Chairman Thomas will stick with the same approach to push the ETI legislation through Congress or whether he will attempt to separate the ETI issue from other international tax reform issues.

Unlike the Senate Finance Committee, bipartisan collaboration is a rarity on the House Ways and Means Committee. For years, Democrats on the panel have complained that they have little input on the timing and substance of the panel's agenda including trade. In particular, Minority Member Charles Rangel (D-New York) has complained of a lack of consultation on matters including TPA renewal; the relationship between trade and environment with WTO and other trade rules; FSC/ETI repeal; among other issues. (Republicans made similar complaints when Rep. Dan Rostenkowski (D) was Chairman.) This partisan sniping on trade and other issues likely will continue on the committee.

OUTLOOK

With Republicans now in control of both chambers of Congress, the Administration's legislative agenda, including on trade initiatives, will receive a decidedly warmer reception (especially in the Senate), but the path to legislative victories is still quite narrow. Both chambers will remain closely divided.

The Republican victories are clearly a positive development for trade policy as control of both the House Ways and Means and Senate Finance committees is held by strong supporters of

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trade liberalization efforts. Nevertheless, leadership of the committees does not ensure that all legislative efforts on trade will pass easily. Both parties must cooperate in order to move forward on issues including compliance with the many recent WTO findings against U.S. laws and practices and an ambitious agenda in WTO, regional and bilateral trade negotiations. Furthermore, with the passage of the Trade Act of 2002, Congress has a stronger oversight role in trade policy – and both committees have demanded greater access and input on trade negotiations.

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ANALYSIS

I. U.S. Paper on "Basis Concepts and Principles of Trade Remedy Rules"

Of the three documents submitted by the United States, the concept paper is most indicative of how the U.S. will pursue negotiations in the Doha round. From the outset of the paper, the U.S. seeks to re-cast how negotiations in the Rules Group should proceed on AD and CVD disciplines. The U.S. accomplishes this task by omitting any reference to the phrase "clarifying and improving disciplines" contained in paragraph 28 of the Doha Ministerial Declaration.[7] Rather, the U.S. focuses its main attention on the language contained later in paragraph 28 that speaks to the need to preserve "the basic concepts, principles and effectiveness of these Agreements…" Indeed, the U.S. Concept Paper goes so far as to claim that preservation of basic concepts was the "focus" of the Doha mandate.[8] The U.S. approach, however, ignores the structure of the sentence in the Declaration, in which the Members agreed to negotiations "aimed at clarifying and improving disciplines . . . while preserving the basic concepts…"[9] Thus, from the language of the Declaration itself, it is clear that the focus (*i.e.* the aim) of the negotiations is to "clarify and improve" disciplines. The need to preserve the *basic* concepts does not become operative unless clarification and improvement is made to those concepts.

The U.S. also highlights the need to enhance disciplines on trade distorting practices, including subsidies. In addition, the U.S. discusses approaches to improving disciplines on transparency and ensuring due process in trade remedy proceedings – which indicate areas where the U.S. and other WTO Members like the AD Friends Group could possibly reach common ground.

A. "Trade Remedy Rules in a Rules-Based Trading System"

After attempting to redefine the Rules Group's role in the Doha Round, the U.S. provides the historical basis for trade remedy rules. The U.S. explains that multilateral negotiations have been designed to turn all barriers to trade into tariffs, and once that was accomplished, lower tariff rates were negotiated. Trade remedies were designed to ensure that subsidies and dumping would not "upset the balance struck at the negotiating table." This section sets up the remainder of the U.S. Concept Paper. By using sweeping historical references, the U.S. attempts to shift the debate towards the need to preserve trade remedy disciplines – a process it continues in the following section.

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[7] WT/MIN(01)/DEC/W/1, 20 November 2001.

[8] U.S. Concept Paper at 1.

[9] WT/MIN(01)/DEC/W/1, 20 November 2001.

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B. "The Role of WTO Rules in Counteracting Trade Distorting Practices"

The U.S. Concept Paper then moves to a discussion of how the WTO rules are designed to respond to trade-distorting government policies. The U.S. notes that in an ideal world, international competition would be based on "real comparative advantages."[10] But, the U.S. claims that governments often distort the efficient allocation of economic resources that would result from trade based on comparative advantage by attempting to create artificial advantages, as seen by chronic capacity problems in the steel and fisheries industries.[11] Hence, the need for AD and CVD disciplines, and the focus of the debate continues its shift.

Next, the U.S. attempts to tie the concept of market distorting practices to the increasing use of trade remedy laws by all Members. The U.S. claims that "the importance of trade remedies has become clear to a broad universe of Members."[12]

- Rather than treating the rising use of antidumping as a cause for concern, however, the U.S. appears to celebrate the increased use of trade remedy laws, because it supports the underlying objective of the U.S. in its paper – the preservation and strengthening of disciplines.[13] Indeed, the U.S. claims that the increased resort to trade remedies "underlines the importance of the Ministers' mandate agreed to at Doha."[14]

1. "Anti-Dumping Rules as a Remedial Mechanism"

After setting forth the general underpinning for trade remedy rules in a light most favorable to the U.S. position, the Concept Paper moves into a short discussion of why AD and CVD remedies are needed. The U.S. explains that AD rules are triggered in response to international price discrimination.[15]

- The U.S., however, fails to address whether it believes that international price discrimination is *per se* objectionable. For instance, there could be situations where legitimate market forces dictate a lower price in an exporting country's home market than

[10] U.S. Concept Paper at 3. The U.S. cites these advantages as "natural resource endowments, labour skills and abundance, availability of capital, and technological innovation."

[11] U.S. Concept Paper at 3.

[12] U.S. Concept Paper at 3.

[13] The U.S. does note, however, that most Members share the goal of reducing an minimizing resort to trade remedy measures. U.S. Concept Paper at 5.

[14] U.S. Concept Paper at 3.

[15] U.S. Concept Paper at 3. The U.S. defines international price discrimination as "where a foreign producer sells its product at a lower price in the importing country than it does in its home country, or, alternatively, in other primary markets."

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in the market to which it exports. This would constitute international price discrimination under the U.S.' simplistic definition, but it is not clear what is objectionable under such circumstances.

The United States also claims that AD rules are needed as a remedial mechanism to address export pricing at levels that are below a company's cost of production plus reasonable amounts for selling, general and administrative expenses.

- The U.S. ignores that the calculations that must be done to arrive at such a determination are complex, and such a finding often hinges on the choice of one methodology over another. Very rarely are there instances of clear pricing below cost of production.

The U.S. also cites the famous "safety valve" argument. By keeping AD rules, Members can assure domestic workers and firms that "unfair trade" can be stopped. This allows trade liberalization to continue because without such assurances, domestic firms and workers, presumably, would coalesce to block liberalization measures (*i.e.*, trade remedies offer a "safety valve"). While this may be so, the question raised is at what point are the gains of further trade liberalization offset by concessions that are made to pacify domestic opposition?

Another situation the U.S. claims AD rules appropriately remedy is the existence of a so-called "sanctuary home market." Under this theory, firms can sell at artificially high prices in their home market, enabling them to sell at artificially low prices in the importing market. Artificially high prices can be obtained in the home market because of government policies that protect domestic producers.

- The "sanctuary home market" theory, however, has no basis in the actual analysis conducted in AD investigations under the WTO rules. Nowhere does the AD Agreement provide for an examination of whether a foreign producer has a "sanctuary home market" that enables it to sell at artificially low prices in the importing country. In fact, AD duties can be levied on a foreign producer that has little or no sales in its home market. In such a situation, the prices of sales in third-country markets are compared to the prices of export sales. Surely in such situations the "sanctuary home market" justification lacks merit.

The U.S. concludes its discussion of the need for AD rules by noting that such rules allow domestic producers to remedy action against "artificial advantages" of foreign firms. Further, the U.S. notes that AD rules are not an end, but the means to create a "level playing field."

- The U.S. ignores the fact that the AD Agreement does not limit the imposition of AD duties to instances where a foreign producer has an "artificial advantage." The U.S. also does not acknowledge whether AD investigations, themselves, can be trade-distorting – as in practice, the mere threat of an AD order can discourage trade.

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2. "The Use of Countervailing Duties to Address Subsidization"

The U.S. briefly discusses use of countervailing duties ("CVD") as an acceptable means of addressing injurious foreign subsidies. The U.S. points out the "progressive deepening of subsidy negotiations" by successive GATT rounds of negotiations[16] and believes that multilateral disciplines aimed at reducing and eliminating distortive subsidies "would be the best solution."[17]

The U.S. concludes the discussion on CVD rules (and implicitly AD rules) with a sweeping statement that "[t]he objective of the Rules Group must be the continuation of the progressive strengthening and expansion of disciplines that have marked nearly every round of trade negotiations since the beginning of a rules-based multilateral trading system."[18]

- This U.S. statement appears to alter fundamentally paragraph 28 of the Doha Ministerial Declaration. The U.S. assumes that every negotiating round has sought to "strengthen" and "expand" AD and CVD disciplines (and not just "clarify and improve" existing disciplines). If left unchallenged, it appears that the U.S. will interpret the Doha mandate as providing the basis for pursuing an anti-liberalization negotiating agenda.

C. Principles Guiding the Rules Negotiating Group's Work

The U.S. Concept Paper concludes by identifying four core principles to guide the Rules Group's work:

(i) ***Preserve trade remedy laws*** – Negotiations should "maintain the strength and effectiveness of the trade remedy laws" and complete an effective dispute settlement system;

(ii) ***Refine transparency and due process*** – Trade remedy laws must operate in an "open and transparent manner" and therefore "transparency and due process obligations should be further refined";

(iii) ***Enhance disciplines on trade-distorting practices*** – Disciplines should "more effectively [address] underlying trade-distorting practices" for example, through the work of the OECD in addressing global overcapacity in the steel sector; and

(iv) ***Ensure standard of review*** – WTO panels and the Appellate Body should "follow the appropriate standard of review and do not impose on national authorities obligations that are not contained in the Agreements" relating to trade remedy laws.

[16] U.S. Concept Paper at note 3.

[17] U.S. Concept Paper at 4.

[18] U.S. Concept Paper at 4.

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The first and third concepts flow directly from the main discussion in the U.S. Concept Paper on preserving trade remedy laws and addressing trade distorting practices, respectively. These concepts also highlight the U.S. interpretation of paragraph 28 of the Doha Ministerial Declaration, and ignore the mandate to "clarify and improve" AD and SCM disciplines.

The second and fourth concepts of transparency and due process, and standard of review, respectively, are not discussed in any detail in the U.S. Concept Paper. Increased transparency and due process should present little difficulty for the U.S. because it can plausibly argue that its system is among the most transparent, and contains ample due process protections.

- The United States, EC and the AD Friends Group countries might benefit from establishing common ground on the need for stronger disciplines on transparency and due process. The lack of transparency and due process are problems more associated with the increasing users and abusers of AD provisions (often developing countries) than with traditional users like the U.S. and EC. Already, more U.S. exporters are pressuring U.S. negotiators to address problems faced in antidumping investigations abroad, including the treatment of business confidential information and legal recourse in administrative proceedings.

The fourth concept, concerning panel and Appellate Body decisions, appears directly attributable to U.S. Congressional urging. An October 18 article in *Inside U.S. Trade* reports that the fourth concept was not included in initial drafts of the U.S. Concept Paper, but was added after the paper was submitted for Congressional review.

- The U.S. Congress and protectionist industries will continue to influence disproportionately the U.S.' negotiating positions on AD and CVD rules. In fact, the Chairman of the Senate Finance Committee Max Baucus has insisted that renewal of trade promotion authority ("TPA") provides for increased Congressional oversight of current negotiations, including access to draft documents and a stronger role in trade negotiations – especially WTO negotiations of the AD and SCM agreements.

II. "Addressing Market Distortions in the Global Steel Sector"

The U.S. attached its submission to the OECD on addressing trade distortions in the global steel industry, but notes that that "market-distorting practices in the steel sector . . . merit broader discussion and consideration in the Doha work programme."[19] Thus, the U.S. may intend for the trade-distorting practices raised in the OECD paper to be addressed across all sectors.

A. Trade-Distorting Practices Identified

[19] TN/RL/W/24, 16 October 2002 at 1.

In the U.S. OECD Paper, the U.S. categorizes trade-distorting practices as follows: 1) subsidies or those measures with a subsidy-like effect; 2) other forms of official support; 3) anticompetitive behavior; 4) tariffs and other market access measures; and 5) financial support for closure of inefficient capacity.[20]

B. Trade-Distorting Practices Addressed

1. Subsidies or those measures with a subsidy-like effect

The U.S. proposes that subsidies should be eliminated with the exception of assistance aimed at promoting capacity closure, facilitating worker adjustment assistance, and covering other social and environmental costs. As part of this proposal, the U.S. suggests that oversight mechanisms should be established to ensure circumvention does not occur. While this proposal was limited to the steel sector in the OECD submission, it could equally be applied to other sectors. This aspect of the U.S. OECD Paper also parallels statements made in the U.S. Concept Paper.

2. Other forms of official support

The U.S. OECD Paper suggests that governments should refrain from the use of export credits for steel plant and equipment and not support multilateral development bank financing for steel plant projects that would contribute to the expansion of global steel capacity. Further, the U.S. proposes addressing preferential access to financing of steel production inputs and bankruptcy procedures that may hamper steel capacity reduction. These proposals appear to be limited to the steel sector, and do not have parallels in the U.S. Concept Paper. These proposals, however, could be applied to other sectors where chronic overcapacity is an issue.

3. Anti-competitive behavior

The U.S. proposes, without prejudice to the ongoing WTO work regarding trade and competition that governments agree to enhanced cooperation and enforcement of competition laws. This element of the U.S. OECD Paper does not have a counterpart provision in the U.S. Concept Paper, and would appear to be limited to the steel sector. Moreover, this element appears to stem from the year 2000 report by the U.S. Department of Commerce on cartel-like activity among certain steel producers. Thus, its potential application to other sectors is likely to be limited.

4. Tariffs and other market access measures

[20] The U.S. OECD Paper does not list trade remedies as a category of trade-distorting practices, yet the issue is discussed in the main text concerning trade-distorting practices. In that discussion, the U.S. basically states that AD and CVD actions are among the few tools available to deal with trade and market distortions. Then the U.S. counsels that the best way to decrease the resort to trade remedies is to eliminate the underlying trade-distorting practices.

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The U.S. proposes that governments should continue to open their markets, and to ensure that dumping out of "sanctuary home markets" does not occur. Further, the U.S. proposes that governments that did not agree to a zero-for-zero tariff elimination in the steel sector should do so in the current round. Increased market access is something that the U.S. can be expected to push across all sectors, and not just steel. As discussed above, "sanctuary home markets" are an alleged justification for AD measures that the U.S. identifies in the Concept Paper.

5. Financial support for closure of inefficient capacity

The U.S.' final proposal relates to governments creating favorable conditions for the closure of inefficient steelmaking capacity. According to the U.S. proposal, government and/or private sector mechanisms should be designed to provide financial support for the social costs of closure. While this element is not addressed in the U.S. Concept Paper, it could be applied to other sectors where chronic overcapacity is an issue.

III. U.S. Response to AD Friends Group, India and Brazil Proposals

The U.S. paper entitled "Questions from the United States on Papers Submitted to the Rules Negotiating Group" proposes some general principles to guide the Doha Round antidumping negotiations, but devotes most attention to posing questions to the proponents of submissions already made to the Rules Group, most importantly the first (April 26th) submission of the so-called AD Friends Group. (The U.S. Response does not refer to the second (June 28th) submission of the AD Friends Group, although more than three months had passed between that submission and the U.S. Response.) The U.S. response to India's submission appears to be of limited interest because it concerns only special antidumping and subsidy rules for developing countries. The U.S. response to Brazil consists mostly of requests for evidence to support various assertions in the Brazilian submission.

A key factual premise of the AD Friends Group submission was that antidumping actions have increased at least in part due to abuse of antidumping laws. The AD Friends Group described the disconcerting trend in measured language, noting the "continuing increase" in AD investigations and the Group's concern "with the misuse of anti-dumping measures and the consequent trade restrictive effects." April 26th Submission of AD Friends Group, page 1. The U.S. Response twists this unexceptionable and well-documented statement into the claim that the "submission appears to equate the increase in the use of anti-dumping measures with the misuse of such measures." This gratuitous distortion sets the tone for the U.S. Response.

The U.S. Response questions the proposed clarification or refinement of such substantive concepts as cost of production, constructed value, sales in the ordinary course of trade, corporate affiliation and threat of material injury. The questions typically introduce alternative ways of looking at the concepts and as such establish the point that the AD Friends Group submission is but one perspective among several reasonable views. The U.S. Response employs this tactic effectively against the examples provided by the AD Friends Group to illustrate their proposals. Although the examples were intended to make the proposals understandable, in many cases they did not provide enough detail to make a compelling case. The illustrations for constructed value and facts available share this weakness, which the U.S. Response exploits with a host of "what

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if" scenarios. By raising numerous hypothetical issues suggested by the examples the U.S. Response creates the impression that this is a debate between subjective points of view.

On other specific issues the U.S. Response is uneven. Some points seem intended to obfuscate while others directly challenge the reasoning of the AD Friends Group, as discussed below.

1. Average Dumping Margins/Zeroing

The U.S. Response poses questions that have been answered for the most part in the *Indian Bed Linens* Appellate Body ruling. An effective response to the U.S. Response would call for codification of the findings against the EC and other WTO Members' practice of "zeroing" as established in *Indian Bed Linens*.

2. De Minimis Standard

The AD Friends Group submission argued that the current two percent *de minimis* standard is too low in light of the inherent uncertainty of dumping determinations. In asking for evidence to support this argument, the U.S. Response shifts a difficult burden to the AD Friends Group: to demonstrate that the margin of error for dumping determinations exceeds two percent. A more fruitful, albeit limited, approach might call for revision of Article 5.8 to require that Members apply the two percent standard in administrative reviews, not just in original investigations. The U.S. has exploited the language of Article 5.8 in order to make this distinction, thus retaining its 0.50 percent *de minimis* standard for reviews.

3. Negligibility

The 3/7 negligibility rule of Article 5.8 is indefensible and among those aspects of the Antidumping Agreement most in need of revision. Although the rule was intended to reduce investigations of marginal suppliers, the effect has been the opposite as petitioners have often added small exporting countries simply to meet the seven-percent criterion.

The U.S. Response seems to dodge the issue with an arcane question unrelated to the substance of the AD Friends Group's proposal. This tactic suggests that the U.S. might not be prepared to defend the illogical 3/7 rule.

4. Facts Available

As mentioned previously, the U.S. Response avoids the real issue whether the use of facts available needs to be disciplined, instead concentrating its questions on the hypothetical illustration provided in the AD Friends Group submission. A useful way to address this important problem might be to propose explicit procedural steps that the administering authority must take, for example a special hearing, before resorting to facts available or other guidance provided in recent WTO findings against U.S. authorities' treatment of "facts available."

5. Lesser-Duty Rule

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The U.S. Response stands the lesser-duty rule on its head by arguing that the injury sometimes exceeds the amount of the antidumping duty imposed. The argument implies that if a lesser-duty rule limits the antidumping duty to the amount needed to offset the actual injury, then in those cases in which the antidumping duty is inadequate to redress injury, the administering authority should be at liberty to impose a duty that exceeds the margin of dumping. This argument challenges the premise of the AD Friends Group "that AD duties are specifically designed to counteract injury being suffered by the domestic industry…." April 26th Submission of AD Friends Group, page 5.

This is an irreconcilable philosophical issue. The premise of the AD Friends Group is correct, but neither Article VI of the GATT nor Article 9.1 of the Antidumping Agreement states that the amount of the antidumping duty is intended to offset the injury actually suffered. The U.S. has staked out a position from which it might not need to negotiate in earnest.

6. Sunset Reviews

The U.S. Response quibbles with the wording of the AD Friends Group's proposal and asks a pointless rhetorical question whether exporters might sometimes withdraw from a market because they cannot sell there without dumping.

The U.S. Response also challenges the AD Friends Group to provide evidence "that the continuation of orders has become a '*de facto* practice.'" The evidence is abundant: According to the International Trade Commission's website, between July 1998 and September 2002, 358 sunset reviews had been instituted. Of the 358 reviews instituted, the Commerce Department revoked the orders in 89 reviews based solely on receiving no domestic response to the Department's notice of initiation. In only four of the reviews instituted did the Department revoke the orders based on negative determinations that there was no likelihood of future dumping. See http://info.usitc.gov/oinv/sunset.nsf (showing "aggregate five-year review status").

OUTLOOK

The broad nature of the U.S.' first submission appears designed to change the overall nature of the debate in the Rules Negotiating Group. To date, almost all submissions to the Rules Group have contained specific proposals or have addressed specific areas of concern. In contrast, the U.S. has attempted to provide a different understanding of the Rules Group's purpose. Rather than making proposals "aimed at clarifying and improving disciplines" pursuant to paragraph 28 of the Doha Ministerial Declaration, the U.S.' first submission has attempted to redefine the Group's purpose as preserving, strengthening and even expanding the disciplines. In the process, the United States has attempted to provide a historical background that justifies the need to preserve, strengthen and expand disciplines.

Based on the United States' proposed four concepts to guide negotiations, subsequent submissions will likely be focused on strengthening and expanding disciplines. Some approaches to these disciplines have not been discussed in the first submission, in particular on

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transparency and due process, and standard of review. At least on transparency and due process, the U.S. can seek to establish common ground with some of its most ardent critics, including the AD Friends Group. Regarding standard of review, the U.S. risks the danger of subjecting its negotiating position to increased Congressional oversight in light of Congressional action (or inaction) on WTO findings against U.S. trade remedy laws and practices.

Although the U.S.' first submission discusses general concepts in need of reform, the U.S. response to questions from the AD Friends Group has shed some light on U.S. reasoning on specific AD issues. The U.S. dismissed most substantive issues raised including de minimis margins and the lesser duty rule, but appears vulnerable on issues including zeroing, facts available and sunset reviews. Furthermore, it would be wise for the U.S., AD Friends Group and other Members to establish common ground on issues where reform could be realistic, including procedural issues and strengthened disciplines on transparency and due process.

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USTR Hearing on Doha Agenda Negotiations on Industrial Market Access

SUMMARY

The Trade Policy Staff Committee ("TPSC"), chaired by the Office of the United States Trade Representative ("USTR"), held a hearing October 18, 2002 on non-agricultural market access issues arising from the Doha Development Agenda. Officials from USTR, International Trade Commission, and the departments of Commerce, Labor, and State heard testimony from witnesses and asked questions on how to best represent their interests in WTO negotiations.

Industry groups that gave testimony include the National Association of Manufacturers (NAM), Walmart, and industry representatives from the textiles and footwear, chemistry, electronics, fisheries and other industries. We present below the questions and answers raised in the course of the hearing.

I. Approaches to Question and Answer Period

Generally, TPSC members had the following approaches to their questions:

- United States Trade Representative (USTR): How to "sell" WTO market-access proposals to other countries.
- Department of Commerce (DOC) and International Trade Commission (ITC): Effects of WTO liberalization on domestic industries.
- Department of Labor (DOL): Effects WTO liberalization would have on domestic employment. In almost all cases, witnesses were asked to follow up with written projections of effects on the labor market.
- Department of State (DOS): Effect of WTO liberalization on US preference programs.

II. Questions to Industry Representatives

A. Counsel to the Rubber and Plastic Footwear Manufacturers Association

DOC: Will the maintenance of tariffs on these items lead to growth in the domestic industry?

A: Yes, an example is the growth of New Balance.

USTR: What is the export potential and the key export markets for this industry?

A: The export potential is VERY limited, as these products are being manufactured very cheaply in China and other markets.

B. American Apparel and Footwear Association

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DOS: What percentage of AAFA members participate in preference programs, such as AGOA (African Growth and Opportunity Act), CBI (Caribbean Basin Initiative), etc.?

A: Most members participate, but to varying degrees. It is unclear what the effects on the preference programs would be if tariffs on these goods were to decrease. The effects likely would vary greatly by program and product.

USTR: The AAFA proposes the same program for developed and developing countries. Does the AAFA suggest using the same approach for LDCs?

A: The AAFA understands the need for some countries to start at different points. However, the faster you can get everyone to the same end point, the better. The future of market access in the sector is in South-South trade and, therefore, we need to get these countries to realize the benefits of trade liberalization.

USTR: What would be your response to LDCs who say that the Doha mandate gives them flexibility?

A: The longer you keep the LDCs out of the "full picture", the longer they will stay out.

DOC: What are some of the non-tariff barriers in the sector?

A: Different labeling and standards requirements and customs valuation issues.

C. Footwear Distributors and Retailers of America

USTR: Has the FDRA developed a consensus with similar groups in other countries?

A: The FDRA has approached other major shoe producing countries, like the EU, Canada, Japan, Thailand, Indonesia, etc., although groups in these countries are "not where the US is." Other groups are now just focusing on the question of the elimination of duties, but there seems to be interest.

ITC: FDRA then, takes a different stance than RPFA?

A: FDRA could not disagree more with RPFA's position. When imported goods are so much cheaper, then obviously domestic companies are differentiating their products by something besides price.

D. American Textile Manufacturers Institute

USTR: Regarding the recent international meetings of textile associations, do all of them support that countries should come down to US levels before the US makes more concessions on textiles and apparel?

A: It was discussed, but the ATMI representative said he "doubts it".

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DOS: How do you propose "selling" to the LDCs that tariffs must be cut to the same low level for all countries?

A: Convince them that they need to start trading with each other and that the US market is not the only market. US negotiators must come to the table saying that it is their mandate to do so.

DOS: The Doha mandate says that LDCs do not have to fully reciprocate.

A: The ATMI feels strongly that the playing field needs to be leveled. These countries are not large consumers of these products. Therefore, decreasing their own tariffs won't stop them from exporting to the US, Japan and the EU.

DOC: The ATMI advocates a sectoral approach—what about treating all industries the same?

A: The ATMI likely would be against such an approach. The ATMI concedes that there are some products where tariffs can be cut, but not on others.

ITC: Do we have the flexibility to look at textiles and apparel differently?

A: Yes.

E. National Association of Manufacturers

DOC: You propose a request-offer approach for those products that can't be adequately addressed by a formula approach—to which industries do you refer?

A: No specific products. NAM wants to reserve its options, though, in case the formula approach does not cover all priority products.

USTR: You recognize that tariffs are a principle source of revenue for governments. How do you suggest we handle this issue in the negotiations?

A: NAM likes the sectoral approach because it allows some countries to opt-out. The NAM is hopeful that the advanced countries will not have a problem with liberalization. The NAM also notes that LDCs are not a huge source of trade for the US.

USTR: You mention a "critical mass" in your testimony. What criteria would you use to determine a "critical mass"?

A: NAM has not laid out a percentage of trade, etc. to determine a "critical mass". NAM wants to the idea open.

USTR: There are some countries that argue a sectoral approach is a way for the US to "cherry pick" sectors that benefit the US.

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A: The US should make clear that developing countries should put their own proposals forward. Also, the US should explain that the formula approach will serve as the "background", so their products of interest still would be covered.

USTR: What if other countries propose liberalizing sectors that are sensitive to the US?

A: In certain sectors, if all parties liberalize, then this would be okay.

F. Section of International Law and Practice and Antitrust Law of the American Bar Association

Generally, TPSC Members seem to be confused why the proposal from the American Bar Association (ABA) on antitrust issues was being brought up at a hearing for non-agricultural market access and questioned whether the WTO was even an appropriate venue for such a discussion.

DOL: Would the US have to change any domestic laws if the proposal was adopted?

A: No, the proposal is consistent with US antitrust law.

USTR: Where do you suggest this proposal be addressed?

A: The principles should be considered in various areas. There is no agreement on whether competition policy should be considered within the WTO.

G. United States Association of Importers of Textiles and Apparel

DOS: What are the effects on countries with preference programs versus those that aren't included in US preference programs?

A: Duty advantage is not necessarily a reason for textile and apparel countries to locate operations in a particular country. Reasons vary, but duty preference programs are not a driving force in the decision-making process. USAITA does not believe the zero-for-zero proposal would affect preference programs much.

H. American Chemistry Council

USTR: What about linking your proposals to address high tariffs in developing countries and eliminating tariffs below 5 percent?

A: They both need to be addressed. The chemical industry tends to lag GNP growth in developed countries and exceeds GNP growth in developing countries. The proposals are not trade-offs for each other.

(The representative did not understand USTR's question, which is why the answer doesn't really "answer the question".)

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DOC: Would developing countries accept your 80-15-5 approach?

A: They should be able to, since the proposal allows flexibility for developing countries to include different products in the first, second and third stages. Therefore, all countries would not have to commit to the same products in the same timeframe.

I. Consumers for World Trade

USTR: Have you worked with similar groups in other countries, especially in those with highly protected markets?

A: CWT has had conversations with other groups, but not with groups in highly protected markets.

USTR: How do you judge the trade-off between benefits to consumers versus industry representatives who want to protect jobs?

A: The evidence shows that the tariffs are not protecting jobs. One needs to look at whether maintaining tariffs will increase jobs. CWT does not think that existing tariff barriers are going to increase jobs in the US.

J. National Fisheries Institute

USTR: What is the ideal percentage for the formula approach?

A: The goal is the elimination of fish tariffs at the end of the day. NFI would support any method, as long as the goal is reached. However, if you base reductions on bound rates, the cuts would have to be very ambitious, as the bound rates are very high.

K. National Electrical Manufacturers Association

DOC: What do you consider priority countries in zero-for-zero initiatives in the medical devices sector?

A: NEMA prefers not to specify, but it could include a group of developing countries that did not participate the first time around.

USTR: Would your proposal benefit SMEs (small and medium-sized enterprises)?

A: NEMA would expect SMEs to benefit, as they have under NAFTA.

L. Wal-Mart

USTR: Does the 3 percent figure in your proposal have any significance?

A: There are several household goods that fall under the 3 percent line.

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ITC: Regarding rules of origin, are you seeking harmonization?

A: Yes, and streamlining.

DOC: What are some of the products that Wal-Mart can't offer because of high tariffs?

A: It is not a question of "can't", but rather choosing not to offer the product based on the high price. Certain shoes are an example.

M. American Restaurant China Council

USTR: Regarding your testimony that the United States should be flexible in deciding the formula or modality for tariff reductions, how do you think the US could be more flexible?

A: An across-the-board tariff cut would be devastating to the commercial china industry. The ARCC wants USTR to remember that in the Tokyo and Uruguay Rounds as well as NAFTA, the US took into account the "special circumstances" of the commercial china industry.

USTR: Is your industry exporting?

A: Very little, especially compared to what is being imported.

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GAO Report Concludes Trade Policy Advisory Committee System Should Be Updated

SUMMARY

On October 23, 2002, the General Accounting Office (GAO) released a report entitled "Advisory Committee Should Be Updated to Better Serve U.S. Policy Needs." The report concludes that the trade policy advisory committee system needs to be updated to reflect changes in the U.S. economy and trade policy.

Various U.S. agencies involved in the formation of trade policy received the report. Some of the agencies have indicated that they will implement some of the GAO's recommendations to strengthen the system.

We summarize the report below. The full report is available at www.gao.gov.

ANALYSIS

I. Background

Congress established the trade policy advisory committee system in section 135 of the Trade Act of 1974, as a way to give interested parties outside the federal government input in U.S. trade negotiations and to provide the U.S. government with a body of private sector experts with whom they can develop an ongoing dialogue. The system consists of three tiers:

- The top tier provides "overall policy advice";
- The second tier provides "general policy advice"; and
- The third tier provides "technical advice and information."

There are approximately 735 advisers spread across 34 committees, with the bulk of these committees in the third tier, 5 committees in the second tier, and just one committee, the Advisory Committee for Trade Policy and Negotiations (ACTPN), in the first tier. The United States Trade Representatives (USTR) administers the advisory system with help from the departments of Agriculture, Commerce, and Labor, among others.

Senator Chuck Grassley (R-Iowa), Ranking Member of the Senate Finance Committee requested that the General Accounting Office (GAO) examine the role, structure, and operations of the Trade Policy Advisory Committee system to ensure that it still meets the objectives set by Congress. Specifically, the GAO examined:

- The system's value to U.S trade policy.
- The participants' level of satisfaction with specific aspects of the consultation process as well as aspects that they said could be improved.

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- The degree to which the system matches the current U.S. economy and supports U.S. trade policy needs.

- USTR and the other agencies' management of the system.

II. Report Findings

The GAO report findings conclude that:

- The Trade Policy Advisory Committee system's consultations are not always timely and meaningful.

- When advice is provided, there is little assurance that Executive branch officials are held accountable for considering it.

- The committee structure has not evolved fully to reflect today's economy, and some key trade interests that have recently surfaced are missing or poorly represented.

- USTR's decentralized management of the agencies has left the system without sufficient direction or support. With limited resources devoted to the system's functioning, its agencies are struggling with administrative tasks.

- Because important negotiations are under way for which Advisory Committee input is expected and desirable (*e.g.*, the U.S.-Chile Free Trade Agreement (FTA), the U.S.-Singapore FTA, the Free Trade Area of the Americas, and the Doha Round), improvements should be made.

III. Recommendations

The GAO recommends that the consultation process should be strengthened by:

- Adopting and amending guidelines and procedures to ensure that (i) the committee system's input is sought on a continual and timely basis; (ii) its consultations are meaningful; (iii) its advice is considered; and (iv) committees receive substantive feedback from the Executive branch on how agencies respond to their advice;

- Filling gaps in committee composition and revitalizing membership;

- Streamlining the nomination and appointment process for committee members;

- Preventing disruptions in committee activity due to lapses in charters that determine committee membership, mainly by making sure that these charters provide for larger industry representation amongst the members; and

- Providing sufficient resources to support these improvements.

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In addition, the GAO recommends that the system be updated to make it more relevant to the current U.S. economy and trade policy needs by:

- Assessing the system's structure and composition;
- Better incorporating new issues;
- Meeting negotiator needs in a more reliable manner by providing clear policy direction and better execution of administrative tasks; and
- Better matching the resources to the management system.

OUTLOOK

The GAO provided draft copies of the report to the USTR, the Department of Agriculture (USDA), the Department of Commerce, the Department of Defense, the Department of Labor, and the Environmental Protection Agency (EPA). USTR and USDA agreed with the overall findings and said they are taking initial steps to implement the recommendations.

Commerce generally considered the report to be "thorough and fair," but disagreed with the GAO on a number of points, such as the timeliness and quality of consultations, accountability for seeking and responding to committee advice, and the need to update the system's structure, citing members' satisfaction with all of these. Commerce, therefore, urged the GAO to make some modifications. Although the GAO added some of these comments to its report, it still maintains its general conclusion that the system's structure needs to be updated.

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Baucus Calls for "Partnership of Equals" Between Congress and Administration on Trade Policy

SUMMARY

In a recent speech to the full Senate, Finance Committee Chairman Max Baucus (D-Montana) proposed several specific guidelines on consultations between Congress and the United States Trade Representative (USTR) regarding trade policy. The Trade Act of 2002 mandates that USTR, in consultation with Congress, develop the guidelines by December 4, 2002.

Baucus' proposals include (i) access to negotiating documents, (ii) access to regularly scheduled negotiating sessions, (iii) clear schedules for consultations relating to negotiating sessions, and (iv) consultations regarding monitoring and enforcement of trade agreements. Baucus believes that the relationship between Congress and the Executive with regard to trade should be "a partnership of equals" and that the guidelines will be the first opportunity "to memorialize this new, interdependent relationship." Some in the Administration, however, oppose what they consider a more intrusive role by Congress in bilateral, regional and WTO negotiations and policy.

ANALYSIS

I. Baucus Proposes Greater Congressional Oversight on Trade Policy

In an October 17, 2002 speech to the full Senate, Finance Committee Chairman Max Baucus (D-Montana) proposed several specific provisions to guide consultations between Congress and the United States Trade Representative (USTR). The Trade Act of 2002 mandates that USTR, in consultation with Congress, develop the guidelines by December 4, 2002 *(Please see W&C September 18, 2002 Report).*

Baucus believes the guidelines will be "the basis for the partnership of equals called for by the Trade Act of 2002." Analysts note that Baucus interprets the consultation provisions in the Trade Act of 2002 to mean that Congress should not only be consultants but full partners with the Administration in trade negotiations. The Administration and some Members of Congress, however, believe that Baucus' interpretation of Congressional oversight is more intrusive than intended by the Trade Act *(Please see W&C October 11, 2002 and October 22, 2002 Reports).*

Baucus asserts that the current full trade agenda necessitates clear rules for Executive-Congressional consultations. The guidelines should address in particular:

- The frequency and nature of briefings on the status of negotiations;
- Member and staff access to pertinent negotiating documents;

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- Coordination between USTR and the Congressional Oversight Group (COG) at all critical periods during negotiating sessions, including at negotiation sites;

- Consultations regarding compliance with and enforcement of trade agreement obligations; and

- A timeframe for the President's transmittal of labor rights reports concerning the countries with which the US concludes trade agreements.

II. Baucus Guidelines on Congressional-Executive Trade Policy Coordination

A. Access to Negotiating Documents

Baucus proposes that USTR provide Congress with negotiating proposals not less than two weeks before U.S. negotiators present them to negotiating partners. Baucus believes this will give Congressional trade advisers time to convey comments and make recommendations "with a reasonable expectation that their comments and recommendations will receive serious consideration." In the same way, Baucus believes that U.S. negotiators should promptly make other country's proposals available to Congress "to keep [Congress] abreast of the give-and-take of negotiations and to provide intelligent input into the development of the U.S. position."

B. Access to Regularly Scheduled Negotiating Sessions

Baucus believes Congressional trade advisers should have access to regularly scheduled negotiating sessions. He acknowledges that some in the Administration will be angered by this proposal, citing separation of powers concerns. However, Baucus points out that he "is not suggesting Congressional trade advisers or staff actually engage in negotiations. I am suggesting only that they attend as observers. This level of Congressional involvement in negotiations has well established precedents." Baucus cited a recent Congressional Research Service (CRS) study that catalogues the history of Senate participation in treaties and other international agreements from 1898 to present.

Baucus explained that the Trade Act of 1974 contemplated a close working relationship between Congress and the Administration. During the Tokyo and Uruguay Rounds, Finance and Ways and Means Committee staff traveled regularly to Geneva, were included in USTR staff meetings, and observed negotiating sessions. In addition, they had regular access to cable traffic and negotiating documents *(Please see W&C October 22, 2002 Report).* According to Baucus, "By all accounts, this process worked well. Staff, and, in turn, Members were kept well informed of the progress of negotiations, which helped to secure Congressional support for the resulting agreements."

Baucus noted that even when fast-track lapsed between 1994 and 2002 and the express mandate for a Congressional-Executive partnership on trade lapsed as well, Members of Congress still sought to remain closely involved in trade matters. The renewal of fast track/TPA in the Trade Act of 2002 contemplates "an even closer working relationship between Congress and the Administration than the Trade Act of 1974." Thus, Baucus believes, "It is time to revive

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and strengthen the practices that solidified a close, robust working relationship in the past." For these reasons, Baucus "sees little basis for excluding Congressional observers from trade negotiations."

C. Clear Schedule and Format for Consultations in Negotiating Sessions

Baucus wants the guidelines to set forth a clear schedule and format for consultations in connection with negotiating sessions. Baucus believes that U.S. negotiators should meet with Congressional advisers' staffs both shortly before regularly scheduled negotiating sessions and shortly after their conclusion. These consultations should be "an opportunity for negotiators to lay out, in detail, their plan of action for upcoming talks and to receive and respond to input from Congressional advisers. Whenever practicable, consultations should be accompanied by documents pertaining to the negotiation at issue. If advisers or staff make recommendations during consultation sessions, arrangements should be made for negotiators to respond following consideration of those recommendations." If Congressional advisers or their staffs are unable to attend actual negotiating sessions, Baucus wants USTR to provide phone briefings during the negotiations.

Baucus concluded, "The key point here is that it is the quality as much as the quantity of negotiations that counts…It matters little that the Administration briefed Congressional advisers a hundred times in connection with a given negotiation, if the briefings amount to impressionistic summaries with no meaningful opportunity for advisers to offer input."

D. Inform Congress of Efforts to Monitor and Enforce Trade Agreements

Baucus also wants the guidelines to set forth a plan to keep Congressional advisers fully apprised and in a timely manner of efforts to monitor and enforce trade agreements. In addition to monitoring compliance, this would allow Congress and USTR to identify provisions that might need to be modified in future trade agreements. Keeping Congressional advisers apprised of monitoring and enforcement should be "systematic" not "episodic." Thus the guidelines should provide for consultations on monitoring and enforcement at least every two months. According to Baucus, "These consultations should not just highlight problems. They should provide a complete picture of how the Executive Branch is deploying its monitoring and enforcement resources. They should identify where these efforts are succeeding, as well as where they require enforcement."

OUTLOOK

Baucus believes the Trade Act of 2002 represents "a watershed" in relations between the Executive and Legislative branches in terms of greater cooperation on trade policy and negotiations. Baucus asserts that Congress sent a clear message in the Trade Act of 2002—"From now on, the involvement of Congressional advisers in developing trade policy and negotiations must be in depth and systematic. Congress can no longer be an afterthought. The Trade Act establishes a partnership of equals." Clearly, he envisions a more expansionist role in Congressional oversight of trade policy.

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Some in the Administration including at USTR, however, object to what they perceive as a more intrusive role by Congress – and perhaps a violation of separation of powers between the Legislative and Executive branches. Recently, USTR negotiators refused attempts by a Baucus staff member to observe negotiations of the U.S.-Chile Free Trade Agreement *(Please see W&C October 11, 2002).* Nevertheless, U.S. officials have made some efforts to gain Congressional input on negotiating texts, including on the first U.S. submission on antidumping negotiations to the WTO Negotiating Group on Rules (which was floated to Congress one week prior to release in Geneva this month).

USTR and Congress are working to finalize the guidelines on greater cooperation on trade policy – due by December 4, 2002. Analysts postulate that the guidelines will be pivotal to concluding the FTAs with Chile and Singapore, and to building trust with Congress to launch new negotiations with Morocco, Central America, and the Southern African Customs Union, among other partners. Moreover, the guidelines will shape Congressional influence on U.S. negotiating positions at the WTO, including on sensitive issues like trade remedy laws and agricultural subsidies.

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McDermott Calls for New Consensus on Trade; Speakers Discuss Future of U.S. Trade Policy Following TPA Passage

SUMMARY

Representative Jim McDermott (D-Washington) recently joined the dispute brewing on Capitol Hill over the interpretation and implementation of the Trade Promotion Authority (TPA) provisions contained in the Trade Act of 2002. McDermott believes that the current lack of consensus on the TPA provisions is a direct result of the failure of the TPA architects to address the most contentious issues in drafting the bill. In his remarks at the annual Washington Trade Expo on October 10, 2002, McDermott called for a new consensus on trade and outlined steps he believes that the US must take to change the current trade debate.

During a panel discussion at the same event, Greg Mastel and Angela Ellard, trade staff for the Senate Finance Committee and House Ways and Means Committee, respectively, discussed the future of U.S. trade policy following passage of TPA. Mastel outlined Senate Finance Committee Chairman Max Baucus' (D-Montana) priorities for trade, and Ellard discussed some of the lessons learned from the TPA debate. Mastel and Ellard disagreed on the role of Congress in negotiations as well as the interpretation of labor and environmental provisions in TPA.

ANALYSIS

I. McDermott Calls for New Consensus on Trade

Addressing the annual Washington Trade Expo on October 10, 2002, Representative Jim McDermott (D-Washington) joined the dispute brewing on Capitol Hill over the interpretation and implementation of the Trade Promotion Authority (TPA) provisions contained in the Trade Act of 2002. McDermott believes that the current lack of consensus on the TPA provisions is a direct result of the failure of the TPA architects (*i.e.*, Senate Finance Committee Chairman Max Baucus (D-Montana), Ranking Member Charles Grassley (R-Iowa), and House Ways and Means Committee Chairman (R-Thomas), among others) to address the most contentious issues in drafting the bill. McDermott stated that they "finessed the whole thing," thus providing no greater clarity on the contentious issues, which he believes will ensure that Congress will have to revisit them with each set of negotiations. For this reason, McDermott concluded that TPA does "as much harm as good" and that the United States will continue to execute its trade policy on an ad hoc basis.

McDermott criticized claims by the Bush administration that it has reinvigorated the U.S. trade agenda with TPA, thus ignoring the Clinton administration's achievements in international trade and the bipartisan consensus that existed on trade issues during the Clinton administration. McDermott claims that TPA has polarized Members on both sides, which will result in debates on future trade agreements that are as "rancorous" as the debate on the TPA bill.

McDermott says that the trade debate needs to be changed fundamentally by:

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- **Transforming the Congressional-Executive Process**: It is imperative that Congress be a full participant in trade negotiations. Consultations are not sufficient because trade policy ultimately is domestic policy. Echoing recent remarks by Senate Finance Committee Chairman Max Baucus (D-Montana), McDermott stated that the United States Trade Representative (USTR) must give Congress information, including actual negotiating texts, within a timeframe that allows Congress to thoughtfully review them and make proposals. McDermott suggested that USTR is moving in the right direction but that it still has a long way to go *(Please see W&C October 11, 2002)*.

- **Deciding How to Enforce Labor and Environmental Provisions**: McDermott rejected the notion of a separate enforcement approach for labor and environmental provisions, stating that future trade agreements should "mirror" the language on labor and environment in the U.S.-Jordan Free Trade Agreement (FTA) (*i.e.*, the Jordan standard). When asked if he envisioned the Jordan standard to include the side letters on enforcement signed in conjunction with the agreement, McDermott replied that they had "undercut the damn argument" and undercut Congressional confidence in the Administration's commitment to protecting labor and environmental standards *(Please see W&C July 26, 2001 Report).*

- **Moving Past "Lip Service" on Labor and Environmental Standards**: The Administration should demonstrate actual support for labor and environmental standards by devoting resources and taking real action. McDermott believes that the Administration sends the message that it is not supportive of improving standards abroad (*e.g.*, USTR has taken no significant steps to address labor and environmental standards in the context of the renewed Andean Trade Preferences Act).

- **Developing a More Cohesive Approach to Trade**: The United States' overall approach to trade seems to lack a coherent strategy, especially given USTR's limited resources, which is especially problematic since the US is currently involved in major bilateral negotiations as well as the Doha Round and negotiations toward a Free Trade Area of the Americas (FTAA).

II. Speakers Discuss Future of U.S. Trade Policy Following TPA Passage

The Washington Trade Expo also included a panel presentation on "TPA: What's Next? Views from the Hill." The panel was comprised of Greg Mastel, Chief International Trade Counsel and Chief Economist for the Senate Finance Committee; Angela Ellard, Staff Director and Counsel, Subcommittee on Trade, House Committee on Ways and Means; and Jan Adams, Minister-Counsellor, Embassy of Australia. The panel's statements were made off-the-record.

A. Mastel Outlines Baucus' Priorities Post-TPA

Mastel outlined Senate Finance Committee Chairman Max Baucus' (D-Montana) priorities:

- **Overseeing Negotiations, including the free trade agreement (FTA) negotiations with Singapore, Chile, Morocco, and Central America, as well as the Free Trade Area of the Americas, and the Doha Round:** In this regard, the Finance Committee is shifting its focus from legislation (*i.e.*, the Trade Act of 2002) to oversight, especially of the many sensitive issues being negotiated, including labor and environmental provisions and investment. Mastel stated that there exists a "deep bipartisan concern" to address these issues.

  The Congressional Oversight Group (COG) has been established and has held its first meeting *(Please see W&C September 18, 2002 Report).* Now Congress must decide how the COG actually fits into the oversight process to facilitate better cooperation on trade matters between Congress and the Administration. Baucus believes that if Congress does not feel like it is a full participant in negotiations, the possibilities for failure are very high. Nonetheless, Baucus does not want the COG to supplant the Finance and Ways and Means Committees in their trade oversight roles.

- **China's WTO Compliance:** Baucus believes that the period of "relaxed consultation" will soon end and that next year Congress will dedicate greater attention to China's compliance with its WTO commitments. Moreover, Congress will begin to focus on what disputes can be brought against China at the WTO, if China does not come into full compliance by 2003.

- **WTO Dispute Settlement:** Mastel referred to remarks Baucus recently made regarding the WTO Dispute Settlement Body (DSB), which he called a "kangaroo court." Baucus is critical of the DSB because the United States has become a net loser in panels over the past few weeks (*i.e.*, the Byrd amendment, lumber, steel 201). Although Baucus admits there is no "magic bullet" to solve all of the issues he has with the DSB, Mastel believes the United States will begin to look for solutions to some of the issues because "the cumulative effect on U.S. trade laws is significant." In the context of the Doha Round, the US may propose permanent panels to attempt to deal with the problems Baucus and other Members want to address.

B. Ellard Discusses Lessons Learned from TPA Debate

Ellard stated that, by definition, the TPA bill was a "thoroughly bipartisan" effort since it was shepherded through a Republican House and a Democratic Senate to the President's desk. Nonetheless, this "carefully drafted" legislation is now the subject of differing interpretations, which is making implementation difficult *(Please see W&C October 11, 2002 Report).*

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Nonetheless, Ellard believes that the Congressional Oversight Group (COG) will build on the bipartisan consensus that led to passage of TPA.

Ellard focused her remarks on the lessons that have emerged from the TPA debate:

- **Need for Consultations:** The consultation process, especially the function of the COG, remains difficult, especially in the House due to (i) the number of committees involved and (ii) the fact that almost half of the House COG members voted against TPA. Ellard echoed Mastel's remarks that the COG should not supplant the Finance and Ways and Means Committees; in fact, TPA also mandates consultations with the two committees of primary jurisdiction over trade.

- **Focus on Trade Remedies:** Trade remedies became the most controversial topic in the TPA debate. Ellard and many analysts thought that labor and environment would be the most sensitive topics. Members have made it clear that the United States must be able to vigorously enforce its trade remedy laws and preserve their ability to use them, which is one of the Principal Negotiating Objectives contained in TPA.

- **Enforcement of Labor and Environmental Standards:** Although the language on labor and environment contained in TPA is based on the Jordan standard, Ellard was quick to point out that the TPA drafters did not intend for enforcement and remedies to be identical in every agreement. Instead they hoped to give the Administration direction in negotiations so that they would negotiate enforcement mechanisms and remedies appropriate to a particular agreement. Republicans generally oppose traditional trade sanctions for the enforcement of labor and environmental standards. Thus Ways and Means Committee Chairman Bill Thomas (R-California) is looking for new types of remedies, like fines, so that innocent parties, like consumers, are not affected downstream.

- **Agriculture Pivotal to Future Agreements:** Ellard explained that Members are paying very close attention to the Doha agriculture negotiations and that strong support for agriculture is necessary to form a strong coalition of support for a future WTO agreement.

C. Mastel and Ellard Disagree on Role of Congress in Negotiations and Jordan FTA Standard

Mastel and Ellard responded to a question regarding whether Congress views USTR's refusal to allow a Baucus staffer to sit in on the recent U.S.-Chile negotiations as a step backward, given the congressional consultations provisions in the Trade Act of 2002.

- Ellard responded that the Congressional Trade Advisors have never been allowed to sit in on actual negotiating sessions, although they were often on-

site. Members of Congress are not observers, nor negotiators. They are meant to serve as consultants, but they do expect a major degree of consultation. For example, Ellard noted that she had recently found a number of significant negotiating documents, not just final negotiating texts, from past negotiations that USTR provided to the House Ways and Means Committee. Her discovery of this wide range of negotiating documents demonstrated to Ellard the level of consultation that Congress expects from USTR and has received in the past.

- Mastel stated that Baucus believes Members should be observers, which would make them feel like a vital part of the process. He stated that he does not understand "for the life of me" why the Administration would not jump at the opportunity to allow Members to observe negotiations, echoing Baucus October 4 remarks *(Please see W&C October 11, 2002 Report).*

- Mastel and Ellard were also asked about labor and environmental provisions in trade agreements and the Jordan FTA standard.

- Ellard repeated her earlier remarks that the TPA drafters did *not* intend for future trade agreements to be identical to the U.S.-Jordan FTA with regard to labor and environment.

- Mastel stated that as the TPA bill moved forward, the drafters decided "one size does fit all" (*i.e.*, the Jordan standard) and that the Committees made that clear in their Joint Explanatory Statement which accompanied the Trade Act of 2002 conference report *(Please see W&C August 2, 2002 Report).* Again echoing Baucus' October 4 remarks, Mastel stated that Baucus expects to see the Jordan standard in the Chile and Singapore agreements and that its absence could "imperil" the agreements.

Referring to Baucus' criticisms of the WTO DSB, Ellard was asked if the same perception that the WTO DSB is undercutting U.S. laws exists in the House. Ellard did not answer the question directly, but rather addressed the pending WTO dispute issues in Congress. In terms of the ETI dispute, Ellard stated that Chairman Thomas has decided that legislation is the only possible response to the WTO ruling. With regard to trade remedies, Thomas believes it is very important that the US begins to address its WTO inconsistencies, even though Members are concerned that the US vigorously enforces its trade remedy laws. She stated that all of these issues would "come to a head this year." Some analysts believe that Ellard meant Congress would address these issues this year.

OUTLOOK

Like Representative McDermott, Mastel and Ellard are concerned about the U.S. strategy for future FTAs. Mastel stated that Baucus would try "to pursue the issue" of what makes a credible FTA partner, especially given USTR's limited resources. Baucus, because of the opportunity cost issue involved in negotiating an FTA, believes the US needs to develop a more

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cohesive strategy for FTAs. Baucus believes FTA partners should be chosen for economic reasons. Using commercial benefits to determine FTA partners would mean that Morocco and Central America would not be priority countries for FTAs, but Mastel conceded that Israel and Jordan probably would not be chosen according to this criteria either.

In addition to the FTAs USTR currently is negotiating with Singapore and Chile, USTR has recently informed Congress of its intention to launch FTA negotiations with Morocco, Central America, and most recently, the Southern African Customs Union *(Please see W&C October 17, 2002 Trade Alert).*

Ellard believes the US needs to look at a combination of factors in developing its FTA strategy. For example, an FTA with Morocco would be important for national security reasons, while an FTA with Central America could serve as a building block towards the Free Trade Area of the Americas. Ellard did, however, point out that although Australia is an important strategic partner of the US, USTR is not pushing an FTA with Australia due to agricultural and sanitary and phytosanitary concerns, so the security issue is not the overriding factor in this case.

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WTO WORKING BODIES

US, EC and Japan Submissions in the Transitional Review Mechanism on China's Import Licensing Regime

SUMMARY

The United States, European Communities and Japan submitted comments and questions to China on its import licensing regime on August 12, 28 and 29, respectively, in the context of China's Transitional Review Mechanism held in the Committee on Import Licensing, which met on September 24, 2002. After the meeting, the US submitted a statement and additional questions to China on September 30.

The US, EC and Japan's main concerns on China's import licensing system are:

- ***Transparency*** — Failure to notify all rules, information and changes concerning import licensing procedures.

- ***Import quotas on automobiles*** — Discrepancy between quotas allocated and actual imports; priority consideration for new entrants in quota allocation; and quota reallocation.

- ***Separate licensing*** — Requirement of separate license applications beside quota applications, and different licenses depending on the modes of trade.

- ***AQSIQ import inspection certificate*** — Requirement that applicants obtain a quarantine inspection certificate before importation.

China submitted its notification and initial responses to Members on September 20 and 23. China responded to some questions on licensing administration; administration for processing trade; allocated quotas vs. actual imports; information on quota value; and transparency. During the September 24 committee meeting, China again rejected the request for written responses to questions from Members and asserted that these requests had no legal basis in China's Accession Protocol. China also insisted that further questions from Members concerning China's trade policies will receive due responses, but not in the context of this TRM. The Chairman finally decided to prepare a factual report on China's TRM, and further discussion on specific questions raised in the TRM would be addressed outside the TRM.

ANALYSIS

I. Transparency a Priority Concern

Among the issues raised by members, the lack of transparency was a common complaint. Members believe that China has not fulfilled its commitment to notify all regulations, changes to its WTO commitments, or submit various report or replies to Questionnaires. For example,

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countries asked for information on quota and licensing procedures, including list of goods that are subject to import licenses, government agencies that are responsible for issuing the licenses, and criteria for import licensing, etc.

II. The United States Highlights Licensing Administration and Other Issues

Separate Licensing Procedures

The US raised the issue of licensing procedures several times in different forms. The US is particularly concerned that China requires licenses to be obtained separate from the allocation of quotas. An example of separate licensing practice is given in the statement submitted by the US on September 30 relating to SDPC's practice. The US also mentioned that the procedure for applying for licenses is burdensome because quota-holders are required to have a signed contract and provide detailed, time-sensitive commercial information such as price and origin prior to obtaining an import license. The application also restricts the quota holder from changing those commercial terms.

AQSIQ Licensing Requirements

The US questioned the quarantine inspection permits ("AQSIQ") application procedures and requirements. In its submission on September 30, it stated that quota-holders are required to apply for and obtain an additional "import license" from the AQSIQ at both the local and national level before the product can be imported. The US further complained that the procedure for applying for such a permit is unreasonable as quota-holders are required to provide detailed, time-sensitive commercial information prior to obtaining an import license. Moreover, the commercial terms cannot be changed thereafter.

Processing Trade

As to processing trade the US raised two issues. First, the US questioned the necessity for entities that wish to import under TRQs related to processing to acquire a Processing Business Approval Certificate. Second, the US said the restriction on the sale of products imported under processing trade on the domestic market is unreasonable.

Quota Application Procedures and Criteria

The US seeks confirmation from China about the period open for quota application, and whether the criteria for quota allocation are those listed in the Working Party Report.

Tariff Rate Quotas (TRQs)

As to TRQs, in submission dated August 29, the US seeks general information on how TRQs are administered and urge a "transparent, predictable, uniform, fair and non-discriminatory" approach. The US asked how China would assure that quota allocation and reallocation will be made by a single, central authority and whether China reserved a portion of the TRQs for non-state trading enterprises.

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Administration of Machinery, Electronic and Auto Quotas

In its submission on September 30, the US asked about the current status of import quota allocation distributed by local foreign trade and economic cooperation offices, and for machinery and electronic products. As for automotive quotas, the US stands with Japan in urging that licenses be extended by the period in which quota allocation has been delayed.

Other Issues Raised

The US refers to some specific regulations on import licensing. These questions can be categorized under transparency, application procedures and criteria (for licenses) and processing trade.

III. EC Submission Highlights Transparency and Legislative Compliance

The EC's questions fall into two categories: (i) transparency; and (ii) legislative compliance with WTO obligations. The EC also requested detailed explanations of the WTO consistency of the following laws:

- Measures on the Administration of Automatic Licensing for Goods;
- Implementing Rules for the Administration of Automatic Licensing of Important Industrial Products; and
- Measures for the Administration of Licenses for the Import of Goods, and Administrative Regulations on the Registration of Foreign Manufacturers of Imported Food

IV. Japan Submission Highlights Import Quotas on Motor Vehicles

Japan's submission points out delays in allocation of automotive import quotas and for other products:

Qualifications

Japan asked about qualifications of the applicant (for import quotas), and in regards to trading rights. Japan asked whether entities without trading rights can qualify as applicants.

Quota Administration

Japan asked the current status of import quota allocation distributed by local foreign trade and economic cooperation offices and State Council-related machinery and electronic products import and export offices.

Quota Value for Autos

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Japan requested China to provide information on the value of import quotas for complete vehicle, CKD and parts, broken down respectively by country of origin, engine displacement and company.

Allocation Procedures

Japan requested China to confirm that quotas for 2003 will be allocated by Oct 30, 2002.

Reallocation of Quota

Japan requested China to reallocate the unused quotas for 2002 and asked whether China intends to postpone the deadline for return of unused quotas due to the delay in quota allocation this year.

New Entrants

Japan asked whether China gave priority consideration to new entrants in quota allocation and about the amount of quotas that went to new entrants.

Import Licenses for Autos

As for import licenses for automotive quotas, Japan requested China to extend the licenses by the period for which the quota allocation was delayed.

V. September 24 Meeting of Committee on Import Licensing

The Committee on Import Licensing met on September 24 and carried out the first transitional review of China. At this meeting, China rejected any request that China provide written responses to questions raised by Members prior to the meeting, saying that these requests had no legal basis in China's accession Protocol. However, China did address orally some questions raised by Members.

For example, in regards to transparency issues raised by Members the representative of China said China had made maximum efforts to comply. China will continue its effort to translate all the relevant laws, regulations and administrative procedures into a WTO working language. China added that it has already published the list of entities responsible for the authorization or approval of imports, and had notified these activities to the WTO.

In responding to the US representative, the representative of China addressed the following issues:

Separate Licensing Requirements

The representative responded that China did not apply any separate import licensing requirement. In agricultural TRQ administration, the quota holder only needs to show to customs its TRQ certification. This was the only import licensing requirement applied. China

considers it within reason for authorities to ask the end-user to sign a contract before applying for a TRQ certificate.

With regard to the question that China requires quota holders to provide further information on use, the representative of China pointed out that the intention was to guarantee the full utilization of the quota.

AQSIQ License

The representative of China said the AQSIQ license concerns a quarantine matter, and should be discussed in the TBT or SPS Committee instead of this Committee.

Administration for Processing Trade

The representative of China explained that processing trade meant the processing and re-export of the imported raw material. China believes it is legitimate to maintain this type of administration because processing trade enjoyed tariff exemptions. Selling products on the domestic market could not be considered as processing trade.

In response to the representative of Japan, China addressed the following issues:

Allocated Quotas v. Actual Imports

The representative said that quotas provide a market access opportunity and are not an importation obligation in themselves. The actual imports depends on the supply and demand of the market, and has no direct relationship with the quota allocated. The Chinese government encouraged the full utilization of quotas but could not guarantee whether the quotas allocated would be fully utilized.

Separate Quota Value for Automobiles and Parts

The representative explained that China maintains a single quota value for automobiles and key automotive parts, and therefore did not have a breakdown of statistics for this quota allocation.

OUTLOOK

The issues raised by Members to China include those which appear easy to resolve; indicate a possible misunderstanding or lack of awareness of existing regulations; or are potentially WTO-inconsistent.

Examples of minor issues include Question 34 of the US' August 29 submission, where the US asked China to explain the meaning of "the list of graded license issuance" and the "Catalog of Graded Issuance for Commodities Subject to Administration of Import Licence" in Article 3 and 9 of the *Measures for the Administration of Licences for the Import of Goods* – and was concerned that it might be another license requirement. The text of the regulation in question refers to a list of products that are subject to import licensing administration and

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designate various organizations responsible for issuing licenses. Also, in Questions 23 of the same submission, the US asked about the requirements to qualify as an "import business operator." This appears a minor translation issue as "import business operator" in Chinese is the same as enterprise with the right to trade.

The second category of issues were raised primarily for general information due to the lack of availability of relevant information or the lack of time to consider these issues. An example under this category can be found in Question 26 of US' August 29 submission where, with regard to Article 15 of the *Measures on the Administration of Automatic Import Licence of Goods* the US asked about the relevant provisions that are applied to licensing of imports by foreign-funded enterprises since the Measures does not apply to them. On Feb 8, 2002, China's MOFTEC and Customs service released the *Implementing Rules on the Administration of Automatic Import Licence of Goods of Foreign-funded enterprises.* Licenses granted under these Rules are "license for one batch" meaning that the same automatic import license can be used in accumulative customs declaration in batches, the maximum is six batches and the validity period is for six months. Nevertheless, the rules only apply to foreign-funded enterprises.

The more difficult issues in the third category relate to practices that are alleged by Members as WTO inconsistent. For example, on the separate licensing issue, the US considers the application for licenses as a separate process since applicants do not receive a license itself when they receive quotas. On the other hand, China probably for the purpose of administration, assigns a body separate from the quota issuance authority to issue licenses – and does not believe it is a separate process because applicants only need to present the required documents to the same authorities. If the documents are available and the content is correct, the license issuance body does not have discretion to refuse the license. Furthermore, the US asserts it is unreasonable for the license issuance authority to require a signed contract before issuing a license.

As many Members and trade associations have realized, nine months is too short to assess China's commitment under WTO. For example, the notification requirement presents tremendous challenge to China in light of the amount of laws China has released, amended or repealed. It is expected that with passage of time and as China becomes more familiar with WTO rules, issues in the first two categories will be easer to resolve.

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GATS "Services Week" Negotiations, 21 October to 1 November Focus on Requests for Market Access Improvements

SUMMARY

On 1 November, services negotiators in the WTO completed the latest period of intensive negotiations under the Doha Round. Though referred to as a services "week", this period ran from 21 October to 1 November. The negotiations will continue to be organized in this manner, which is intended to facilitate the presence of capital-based experts in Geneva; the next "week" is scheduled for 2-10 December. The process is therefore intense, and it is making good progress.

I. Bilateral Request-Offer Negotiations

Meetings of the Services Council and all of its subsidiary committees were also held during this period, but the main focus of attention was the bilateral meetings between delegations, the subject of which was requests for improved access to national services markets. Thirty Members, the EU counting as one, have submitted lists of requests, and all 145 WTO Members have received requests. It is known that a substantial number of developing countries are still preparing, and will shortly submit, their own requests. (The agreed date of 30 June 2002 for submission of requests was a target, not a deadline; the target date for submission of offers, 31 March 2003, will be treated with the same flexibility).

Well over 100 bilateral meetings took place during this period. In the review of progress in the negotiations carried out in the special session of the Services Council on 1 November, the vast majority of the 37 delegations which spoke expressed satisfaction with the process. The bilateral meetings were generally fruitful and positive, greatly assisted by the presence of sectoral experts from capitals. So far as the market access negotiations are concerned, therefore, the position is very satisfactory, giving promise of significant improvements in commitments at the end of the Round. But this could change. A number of countries complained about slow progress in others areas of the negotiations (see below) and this dissatisfaction could affect their readiness to put offers on the table.

More significantly, the Ambassador of Brazil, Mr. Seixas Corrêa, made a deliberate intervention on 1 November in the Service Council, which he normally does not attend, to underline that if there is no progress in the negotiations on agriculture there will be none in services. The statement was made on behalf of MERCOSUR-Argentina, Brazil, Paraguay and Uruguay-, and it noted that: "There has been a clear lack of engagement in the agricultural negotiations on the part of some key Members… As the deadline of 31 March approaches for the services initial offers for the definition of modalities in the agriculture negotiations, we expect to see some symmetry between the two areas". This has always been the underlying reality: for many developing countries, and for others such as Australia and New Zealand, the most important objective of this Round is liberalization of agricultural trade, and particularly the reduction of agricultural subsidies. If this does not happen the Round will fail. Since services liberalization is a major priority for the EU, the US and Japan, along with other industrialized countries, it is an obvious and legitimate tactic for agricultural exporters to stress the link with agriculture - and it is not just a tactical posture. Following the apparent decision of the EU at the

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Brussels summit meeting to defer any serious reform of the CAP until 2013, Brazil's firm statement is a necessary and salutary reminder that the Doha Round is a single undertaking.

II. Multilateral Issues

A number of Members, mostly developing countries, have expressed concern about slow progress in negotiations on multilateral issues to which they attach importance. It is to some extent inevitable that the priority given to request-offer negotiations will slow down other work, but it is unfortunate that on most of the slow-moving subjects developing countries are demandeurs.

Working party on GATS Rules

The main item of work in this group, the negotiation on Emergency Safeguard Measures, is reported to be completely deadlocked. After more than 6 years there is still no agreement on the need for a safeguard provision in the Services Agreement, which many developing countries support (though some are opposed). Developed countries, especially the US, the EU, Canada and Switzerland, believe that a safeguard will create unnecessary instability of market access commitments and are under pressure from domestic industries to resist it. There are also major technical difficulties, including the demonstration of a causal link between imports and injury to the domestic industry and the question whether and how a safeguard could be applied to foreign service suppliers established in the market. On none of these is there agreement. Failure to agree on a safeguard mechanism may not be a practical problem, since so far no concrete examples of situations justifying safeguard action have been identified, but it is a political problem. Developing countries may withhold market access commitments in the absence of a safeguard provision, and deadlock on this subject could sour the atmosphere in the Services negotiations as a whole.

The other subjects under negotiation in this Working Party are subsidies and government procurement of services. Work on subsidies is effectively confined to transparency, the collection of information on services subsidies offered by Members, as a necessary preliminary to consideration of disciplines. But few countries are ready to provide hard information on their own subsidy programmes. The likelihood of agreement on any disciplines is very small indeed. On government procurement, the EU has tabled a proposal on a framework of rules and has proposed that Members make commitments on their governments' procurement of services. Some delegations express interest in these proposals but others maintain that GATS Article XIII excludes from the negotiations the obligation of most-favoured nation treatment, market access and national treatment. (If it had been the intention of Article XIII that these obligations should be permanently excluded from the GATS, it would be hard to see what would be the content of the negotiations mandated by that Article. (But the fact that this position is taken by some delegations, indicate how difficult it will be to enter serious negotiations on this subject.)

Working Party on Domestic Regulation

The Secretariat was requested to consult international professional organizations on the question whether and how far the Disciplines on Domestic Regulation in the Accountancy Sector,

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negotiated in 1999, could be applied to other professional services. A possible outcome of negotiations in this area would be agreement that disciplines similar to those on accountancy should be applied to all or some other professions.

Committee on Specific Commitments

There was a revival of interest in the classification of services, probably prompted by the different approaches to the classification of some services manifested in requests by trading partners. It is hoped that agreement on the classification of some services will result. The EU tabled a proposal on the coverage of Computer and Related Services, which advocates a "functional" approach to the coverage of the sector, to include all services which "enable" the provision of "core" or "content" services, both by electronic and other means.

The Committee has agreed that at the end of the current Round, all existing schedules of commitment will be withdrawn, to be replaced by new consolidated schedules incorporating Doha Round commitments.

Committee on Financial Services

Bolivia announced that it is ready to implement the commitments on financial Services, which it negotiated in 1997. Poland, Uruguay and the Dominican Republic will shortly do the same. Three other countries-Brazil, Jamaica and the Philippines will then remain outstanding.

The most important issue at this meeting was the first transitional review of China's implementation of its commitments on financial services. This was a difficult discussion; some of the questions raised to which the replies were found unsatisfactory will be taken up again in the December discussions of the Chinese transitional review in the Services and General Councils. China replied orally to written questions which had been submitted by the EU, the US, Canada, Japan and Chinese Taipei. In the subsequent discussion China maintained its position that it is not required to respond in writing, though its oral statement was subsequently circulated. On a number of points, the replies given were found confusing. There was also discontent because a notification by China to the Service Council of regulatory measures covering all services, including financial services, had been submitted to late to be available at this meeting. For these reasons the US concluded, as it has done in some other committees, that in its view the review had not been satisfactorily completed. There was also difficulty between China and Chinese Taipei. In a number of committees China has maintained that it will not respond to questions from Taipei because their bilateral relations are not governed by the WTO, prompting Taipei to threaten action under the Dispute Settlement Understanding.

Services Council in Special Session

Much of the Council's work is devoted to issues essentially concerning developing countries: the assessment of trade in services; treatment of autonomous liberalization; and modalities for the special treatment of least-developed countries. It is increasingly recognized that the assessment of the results of liberalization under the GATS can only be done at the national level, and several countries, most recently Thailand, have produced studies of their own

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experience. At this meeting South Africa made a good presentation on the effects of the liberalization of telecommunication services in southern Africa.

Much time has been spent on the negotiation of guidelines for the treatment of autonomous liberalization, meaning the credit which should be given in the negotiations for liberalization already undertaken unilaterally - ie, without reciprocity. Since the guidelines will not be binding it is questionable whether this time is well spent, but failure to agree would again have negative political, rather than practical, implications. Obstacles remain with the treatment of developing countries and the situation of recently acceded countries (such as China). These countries have argued that given the commitments they had to undertake in joining the WTO it would be unreasonable to expect further liberalization from them, and that they should receive credits for what they have already done. Other Members take the view that full credit has been given, in the form of WTO membership.

Draft modalities for the special treatment of least-developed countries will be tabled shortly. A proposal has already been made by a group of Caribbean and Andean countries on increasing the participation of developing countries in services trade, and at this meeting Mauritius tabled a proposal with the same objective in relation to small economies. A proposal was also submitted by the US on the promotion of small and medium-sized enterprises (SMEs) as international providers of services.

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Update on WTO Electronic Commerce: October Meeting and U.S. Proposal on E-Commerce

SUMMARY

We provide here an update on the work programme on electronic commerce in the WTO. In particular, we discuss the recent deliberations at the 25 October meeting in Geneva at which WTO Members engaged in a further "dedicated discussion" of horizontal issues arising in the ongoing work programme. The last such meeting was held on 6 May. The discussion provides an occasion to review the state of work in the WTO on this subject, which has sometimes given rise to confusion and is still not well understood.

We also discuss the recent paper on electronic commerce submitted by the United States on "Proposed Goals for E-Commerce in the WTO."

ANALYSIS

I. Background on the Work Programme on E-Commerce

The WTO work programme on electronic commerce, which was inaugurated in 1998, has for the most part been carried out in the bodies responsible for key aspects of the matter, notably the Councils on Services, Goods and TRIPS. However it has been agreed that there are certain horizontal or "cross-cutting" issues, affecting a wider spectrum of WTO work, which need to be considered on a general level, and a number of dedicated discussions on these have been held under the auspices of the General Council. Previous meetings of this kind have been chaired by former Deputy Director-General Andew Stoler; last week's meeting was chaired by his successor, Rufus Yerxa. In general the discussions have not produced agreement on the questions considered, but they have contributed to better definition of the issues and better understanding of the application of WTO law to electronic commerce.

The meeting of 25 October was devoted to two issues: (i) the classification of the content of certain electronic transmissions and (ii) the fiscal implications of e-commerce. It was attended by some 50 delegations, mostly services specialists.

II. Debate Over E-Commerce Classification Issues

There has been a long and potentially harmful debate about the classification of electronic commerce, stemming from the question whether it should be classified as trade in goods, trade in services or something different from either; there were suggestions that it involved "hybrid products", neither goods nor services. This is a harmful idea; rules exist on trade in goods and services, but not on "hybrids."

The debate on classification was a profoundly misconceived idea, since it could have implied that neither GATT nor GATS would apply to a vast and rapidly expanding range of international trade. For the GATS in particular any suggestion that electronic transmissions should be regarded as outside its scope would have been disastrous, since the vast majority of

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trade in many sectors is done electronically. GATS commitments on financial services, for example, would be worthless if they were held not to cover electronic supply of the services.

Classification: Nature of Product Traded, Not Means of Delivery

The answer to the question whether GATS or GATT applies is that it depends entirely on what is being sold. The legal regime applying to transactions throughout the WTO system – whether they are governed by the GATS, the GATT or a sectoral agreement such as those on agriculture or textiles – is determined by the nature of the product being traded, not by the means of delivery. Banking is a service whether done electronically or across the counter and GATS commitments must be understood as covering all technological means by which the service can be supplied. This is what is meant by the "technological neutrality" of the GATS.

But it must be understood that in this sense the GATT is also technologically neutral. For example, a regulation preventing the offering for sale of imported, but not domestic, goods on the Internet would certainly be challenged and found illegal as a national treatment violation under Article III of the GATT. It could not be argued that the GATT does not apply to Internet transactions. Nor can it be argued that GATS commitments do not cover electronic supply because the development of e-commerce was unforeseen in 1993 – which is factually untrue in any case. In this sense the position often stated by the EC, Hong Kong and others that electronic commerce is just another way of doing business and that normal WTO law applies to it is fully justified.

Fortunately this is now understood by most delegations, and the classification of electronic commerce *per se* is no longer discussed in these terms in the WTO, though it is still widely misunderstood in public discussions.

Treatment of Digital Products

It is agreed that the debate on classification concerns the question whether certain products which can be delivered both in physical and electronic form should be classified as goods or services. Computer software is the most obvious example, because the physical and electronic forms are virtually identical, and perhaps the most significant commercially. Films and music are also discussed, as being available both electronically and on physical carriers. Books are a much less convincing case; it is hard to maintain that their physical and electronic forms are interchangeable.

There is no definition or other authority which can settle this question; it is simply a matter for agreement between governments. If WTO Members can agree that computer software or any other product is a good and should be subject to GATT rules, even in its electronic form, this need not necessarily do systemic harm. But to agree that this or any other product is not a service *because it is delivered electronically* would be very harmful indeed. Care would be necessary in establishing the criteria by which such products would be distinguished from other products delivered electronically which would continue to be classified as services, so as not to undermine GATS commitments.

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U.S. and EC Positions Based on Commercial Interests

The debate on electronic commerce is, however, driven only in part by systemic considerations. The positions taken by the U.S and the EC, in particular, are clearly in large part a reflection of commercial interests.

The EC has consistently argued that all products which can be delivered in digital form are services, and there are grounds for maintaining that this straightforward position has systemic value in providing clarity and certainty. But it is also motivated in large part by concern for the EC's policy on audiovisual services. From the beginning, the interest of the U.S in the classification of e-commerce was driven by the belief that the application of GATT disciplines would have a greater and above all faster liberalizing effect than negotiation under the GATS. Above all, quantitative restrictions which are permitted by the GATS would be illegal under GATT.

If, in addition, agreement could be reached on a permanent moratorium on tariffs on e-commerce, a highly liberalized environment could be achieved very much more quickly than through the negotiation under GATS of specific commitments on services capable of being supplied electronically. However, the application of GATT rules was seen as a threat to the EC system of quotas on imported films and television programmes, and perhaps to the heavy subsidisation of these industries in countries like France. Since audiovisual policy is still a highly sensitive issue for the EC, relaxation of their position is unlikely.

Other Delegation Views

Brazil, Hong Kong, Switzerland and Singapore among others, share the view that virtually all, if not all products delivered in digital form are services. Australia, on the other hand, maintains that a good should continue to be classified as such even when electronically delivered. Canada is among those supporting further study, in line with its generally cautious attitude to all systemic issues arising under the GATS.

III. Development of "U.S Goals for Electronic Commerce in the WTO"

With a view to achieving some progress on the e-commerce issue at Cancun, the U.S submitted some guiding principles on the conduct of electronic commerce ("U.S. E-Commerce Paper") at the 25 October meeting.[21] Work on the development of such principles, in collaboration with the Coalition of Service Industries ("CSI") and other interested parties has been in progress for months, and several versions of the guidelines have been produced. The leading role on the industry side has been played by AOL Time-Warner. A copy of the document is attached.

[21] The U.S. paper is titled "Proposed Goals for E-Commerce in the WTO" was prepared by the Office of the United States Trade Representative in collaboration with input from U.S. industry associations. The latest version was finalized on 17 October 2002 (after several months of input), and submitted to WTO members on 25 October 2002.

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The U.S.E-Commerce Paper outlines four general goals, as follows:

(i) ***"Technological neutrality"*** – Ensure market access for digital products and no imposition of discriminatory measures or quantitative restrictions;

(ii) ***Non-discriminatory domestic regulations*** – Urge that domestic regulations be transparent, are non-discriminatory and are least-trade restrictive as possible;

(iii) ***E-commerce moratorium*** – Make permanent and binding the moratorium on customs duties on e-commerce;

(iv) ***Market access*** – Improve market access and national treatment commitments across all sectors and modes of supply, including services and IT products.

Moratorium is the Most Controversial Goal

Of the four proposed goals for e-commerce, the one most likely to be controversial is the suggestion that the moratorium on customs duties should be made permanent and binding. There has never been clarity as to whether the tariffs covered by the moratorium would apply to the electronic impulse itself – a "bit tax" – or to the value of the content transmitted, or to both. The difference is of course vast, and this uncertainty would need to be resolved before the moratorium were made permanent or legally binding. Developing countries will also be likely to make the point that a permanent moratorium on tariffs would have heavier implications for them than for developed countries.

Classification Not Addressed

The U.S. E-Commerce Paper also leaves aside the question of classification. The U.S. policy line on classification issues is strongly influenced by the manufacturers of software (*e.g.* Business Software Alliance, Microsoft, *et. al.*) and by Hollywood (*e.g.* Motion Picture Association of America, AOL Time Warner, *et. al.*). Nevertheless, the U.S has not yet taken a firm position on the classification of "hybrid products" such as software and films. On 25 October, it still maintained that a decision at this stage would be premature and that further study, with the overriding objective of ensuring a liberal trade environment, was needed.[22] If the US has formed the view that the work on classification is unlikely to produce a helpful result, at least in the period before Cancun, they are probably right.

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[22] The U.S. E-Commerce Paper states:

"Whether considered a good or service, digital products should continue to flourish in a liberal and open trade environment, with full market access and national treatment, and no imposition of discriminatory measures or quantitative restrictions;" at para 1.

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There have been suggestions in U.S. industrial and official circles that the EC's insistence that all digital products are services would "lock in" high tariff rates, or might be intended to facilitate higher tariffs. This is difficult to understand, since one effect of GATS commitments is to impose a legal, not a hypothetical, barrier to the imposition of tariffs on scheduled services. The legal status of tariffs on services is discussed later in this paper.

Strong Emphasis on Market Access

In relation to market access, the U.S. E-Commerce Paper focuses on market opening commitments on all services that can be delivered electronically, and in the goods context on the elimination of tariffs on information technology products. Where such products contain digital content it is proposed that tariffs should be levied only on the value of the carrier medium.

The emphasis in the U.S., as influenced by the information technology and Internet content industries, has rightly moved to the request/offer negotiations, with the objective of securing improved commitments on those services most capable of electronic delivery and on services essential for the functioning of e-commerce.[23] This is likely to be more rewarding than continued debate on classification, which is unlikely to produce agreement and which could be harmful if it led to the conclusion that WTO Members could not agree whether electronic delivery of certain products is covered by GATS or the GATT. Even inconclusive discussion can produce legal uncertainty.

A "Deliverable" for Cancun

Agreement on the U.S. E-Commerce Paper would no doubt be an acceptable outcome from Cancun, and one that U.S. industry is keen to have as an interim achievement or "deliverable" from the meeting. However, on 25 October some delegations were unsure of the need for such principles, and it may not be a simple matter to gain agreement on them. There will be difficult negotiations before and at Cancun on the balance between the reciprocal demands of developed and developing countries, and some will seek to use this request by the U.S as negotiating leverage on other issues, such as implementation.

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[23] The U.S. paper places particular attention on improving market access and national treatment objectives on "a broad range of relevant goods and services sectors" including:

- Pursue market access and national treatment commitments across all sectors and modes of supply without limitations for the services essential to e-commerce transactions;
- Make meaningful market opening commitments for all services that can be delivered electronically;
- Eliminate duties on all IT products delivered physically, including zero duties on all digital content contained on such products; and
- Where customs duties are applied on IT products that contain digital content, agree that valuation for customs purposes should be based on the value of the carrier medium only.

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IV. Fiscal Implications of an E-Commerce Moratorium

We discuss here the implications, for developing countries in particular, of a permanent moratorium on customs duties on electronic transmissions. The provisional moratorium first agreed at the Geneva Ministerial in 1998 was renewed at Doha until the Cancun Ministerial in September 2003, but it has no practical effect because it seems that no country is yet capable of levying tariffs on cross-border transmissions. When such charges become possible, however, they will have differential implications for developing and developed countries. Developing countries are in general much more heavily dependent on tariff revenues than the developed countries, which have greatly reduced their tariffs but rely on value-added taxes as a source of revenue.

Some developing countries have pointed out that a moratorium on tariffs would be an unbalanced deal, since it would require developing countries to forgo a source of revenue of potential importance to them, whereas there is no suggestion that developed countries would desist from VAT charges on e-commerce. Indeed, there have been indications that some State Governments in the U.S are looking at inter-State e-commerce as a potential source of VAT receipts. It is true that reliance on tariffs as a revenue source is undesirable, since they create distortions, but many developing countries will continue to depend on them until efficient VAT systems can be put in place. India is very much alive to this issue; their chief collector of taxes pointed out to us the relative importance of tariffs as a source of revenue to developed and developing countries in 1999.

On 25 October only the U.S spoke on fiscal implications, making the point that the administrative costs of levying tariffs on electronic transmissions might be large, perhaps exceeding revenues realized, and that developing countries should rather focus on creating a liberal, positive regulatory environment in which e-commerce could flourish and generate much greater revenues.

Developing countries did not respond, but it should not be assumed that their silence on this occasion means that they will not seek a *quid pro quo* for extending the moratorium at Cancun – and still more for a permanent one.

V. Legal Status of Customs Duties on Electronic Commerce.

There has been confusion since 1998 about the implications and particularly the legal status of the moratorium on electronic commerce. The US initiated the effort and secured agreement in 1998 that customs duties should not be levied on electronic commerce. However, because of a common but false assumption that tariffs can only be applied to goods, the U.S. initiative on the moratorium helped to generate the misconceived debate as to whether e-commerce is goods or services trade.

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Existing GATS Commitments Are a Moratorium on Duties

One point is already clear – Members' GATS commitments already constitute a binding undertaking not to apply tariffs to the services committed, if that would raise the level of protection specified in the schedule. This would be the case even if the tariff were applied only to electronic delivery of the service. Furthermore, no Member has entered a national treatment limitation covering the application of tariffs to a scheduled service, and this cannot be done retrospectively.

Application of Tariffs to Services Not Scheduled

The corollary of this is that tariffs could legally be applied to services not yet scheduled. *One of the unfortunate consequences of the debate about tariffs on e-commerce is that it might cause some countries to conceive the idea of making such limitations on services which they are scheduling for the first time in the current Round.*

The option of applying such tariffs to services would not, of course, be open to the industrialized countries or to other Members which have made extensive GATS commitments, except on those few services on which they have made none. Also, it would be in these Members' interests that it developing countries should not impose such tariffs. Maintaining the moratorium is one way of achieving this, and hence the debate remains an active one. In that sense also, as far as the GATS is concerned, the moratorium might be seen as an unbalanced deal to developing countries.

Of course, if the application of tariffs on electronic deliveries remains infeasible for practical reasons, nobody is conceding anything significant. But in that case, developing countries will ask, what purpose does the moratorium serve?

A useful resume of the applicability of GATS provisions to electronic commerce was produced by the WTO Secretariat in 1998 (S/C/W/68).

OUTLOOK

The deliberations among WTO Members on the relationship between electronic commerce and WTO rules continue to be muddled by issues like classification and the debate on extension of the moratorium. There seems to be no early prospect of resolving the classification issues, but care should be taken not to allow this debate to undermine existing GATS commitments, especially in the new round of negotiations.

The matter of the moratorium is also difficult as many developing countries remain skeptical of the need to extend it, on a binding and permanent basis. Underlying efforts among U.S. states also adds to their suspicion as many are eager to impose such taxes on intra-state transactions, regardless of technological feasibility. Since developing countries are particularly sensitive about the loss of customs and tax revenue they will probably resist the idea of a permanent moratorium, including at Cancun.

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Nevertheless, the 25 October discussions did yield some progress, including a renewed initiative on market access issues, as promoted in the U.S. E-Commerce Paper. The approach on market access, including in GATS and GATT negotiations, would be far more productive given the current mandate. Such guiding principles on electronic commerce, if agreed upon, would constitute a "deliverable" in Cancun.

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UNITED STATES
PROPOSED GOALS FOR E-COMMERCE IN THE WTO

Whether considered a good or service, digital products should continue to flourish in a liberal and open trade environment, with full market access and national treatment, and no imposition of discriminatory measures or quantitative restrictions;

Where legitimate public policy objectives require domestic regulations that affect e-commerce, any such regulations should be consistent with existing WTO principles, namely, they should be transparent and non-discriminatory, should represent the least trade-restrictive measures available, and should promote an open market environment;

In light of the importance of trade liberalization in digital trade, the moratorium on customs duties on electronic transmissions should be made permanent and binding; and

Greater market access and national treatment commitments across a broad range of relevant goods and services sectors will lead to greater flows of e-commerce and economic growth. As such, all WTO members should:

- Pursue market access and national treatment commitments across all sectors and modes of supply without limitations for the services essential to e-commerce transactions;
- Make meaningful market opening commitments for all services that can be delivered electronically;
- Eliminate duties on all IT products delivered physically, including zero duties on all digital content contained on such products; and
- Where customs duties are applied on IT products that contain digital content, agree that valuation for customs purposes should be based on the value of the carrier medium only.

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Update on Negotiations of a GATS Emergency Safeguards Mechanism

SUMMARY

This note analyses the current state of the negotiations under Article X of the General Agreement on Trade in Services (GATS) on the question of an emergency safeguard mechanism ("ESM"), in the light of the most recent meeting, on 25 October, of the Working Group on GATS Rules, which is carrying out the negotiations. The prospects for a successful outcome, in the sense of an agreement on safeguard disciplines within the time-frame of the Doha Round of negotiations, are poor. Moreover, the lack of progress on the ESM could have negative effects on negotiations in other areas.

ANALYSIS

I. Background

The GATS, unlike the GATT, contains no "safeguard" provision that would allow a Member to suspend a market access commitment in the event of damage or threat of damage to a domestic industry. There was no agreement in the negotiation of the GATS on the need for such a provision, but further negotiations "on the question of emergency safeguard measures based on the principle of non-discrimination" were mandated by Article X of the GATS and have been in progress since 1995. They have made some progress in clarifying legal and technical issues, but have never approached agreement, because a fundamental lack of consensus on the need for and the practical feasibility of a safeguard provision for services has never been resolved.

The ambivalence of the negotiating mandate itself is significant. The negotiations are about "the question" of emergency safeguard measures, implying no agreement on their necessity. But Article X also says that "the results of such negotiations shall enter into effect" not later than 1 January 1998, implying that there will be results. This deadline was missed, as two subsequent ones have also been, and the current deadline of 15 March 2004 is in doubt, since it seems unlikely that by that time there can be either agreement on a safeguard discipline or agreement that none is necessary.

II. Desirability and Feasibility of an ESM

A. North-South Divide Prevalent

The negotiation of an ESM has assumed a North-South aspect from the beginning, since those Members in favour of a safeguard agreement have all been developing countries, while the industrialized countries have in general been skeptical if not hostile. The main intellectual and negotiating impetus for an agreement has come from certain ASEAN countries, above all from Thailand, and without them the issue would now be as dead as the parallel negotiations in the same Working Party on subsidies and government procurement of services.

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On the other hand, industrialized countries, notably the US, have argued that the GATS already provides great flexibility both in assuming commitments and in modifying them – through re-negotiation under Article XXI; through the "prudential carve out" of the Annex on Financial Services; or through waivers, for example - and that additional flexibility in the form of suspension of commitments for safeguard reasons would undermine the stability which is the main value of GATS commitments to business. This is the essence of the argument about the "desirability" of a safeguard discipline.

Developing countries have argued that even if it were seldom used, which is the general expectation, the existence of a safeguard, permitting suspension of a commitment if liberalization gave rise to unforeseen damage, would make it easier to persuade their politicians and domestic industry of the case for further liberalization of services.

As a result, the negotiations have never really progressed beyond debate on the desirability and feasibility of a safeguard provision and the repetition of familiar positions, despite the tabling in 1999 by Thailand of a draft agreement – which borrows from many concepts in the Agreement on Safeguards applicable to goods trade, and which has since been refined.

B. Desirability and Feasibility of an ESM

The argument that there is already sufficient flexibility in the GATS to meet all reasonable needs may be slightly over-stated. There is great flexibility, notably in scheduling commitments, but the gap that a safeguard measure might address is that of genuinely unforeseen developments, which clearly cannot be provided for by ex-ante flexibility in scheduling commitments. Other remedies exist, such as seeking a waiver under the WTO Agreement or renegotiation of a commitment under Article XXI of the GATS, but they have drawbacks. For instance, waiver procedures are heavy and unpredictable, and Article XXI is designed for withdrawal, not temporary suspension of a commitment. Both also have counterparts in the GATT, which nevertheless has a safeguard provision. It is not obvious why a safeguard should be less appropriate in services trade than in goods. The circumstances in which it might be used might be narrowly circumscribed, restricted to genuinely unforeseen developments, but it is not for that reason worthless

The same stalemate has resulted from discussion of the "feasibility" of safeguard action in the services context. It is clear that trade in goods, subject to effective and relatively simple controls at the border, offers much easier and more transparent possibilities for emergency action than services trade, where border controls are largely absent and much trade is done through establishment in the export market. Different views as to what constitutes the "domestic industry" in this context and the difficulty of remedies restricting the trade of foreign suppliers established in the market have led to the suggestion that safeguard actions should not apply to Mode 3, supply through commercial presence.

The insistence of the EC on the difficulty of applying safeguard measures within the framework of the four GATS modes of supply is perhaps somewhat exaggerated: all limitations

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in GATS schedules of commitments are expressed and presumably administered on a modal basis, and it is not evident why this should be impossible in the case of restrictions introduced for safeguard purposes. The real technical difficulty in taking a safeguard measure would be in demonstrating the causal connection between imported services and the alleged injury or threat of injury to the domestic industry, because of the general lack of reliable statistics.

III. Meeting of 25 October of the Working Party on Safeguards

At the most recent meeting of the GATS Working Party on Safeguards, on 25 October, there was no advance and the position of some delegations, notably the EC, appeared to have hardened. The EC Commission has always been in a slightly difficult position because of different shades of opinion among EC member states: Denmark has been vehemently opposed to a safeguard because of concern about its possible use against her maritime industry, which is seen as vulnerable to actions such as denial of port and harbour facilities; the UK and Germany have been very skeptical; while Greece and some other "southern" EC members have been more open.

For these reasons, and because of concerns about general relations with developing countries, the Commission has taken a more nuanced position towards the ESM than the US. The EC is now apparently as hostile as the US, but is stressing the feasibility issue – the practical difficulties of applying safeguards to particular modes of supply – rather than saying that a services safeguard is undesirable *per se*.

The current view of the WTO Secretariat is that prospects of agreement have worsened in the most recent meetings – so much so that repercussions are beginning to manifest themselves in other negotiations. For example, the representative of Thailand at last week's meeting of the Working Party on Domestic Regulation said that she was not persuaded that negotiations on domestic regulation were "desirable," in a clear reference back to the safeguards debate.

IV. Outstanding Technical Problems Raised by the ESM

A large number of technical and legal issues have been discussed in the context of the ESM, but without resolution. Generally, many of these concepts are borrowed from those used in the context of goods under the Agreement on Safeguards. Among the most important of these are the following:

- <u>STEP 1: Definitional Issues</u>

- *"Unforeseen developments"* – The introduction of this phrase is supported by some delegations as giving substance to the concept of emergency and is opposed by others as being ambiguous and a possible barrier to action, since it might be very difficult to demonstrate what could not have been foreseen.

- *Like services* – It has been suggested that criteria should be developed for the determination of like or directly competitive services and service suppliers. This has

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always be a serious difficulty in the GATT context, and has been left to case-by-case determination by panels.

- *Definition of domestic industry* – Difficulties arise on the question whether definition of domestic industry should be confined to national suppliers, or should also include established foreign suppliers.

➢ STEP 2: Demonstration of injury

- *Demonstrating causality and injury* – The lack of reliable statistics on services trade creates a particular difficulty in demonstrating a causal connection between imports and injury to the domestic industry.

➢ STEP 3: Application of remedies

- *Applicable remedies* – It is generally agreed that safeguard measures should be temporary and applied on an MFN basis, and that they should take the form of a suspension of GATS commitments. However, the type of remedy is disputable (*e.g.* Would the application of a safeguard on established suppliers imply forced divestment, limit scope of business, or expel foreign personnel?).

- *Modal application* – The difficulty of applying a safeguard measure under Mode 3 has been emphasized, but the relative ease of application under Mode 4 creates its own problems for countries with a strong interest in the movement of natural persons.

- *Protection of acquired rights* – Difficulties regarding protection of the rights of established foreign suppliers (and threat of divestment or restrictions on scope of business) have caused some to propose the exclusion of Mode 3 from the scope of a safeguard.

➢ Other Issues

- *Special and differential treatment* – Various forms of flexibility for developing countries have been proposed both in their use of safeguard measures and in the application of safeguard measures to them.

V. Australian Proposals Attempt to Break Deadlock

In an effort to break the circular debate about desirability and feasibility, the delegation of Australia has made two communications to the Working Party, in February and July 2002, on the temporary suspension of GATS commitments. Their idea was to focus on the safeguard mechanism itself, leaving aside arguments about desirability and feasibility, to see if a workable procedure could be devised.

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Their first communication proposed two "Models." Under Model I, safeguard action would require prior notification to the Council for Trade in Services and agreement by the Council that just cause for the action had been shown. The safeguard measure would then be approved for the duration not exceeding two years. In the absence of agreement in the Council, the invoking Member could seek a waiver or have immediate recourse to renegotiation under Article XXI of the GATS. Under Model II, no prior approval would be required, merely prior notification and an obligation to consult with affected parties. The second communication expands on some elements of the first and responds to questions raised.

The Australian proposals have not attracted much interest or support, though their constructive intent is recognized. Model I is seen as, in effect, a waiver granted by the Council rather than the right to invoke a safeguard in emergency, and as adding little to the existing waiver provision. Model II provides for the autonomous action of a safeguard but lacks the detailed criteria and safeguards against abuse which any agreed discipline must have. Once these were introduced, all the difficulties encountered in negotiating the Thai draft text would re-emerge. Australia again made the case for its proposal on 25 October, but other delegations in general saw in it no real advance on what has for so long already been on the table.

OUTLOOK

If it is true that no agreement is likely in the negotiation of an ESM, the question becomes what implications this may have for the services negotiations in general and for the rest of the Doha agenda. It has always been clear that there is an implied trade-off between the quality and extent of the market access commitments that some developing countries will offer and the availability of a safeguard mechanism. How far such countries would actually withhold liberalization in the final analysis is uncertain; liberalization will be driven essentially by their own needs and by their objectives in other areas in the Doha Round.

Nevertheless, failure to agree on safeguards will certainly have a negative effect on the negotiating climate and will be used as an argument by those seeking to slow down or block the process, and who are not necessarily the main *demandeurs* for the ESM. Failure may also have negative consequences in other areas of the services negotiations where industrialized countries are seen as being the main demandeurs; the negotiation on disciplines on domestic regulation is a case in point, even though developing countries are increasingly seeing potential advantage for themselves in strengthening disciplines on qualification requirements, mutual recognition and other regulatory matters.

The ESM issue does not present a clear dividing line between developed and developing countries. Some developing countries - Mexico, Chile and Costa Rica for example- have stated their opposition to a safeguard and there are others who have serious doubts. Singapore is detached from its ASEAN partners on the question. India, though it does not state its opposition, is in fact opposed because of its fears that a safeguard mechanism could most easily be invoked against the supply of services through Mode 4, the movement of natural persons. Others share these fears. On the other hand, Brazil, Venezuela, Cuba and some other Latin American countries support the safeguard, as do China and most African countries. This support, however,

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tends to be on the political level rather than contributing to the technical discussions. The problem is that technical difficulties are as intractable as the political divide.

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WTO DISPUTE SETTLEMENT

Proposals by the United States and Developing Countries on Reform of the WTO Dispute Settlement Understanding

SUMMARY

Three new submissions have been made by developing countries on the revision of the WTO's dispute settlement system, in the context of the review of the Dispute Settlement Understanding ("DSU") which is to be completed by May 2003 for submission to the Fifth Ministerial Conference in Cancun, Mexico, in September 2003.

The main issues treated in the proposals are:

(i) Panel procedures and role of the WTO Secretariat – Suggest more flexible time frames, provision for dissenting opinions; and a strengthened role for the WTO Secretariat as legal counsel to developing countries on disputes;

(ii) Retaliation for failure in compliance – Assert need for more effective compliance procedures, including cross-retaliation, collective retaliation and monetary compensation;

(iii) Special and differential treatment – Argue for more flexible provisions in treatment of developing and least-developed countries, including revision of existing provisions and time frames for consultations and submissions; and

(iv) Costs of litigation and access to legal services – Believe that litigation costs are too high, and some suggest developed countries should reimburse developing countries for litigation costs if claims are rejected.

This report summarizes the proposals and initial reactions to them by WTO Members in the Special Session of the Dispute Settlement Body ("DSB"), which met from October 14, 2002. In addition, we discuss the U.S. proposal on transparency in dispute settlement, which was discussed at a special session of the DSB on September 10-11, 2002.

ANALYSIS

I. Background on Latest DSU Proposals

In the context of the review of the WTO Dispute Settlement Understanding ("DSU"), as mandated by the Doha Ministerial Conference and due to be completed by May 2003, three new proposals have been made by developing countries: by the Group of Least-Developed

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Countries ("LDC Group") on various DSU procedural and compliance matters[24]; by Cuba, Honduras, India, Indonesia, Malaysia, Pakistan, Sri Lanka, Tanzania and Zimbabwe ("Group of Nine") on cross retaliation, litigation costs and special and differential treatment[25]; and by Jamaica on procedural issues, resource restraints and other issues.[26]

The papers were discussed for the first time at a meeting of the Dispute Settlement Body ("DSB") in Special Session on October 14, 2002. The DSB is required to make proposals on the revision of the DSU to the WTO Ministerial Conference in Cancun, Mexico, in September 2003.

In addition, we discuss the proposal made by the United States on transparency in dispute settlement, which was considered at a Special Session of the DSB on September 10-11, 2002.

II. Proposals on the DSU by Developing Countries

All three proposals from developing countries focus on the experience and treatment of developing and least-developed countries under the new dispute settlement régime, in which developing countries have been far more involved, both as plaintiffs and defendants, than under the pre-1995 GATT régime. (They have raised 47 complaints against developed countries and 37 against other developing countries.) However, no least-developed country has yet initiated or been a target of a dispute, and there is reason to believe that some have been deterred by the cost and complexity of the system, as well as by their own resource constraints.[27]

As is to be expected, all three submissions stress the particular difficulties of these countries in making use of the system and call for a greater degree of special and differential treatment of developing countries than is already provided for in the DSU. The most radical proposal is that of the LDC Group, which in some areas, would substantially alter the way in which judgements are now formulated and the relative weight of legal and political considerations in reaching findings.

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[24] TN/DS/W/17, Negotiations on the Dispute Settlement Understanding: Proposal by the LDC Group, 9 October 2002.

[25] TN/DS/W/19, Negotiations on the Dispute Settlement Understanding: Special and Differential Treatment for Developing Countries Proposals on DSU by Cuba, Honduras, India, Indonesia, Malaysia, Pakistan, Sri Lanka, Tanzania and Zimbabwe, 9 October 2002.

[26] TN/DS/W/21, Contribution by Jamaica to the Doha Mandated Review of the Dispute Settlement Understanding (DSU), 10 October 2002.

[27] The LDC Group asserts the lack of disputes "is definitely not because these countries have had no concerns worth referring to the DS (dispute settlement system), but rather due to the structural and other difficulties that are posed by the system itself." TN/DS/W/17 at para 1.

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The main issues treated in the proposals are: (i) panel procedures and role of the WTO Secretariat; (ii) retaliation for failures in compliance; (iii) special and differential treatment; and (iv) costs of litigation and access to legal services.

Because they were submitted shortly before the meeting of the DSB Special Session in October, other Members were not able to give a considered reaction to the proposals. The Quad countries – Canada, EU, Japan and US – who are the most frequent users of the DSU, did not comment in the DSB meeting. However, some comments were made in the meeting and others have been communicated privately. We discuss below some perspectives on these issues.

A. Panel Procedures and the Role of the Secretariat

1. Article 4 and 5: Emphasis on Consultations and Mediation

Jamaica argued for the need to emphasize consultations and mediation over litigation in disputes involving developing countries, as provided by Article 4 and 5 of the DSU, respectively. Jamaica cited that paragraphs 3 and 4 of Article 5 emphasizing "good offices, conciliation and mediation" are linked to Article 4 on consultation, and that Members should "make more frequent use of the facilities provided and every opportunity to do so should be given to them particularly in the case of developing countries."[28] Jamaica did not offer specific language to this effect.

Although most DSU disputes begin with Article 4 consultations, most complainants seek the establishment of a panel if consultations fail to resolve the dispute. There are few cases where disputes where resolved through Article 5 mediations. One recent example is the dispute between the Philippines and Thailand against the EC on their tuna exports.

2. Article 4.11: Enhanced Third Party Participation

Jamaica believes that third party participation as provided by Article 4.11 of the DSU should require "substantial interest" and not "substantial trade interest." This suggestion is somewhat controversial as "substantial interest" would require a lesser threshold than "substantial trade interest" – as seen in the participation of the US in the *EC – Bananas* dispute.

In addition, Jamaica proposed establishment of guidelines for enhanced participation of third parties – based on factors demonstrating their substantial interests in a dispute.[29] This proposal should attract support as some parties including the EC have complained that third party participation rights are too limited, even if the third party has substantial trade interests – as was the case in the *Turkey – Textiles* dispute raised by India, but not against the EC even though Turkey's regime was modified after establishment of a customs union with the EU.

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[28] TN/DS/W/21 at para. 1.

[29] Ibid at para 4-5.

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3. Article 8.10 Composition of Panels: Developing Country Panelists

Article 8.10 of the DSU currently provides for at least one panelist from a developing country member, if requested by the developing country involved in a dispute with a developed country. The LDC Group proposed that in all cases involving developing or least-developed countries, panels must include at least one panelist (or two if so requested) from developing or least-developed countries.[30] The proposal is controversial as the selection of panelists is already difficult in many instances – much less adding a requirement to include two developing country members out of three.

4. Article 27 Role of the Secretariat: Impartiality and Counsel to Developing Countries on Disputes

The proposals from the LDC Group and Jamaica discussed modifying the role of the WTO Secretariat in serving panels, as currently provided in Article 27 of the DSU, including the idea of having Secretariat legal experts serve as counsel during disputes.

The LDC Group questioned the impartiality of the Secretariat, suggesting that legal research and commentary undertaken by the Secretariat on behalf of panels (as provided in Article 27.1 of the DSU) is "often… pernicious" and should be made available to the parties, in order to "complete the picture" on how decisions are reached.[31] The "legal research and commentary" cited by the Group is the "Issues paper" which the Secretariat provides to all panels. Publication of these papers has been suggested before but has been resisted on the ground that it would transform the Secretariat from the servant of the panel to something more like an autonomous commentator on the issues. Members have felt that it is important to preserve the principle, which is also a fact, that panels are fully responsible for their findings. They by no means always share the Secretariat's view of the issues, and their position would be prejudiced by publication of its advice.

The LDC Group also cited Article 27.2 of the DSU on the Secretariat's role in making legal expertise available to developing country Members on an impartial basis, and believes that impartiality prevents the Secretariat from offering "the full breadth of assistance as envisaged by the Members."[32] The Group made a suggestion that Secretariat staff members be detached to assist in acting as counsel to developing countries in particular cases and "assume the full role of 'counsel' as properly understood."[33] This proposal would place a much greater burden on WTO

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[30] TN/DS/W/17 at para. 4.

[31] TN/DS/W/17 at para. 20.

[32] Ibid at para. 21.

[33] Ibid.

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legal staff and would require significant additional resources. In addition, Members have been traditionally resistant to any attempts to erode the impartiality of the Secretariat.

Finally, Jamaica noted its appreciation of technical assistance on DSU matters by the Secretariat, as provided under Article 27.3 of the DSU[34], but criticized the inadequate services of part-time legal consultants, as provided under Article 27.2 of the DSU, saying that these part-time consultants only offer advice and do not assist in the preparation of dispute submissions.[35]

5. Formal Procedures for Dissenting Opinions

The LDC Group cited that there is no provision for dissenting judgments in the DSU, and believes these should be allowed formally. In particular, the Group proposes that dissenting judgments should be allowed through a rule that the Members of the panel or Appellate Body should each deliver a judgment and the final decision be taken on the basis of a majority.[36]

The DSU currently has no provision for dissenting judgements, but these are allowed, and might reveal arguments otherwise unheard and perhaps permit the evolution of development-friendly jurisprudence. Dissenting judgements are in fact possible within the present system and have been delivered *ad hoc* despite formal procedures in the DSU; one was delivered in July 2002 in a case involving *US – CVD on German steel*. But the general view is likely to be that to require individual judgements by panellists would destroy the collegiate, consensus-based quality of the system and would not be conducive to predictability and security. Reactions to this idea have been very negative.

6. Preliminary Hearings

Jamaica suggested that panels should convene special preliminary hearings on procedural issues and render an immediate judgement upon them, rather than addressing such issues much later in the final report.[37] For example, these hearings could address the *locus standi* ("standing") of parties and whether the legal basis of complaints are adequate. Such early rulings are already provided in some cases and panels would normally do it on request wherever possible. But it may not always be possible because of the difficulty of separating substance from procedure.

7. Negotiating History

[34] TN/DS/W/21 at para. 11.

[35] Ibid at para. 2.

[36] TN/DS/W/17 at para. 5.

[37] TN/DS/W/21 at para. 3.

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Jamaica cited the need to develop a negotiating history in the course of DSU negotiations, in order to account for a "clear and precise record of negotiations and discussions, whether formal or informal."[38] The negotiating history would then be referred to by panels and the Appellate Body in the course of their findings – in accordance with international law in general and the Vienna Convention on the Law of Treaties. This proposal could help facilitate the negotiations by documenting the rationale behind reform of certain DSU provisions.

B. Compliance and Retaliation

1. Art. 21.2: Compliance with DSB Decisions

Article 21.2 of the DSU requires that in its oversight of compliance with dispute findings the DSB should pay particular attention to "matters affecting the interests of developing-country Members with respect to measures which have been the subject of dispute settlement." The LDC Group proposed that this should be treated as an overarching principle in all cases involving developing countries, including by clarifying that Article 21.2 (on developing country and, insert "least developed country Member concerns") qualifies Article 21.1 (on "prompt compliance").[39] This proposal does not appear to be controversial as it is more hortatory than operational.

2. Articles 21.2 and 21.3 on "Reasonable Period of Time" for Compliance and Article 21.5 Compliance Review

In relation to Articles 21.2 and 21.3 of the DSU on "reasonable period of time" for compliance with recommendations, the Group of Nine proposed that in cases where a developing country has lost against a developed country, this should be 15 months, or 2 or 3 years if a change in law or in long-held policies is entailed.[40] In cases of successful complaint by a developing against a developed country, the 15-month rule should be rigorously applied and compensation should be paid for trade losses in case of delay.[41] The Group's proposal is controversial as it would apply two different standards for compliance – based not on the matter of the dispute, but only on a country's development status. Furthermore, certain Members have been very resistant to extending the time frame for compliance.

In addition, the Group proposed that compliance review panel procedures under Article 21.5 of the DSU be modified – consultations should be considered as mandatory and time for

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[38] Ibid at para. 10.

[39] TN/DS/W/17 at paras. 9-10.

[40] TN/DS/W/19 at 5-6.

[41] Ibid at 6.

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proceedings should be extended from 90 days to 120 days.[42] The proposal to extend this time frame might also be controversial as it could prolong certain disputes.

Jamaica cited the need to clarify the "sequencing issues" between Article 22 and Article 21.5 – asserting that current practice implies resort to Article 21.5 prior to Article 22.[43] This proposal briefly touches upon an area in need of clarification, as demonstrated in the dispute over whether the US had the right to retaliate against the EC in *EC – Bananas*, and prior to the findings of an Article 21.5 panel.

3. Article 21.8: Impact of Measures on Developing Countries

The LDC Group and Jamaica proposed strengthening the requirement in Article 21.8 to take account of the impact of measures under investigation on the economies of developing country Members concerned in the course of compliance. For example, by adding the requirement that panels and the Appellate Body consider these factors in making their rulings, and should consider "the development prospects" for "least-developed country Members concerned."[44] This proposal does not appear to be controversial as it is more hortatory than operational.

Jamaica also proposed that this provision should apply not just to cases between developed and developing countries, but also to those where only developing countries are concerned.[45]

4. Article 22.2: Monetary Compensation Preferred

The LDC Group proposed to make compensation as provided in Article 22.2 of the DSU mandatory by elimination of the phrase "if so requested" and made a case for monetary compensation in case of non-compliance.[46] The Group cited the *EC – Bananas* dispute as an example of a problematic case in which developing countries suffered as a result of an illegal measure. They stated that "such monetary compensation should be equal to the loss or injury suffered and directly arising from the offending measure or foreseeable under the offending measure" and from the date the measure was adopted.[47] The Group also proposed a mandatory requirement to research the effects of a negative decision against an LDC, including a role for

[42] Ibid at 5.

[43] TN/DS/W/21 at para. 8.

[44] TN/DS/W/17 at para. 11.

[45] TN/DS/W/21 at para. 6.

[46] TN/DS/W/17 at para. 13.

[47] Ibid.

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UNCTAD and UNDP in this task.[48] Jamaica reiterated the need to review compensation in regard to developing countries.[49]

The Group's proposal on monetary compensation is controversial as most Members with inconsistent measures have not offered compensation (e.g. EC in the *Bananas* and *Hormone-treated beef* dispute) including on tariff adjustments, and would be resistant to offering monetary compensation. Nevertheless, there is some precedent for this compliance approach as the US offered monetary compensation to a European artists' development fund in the dispute on *US – Section 110(5) Broadcast Copyrights* – the sum of $1 million annually for three years.

5. Article 22.3: Simplify Cross-Retaliation Procedures

The Group of Nine proposed to simplify cross-retaliation procedures for developing country Members due to their difficulties in retaliating effectively against developed Members' failure to amend or remove offending measures. The Group acknowledged the precedent set in Ecuador's case against the EC in the *Bananas* dispute – in which the compliance review panel allowed for cross-retaliation, but the Group asserted that Ecuador's encountered difficulties in obtaining this right. (Ecuador had argued it was impossible to retaliate against the EC effectively without serious harm to itself.) Therefore, the Group proposed modifying Article 22.3 of the DSU to allow retaliation "with respect to any or all sectors under any covered agreements."[50]

The Group's proposal is controversial as it could potentially threaten developed countries' services and intellectual property industries (*e.g.* GATS and TRIPs commitments), since most disputes raised by developing countries involve GATT obligations.

6. Collective Retaliation

The LDC Group made a bold suggestion to introduce the principle of "collective responsibility" – somewhat similar to its equivalent under the *Charter of the United Nations*, which would allow all WTO Members to have the collective right to ensure compliance, including through collective retaliation.[51] The Group believes developing or least-developed country Members should be allowed to collectively retaliate automatically. Furthermore, these actions should not be restrained "on the basis of the rule on nullification and impairment." This proposal is certain to attract much opposition by many Members as retaliation is limited to the parties in the dispute and often after the findings of arbitration panels.

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[48] Ibid at para. 14.

[49] TN/DS/W/21 at para. 9.

[50] TN/DS/W/19 at 1-2. (*See* "Suspension of Concessions and Other Obligations")

[51] TN/DS/W/17 at para. 15.

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C. Special and Differential Treatment

There are several provisions in the DSU calling for special consideration to be given, at the various stages of dispute settlement proceedings, to the special problems and interests of developing and least-developed countries. In general, they are hortatory rather than mandatory, and it is hard for compliance with them to be enforced or tested. The effect of the proposals made in the review would be to make such provisions either mandatory or at least more operational.

1. Art. 4.10: Consideration to Developing Members' Concerns and Interests

Article 4.10 of the DSU states that "During consultations Members should give special attention to developing-country Members' particular concerns and interests." The Group of Nine proposed that this should be made mandatory (replacing "should" by "shall" and requiring developed countries to explain in panel submissions how they had complied with this requirement, and panels to rule on compliance).[52]

The LDC Group proposed adding the phrase "especially those of least-developed country Members" to Article 4.10. The LDC Group also pointed out that LDCs face significant human resource constraints and are often under-represented or not represented in Geneva. The Group suggested that consultations could be held in the capitals of LDCs.[53]

Both these proposals make such provisions more operational, but "special attention" to developing and LDC concerns is a loosely-defined requirement. But consultations often take place outside Geneva in the respective country capitals, so Members could make an effort to hold such proceedings in LDC capitals in future disputes.

2. Arts. 12.10: More Flexible Time Frames

Article 12.10 of the DSU allows the panel chair the discretion to extend the normal consultation period in cases involving measures taken by developing countries. The Group of Nine proposed to replace this with a mandatory extension of at least 30 days, or 15 days in cases of urgency.[54] In addition, panels would be required to allow additional time of at least two weeks for developing countries to prepare a first written submission and one week for each subsequent submission (as granted to India in the dispute on *India – Quantitative Restrictions*).[55] This proposal is controversial as it would extend certain timeframes based only on the

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[52] TN/DS/W/19 at 3 (*See* "Other Special and Differential Provisions").

[53] TN/DS/W/17 at para. 3.

[54] TN/DS/W/19 at 3-4.

[55] Ibid at 4.

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development status of a country and not the matter of the dispute. Nevertheless, the time frames proposed are not overly ambitious.

3. Article 12.11: Mandatory Consideration of LDC Concerns

The LDC Group proposed that Article 12.11 of the DSU be modified to make specific mention of "least-developed country Members" and require that panels and the Appellate Body "invoke all applicable legal principles" (*e.g.* special and differential treatment provisions) and not only consider these issues when raised in dispute proceedings.[56] This proposal also seeks to make such provisions more operational, but the requirement of invoking "all applicable legal principles" is not clearly defined.

4. Article 24: Ensure Due Restraint

The LDC Group cited Article 24 of the DSU ("Special Procedures Involving Least-Developed Countries") as essential to their interests, and proposed strengthening the provision on "due restraint." In particular, the Group questioned the *prima facie* legitimacy of raising disputes since these cases can proceed automatically if complainants so desired. Thus, due restraint should become an operational provision – but the Group did not provide further clarification.

The Group also suggested that a preferable approach (for such questionable disputes) would be mediation through the "good offices of the Director-General" as provided by Article 24.2.[57] The Group also urged "due restraint" in matters involving compliance and believes that no compensation or retaliation should be sought from, or taken against an LDC Member. Nevertheless, the Group was agreeable to adding a provision that "*a least-developed country Member against whom a case has been determined shall be expected to withdraw the offending measure*."[58]

The debate over "due restraint" has been raised in WTO deliberations to the dissatisfaction of developing countries, which have complained that the phrase is hortatory and not operational. The US and other Members have argued that "due restraint" imposes no legal obligation which would "nullify or impair benefits to any Member under those agreements"[59] to the detriment of its "rights and obligations" under the DSU.[60] The US was challenged in its exercise of "due restraint" when it raised a dispute against the Philippines in *Philippines* –

[56] TN/DS/W/17 at paras. 6-8.

[57] TN/DS/W/17 at paras. 16-19.

[58] Ibid at para. 18.

[59] *See* Article 3.5 of the DSU.

[60] *See generally* Article 3 of the DSU.

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Automotive TRIMs, but the panel was suspended as a result of a bilateral resolution between the two parties. Thus, the US and other Members are certain to oppose any mandatory requirements on the phrase "due restraint" – whether it involve raising disputes, retaliatory measures or other perceived limitation of rights under the DSU.

D. Costs of Litigation and Legal Advice

The Group of Nine complained that the cost of litigation before WTO panels and the Appellate Body is "prohibitively high." The Group proposed that in cases where a developed country loses a case against a developing country, whether as plaintiff or defendant, the panel or the Appellate Body should determine a "reasonable amount" of the costs incurred by the developing country, which would be borne by the developed country. [61] The Group also suggested adding a provision to give effect to such compensation in the working procedures of panels in Appendix 3 of the DSU and of the Appellate Body.[62]

Jamaica was even more assertive that the Group of Nine on reimbursement for disputes, and proposed that developed country Members who do not prevail in disputes against developing country Members should pay the full costs of legal fees incurred by developing countries. Jamaica specified that the costs to be covered would include attorney's fees as well as fees for experts assisting in the preparation of legal arguments.[63]

Jamaica also suggested that additional independent mechanisms should be developed, not just for the provision of legal advice but also in arguing a developing country's case before a panel or the Appellate Body. Jamaica also supported participation of private lawyers, and said that this appears to have become an accepted practice after the Appellate Body decision in the *EC – Bananas* dispute.[64]

The proposals requiring some provision for reimbursement of litigation costs by developed countries to developing countries are controversial, even though the practice is accepted and commonplace in some domestic jurisdictional bodies, *e.g.*, in the US. Developed country Members are likely to question the need by certain developing country governments to engage outside counsel or specialized experts – since most of these costs, if incurred, are now borne by the affected domestic industries who raise, or are targeted by disputes. In addition, developed country Members would probably find it difficult to allocate these costs in their own budgets, or in requiring their own domestic industries to be liable for such costs. Nevertheless,

[61] TN/DS/W/19 at 2 (*See* "Litigation Costs").

[62] Ibid.

[63] TN/DS/W/21 at para. 7.

[64] TN/DS/W/21 at para. 2.

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such opposition by some developed countries would run counter to their own domestic practices which allow for reimbursement of legal expenses.

As a general matter, litigation costs have risen as the WTO's dispute settlement system becomes more like a true judicial system and as submissions to panels and the Appellate Body become longer and more professional. In recognition of this an Advisory Centre on WTO law was established in Geneva in July 2001, to function essentially as a law office specialised in WTO law and providing legal services and training to all least developed countries and to those developing countries and economies in transition which join the centre. It is financed by endowments from governments of developed countries and by fees charged to users. Though subsidised, these are still said by some like Jamaica, to be too high. Some Members felt that the criticism of the Advisory Centre was not justified.

III. Comments at October Special Session of the DSB

Those WTO Members who commented on these proposals in the DSB Special Session were in principle sympathetic to the idea of making provisions for special and differential treatment more operationally effective. It is true that in many areas such provisions have been pious statements of good intentions rather than hard commitments. But both in the DSB and more especially in private comments, WTO Member delegates have expressed concern about the insertion of political and developmental considerations into the dispute settlement process if this would imply departure from the strict interpretation of the law. Proper application of existing special and differential treatment provisions is accepted as a legitimate demand, but suggestions that the normal application of law should be set aside on these grounds (*e.g.* regarding "due restraint") would be strongly resisted. The coherence of the system is seen as the overriding concern.

Interestingly enough, regarding the allocation by panels of legal costs between participants, Norway commented that this might be of general interest, and not confined to developing countries.

IV. U.S. DSU Reform Proposal

The U.S. submission on DSU reform tabled in August 2002 emphasized greater transparency in WTO dispute proceedings, including through (i) more open panel proceedings; procedures for submission of amicus briefs; and expedited release of dispute documents.[65]

A. Wider Access to Meetings

The US criticized the fact that civil society and Members not party to a dispute have been unable to observe dispute proceedings at the WTO, unlike some degree of access granted by

[65] TN/DS/W/13, Contribution of the United States to the Improvement of the WTO Dispute Settlement Understanding of the WTO Related to Transparency, 22 August 2002.

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other tribunals including the International Court of Justice, the International Tribunal for the Law of the Sea, the International Criminal Tribunal for the former Yugoslavia, the International Criminal Tribunal for Rwanda, the European Court of Human Rights, and the African Court on Human and Peoples' Rights. Nevertheless, some of these tribunals do not allow public access to all of their proceedings.

The US suggested that implementation of WTO findings may be facilitated if constituencies or legislators believe that the rulings are a result of a "fair and adequate process." The US also believes that non-party WTO Members would benefit from being able to observe the arguments and proceedings of WTO disputes as it would assist Members, including developing countries, to understand better the issues involved as well as gaining greater experience with dispute settlement.

In this regard, the US proposed that the public and non-party WTO Members be permitted to observe all substantive panel, Appellate Body and arbitration[66] meetings – except those portions dealing with confidential information (*e.g.* business confidential information or law enforcement methods). The US suggested that the DSU could provide a basic set of procedures to allow for public participation with special regard to the particular circumstances of each proceeding. For example, the US suggested broadcasting meetings to special viewing facilities. The broadcast of all, or certain proceedings would be an innovative approach as such practices are not common in international dispute settlement.

The U.S. proposal to open WTO proceedings, including attendance at proceedings and through remote broadcasts, is controversial and likely to generate opposition from many WTO Members. The opponents of public proceedings often argue that the public is not entitled to such rights and benefits since they are not recognized as Members of the organization, and that it is difficult to protect confidential or proprietary information in such proceedings.

B. Faster Access to Submissions

The US proposed that parties' submissions and written versions of oral statements in panel, Appellate Body, or arbitration proceedings should be made public, except those portions dealing with confidential information. In addition, the Secretariat should maintain them in a central location and documents should be available to the public.

Panel and Appellate Body procedures already require the release of non-confidential versions of party submissions – which the US routinely provides. However, many Members do not adhere to these deadlines, and there is no central location for these documents.

C. Faster Access to Final Reports

[66] This would include arbitration under Articles 21.3(c), 22.6 and 25 of the DSU.

The US proposed that final panel reports should be available to WTO Members and the public once they are issued to parties. This proposal should not be controversial, but has been opposed in the past due to Members' differences on translation delays into the WTO's three official languages of English, French and Spanish – especially French.

D. *Amicus Curiae* Submissions

The US suggested that WTO Members consider proposing guidelines on *amicus curiae* submissions to panels and the Appellate Body, in light of procedural concerns that have been raised by Members and WTO bodies.

Similar to the U.S. proposal on opening WTO proceedings, the proposal on amicus briefs is controversial and likely to generate opposition from many WTO Members. The opponents of amicus briefs believe that unsolicited submissions should not be permitted in dispute proceedings as non-parties are not entitled to rights and benefits accorded to the WTO membership.

OUTLOOK

Although the engagement of developing countries in the DSU review is welcomed, and there is recognition of the need to make special and differential treatment provisions more than a polite fiction, the main concern of industrialized countries in reacting to these proposals will be to preserve the coherence of the legal system. Some of the recent proposals, including flexibility in time-frames, more assistance to developing country litigants, and cross retaliation could reasonably be accepted.

Other ideas, including collective retaliation, monetary compensation, exercise of "due restraint" and reimbursement for legal services are likely to be controversial. The primary users of the DSU will argue that the function of panels is to establish the legal facts, and that they should do so in pure objectivity; that it is for others to worry about the economic and political implications of decisions.

The number of proposals submitted in the DSU review – now over twenty – makes it seem increasingly unlikely that the target date for completion – May 2003 – can be met unless there is a real effort to concentrate on core issues, as India has suggested. This would not in itself be a major problem for the Cancun Ministerial in September of 2003, but it would add to the general perception of great difficulty in meeting the January 2005 deadline for conclusion of the Doha Round. Clarification and improvement of the DSU is part of the Doha agenda, despite its earlier deadline.

In regard to the U.S. submission on transparency in the DSU, the proposals are quite modest compared with prior efforts on DSU reform during the preparations for the Seattle Ministerial in 1999. Back then, the Clinton Administration was under intense pressure from labor, environmental and consumer groups to make the WTO more responsive to civil society concerns – and thus advocated opening proceedings to the public, and the right to submit amicus briefs, among other issues. Still, U.S. civil society groups the private sector and the U.S.

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Congress remain like-minded about seeking greater transparency in WTO dispute proceedings, especially since they are accustomed to a transparent and open system in the US. Many groups are critical of the fact that they have limited opportunities to provide direct input in WTO proceedings, even if the issues affect them significantly.

Nevertheless, in the recent U.S. proposal, the suggestion of broadcasting meetings to a viewing facility should be more acceptable than having spectators in the room. In addition, the reference to amicus briefs is very restrained and only suggests preparing guidelines. The request for quicker publication of reports is reasonable since current delays are more attributed to the lack of WTO resources in translation than to objections in principle. Nevertheless, there will be opposition to the U.S. transparency proposal, especially from developing countries on public proceedings and amicus briefs. Developing countries assert that opening proceedings to input from the public would erode the rights of WTO Members, to the benefit of lobbies and NGOs from the industrialized world. These groups might also increase pressure on developing countries in regard to environmental and labour issues.

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Panel Discussion and Deputy Treasury Secretary Speech on U.S. Implementation of WTO Findings Against the FSC/ETI Regime

SUMMARY

The Washington International Trade Association ("WITA") and Women in International Trade ("WIIT") held their annual Trade Expo on October 9, 2002, which included a panel discussion – off the record – on U.S. approaches to implementation of the WTO findings against the U.S. Extraterritorial Income Act/Foreign Sales Corporations ("ETI/FSC") regime.

Panelists included representatives from the U.S. Treasury Department, National Foreign Trade Council – which coordinates the industry coalition on the matter; European-American Business Counsel; and the tax counsel to Chairman Bill Thomas of the House Ways and Means Committee. Panelists agreed generally on the need to change the current ETI/FSC regime, but differed on taking either a legislative or negotiated approach, or a combination of both.

In addition, Deputy Secretary of Treasury Kenneth Dam spoke recently on the need for a serious fix of the ETI/FSC regime. Dam warned that a solution will result in some "winners and losers," as the ETI/FSC will not be replicated.

ANALYSIS

I. WITA/WIIT Panel on FSC/ETI Implementation

The Washington International Trade Association ("WITA") and Women in International Trade ("WIIT") held their annual Trade Expo on October 9, 2002, which included panel on "Beyond FSC: International Taxation Rules" – a discussion of U.S. approaches to implementation of the WTO findings against the U.S. ETI/FSC regime.

A. Pamela Olson, Department of Treasury

Pamela Olson, Deputy Assistant Secretary (Tax Policy) for the Department of Treasury began by saying it was "time to review U.S. tax rules" which she explained were designed at a time when most foreign investment was from U.S. multinationals and was mostly outbound. She said times have changed, and we no longer live in a closed economy. For example, the U.S. tax structure appears outdated by maintaining a strong incentive to keep money offshore (e.g. 35 percent tax credit), and does not permit border adjustments or other less-restrictive tax credits. On the other hand, other countries including in the European Union ("EU") have introduced benefits including rebates on value-added tax (VAT), or tax credits – which is based more on a territorial system. These countries appear to have little tolerance for ETI/FSC-style tax reduction approach, which shelters earnings abroad.

Olson pointed out that VAT rebates and other tax incentives can act as barriers to investment, and that there is a need to "level the playing field." She acknowledged that the FSC/ETI was a failed attempt to do so, and new structural approaches should be considered to

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reduce corporate tax burden. She did not offer specific recommendations, and said Treasury is coordinating closely with the Administration, Congress and industry on developing a solution.

B. William Reinsch, National Foreign Trade Council

William Reinsch, President of the National Foreign Trade Council ("NFTC") stated that NFTC coordinates the industry coalition developing responses to the ETI/FSC issue. He outlined that there are mainly two paths to follow: (1) repeal of the ETI/FSC; or (2) negotiate a settlement with the EU. He mentioned that the House Ways and Means Committee (e.g. Chairman Thomas) preferred option (1) of repeal while Senate Finance Committee (i.e. Chairman Baucus) preferred option (2) of negotiating with the EU and other WTO Members on an acceptable solution.

Reinsch explained that the NFTC preferred a combination of both approaches – or a "repeal and salvage" of some measures. He referred to Treasury Deputy Secretary Kenneth Dam's recent speech on the matter as thoughtful, and clearly underlined the need to fix the ETI/FSC (See below). He added, nevertheless, that industry recipients of the tax breaks would not dismiss the issue quietly, and have made several proposals – which have created some controversy.

Reinsch referred to the coalition's four-part approach (See Attachment 1)[67], which includes clarification of "Footnote 59" of the Agreement on Subsidies and Countervailing Measures ("SCM Agreement"), perhaps in the course of Doha Development Agenda ("Doha Round") negotiations. He believes, however, that the Administration is reluctant to negotiate clarification of Footnote 59 to exempt certain aspects of the ETI/FSC, despite the mandate at Doha to negotiate aspects of the SCM Agreement. He also criticized the Rep. Bill Thomas' bill (H.R. 5095), asserting that it does not take into account the NFTC's recommendations. In particular, the Thomas bill does not address the tax burdens of beneficiaries in the defense sector – which would face a heavy tax burden if the ETI/FSC were repealed.

[67] NFTC FSC-ETI Coalition, Drafting Specifications for Unitary Proposal: Executive Summary, May 1, 2002. The proposal suggests the following four approaches:

(1) Footnote 59 exception – Implement SCM exception to prohibited export subsidies by excluding from U.S. tax foreign-source income earned by U.S. taxpayers in export transactions.

(2) Subpart F modification – Repeal certain exceptions under the unlimited deferral rule on U.S. income tax on business profits earned abroad.

(3) WTO-permissible transactions – Enact an exemption for transactions that are permissible because they are not exports under international norms.

(4) Wage-based tax credits – Provide new wage-based text credits.

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Reinsch concluded by saying that no resolution of the dispute seems imminent this year, considering the upcoming November elections. He hopes a bipartisan process will begin in early 2003 – which will include elements of both legislation and negotiation. He cited the US-EU bananas dispute as a good example of cooperation as both parties reached a negotiation solution to the matter, and the EU modified its regime, but did not entirely repeal the discriminatory quotas. He regretted, however, that the U.S. Administration did not seem to pursue this route, and the Ways and Means Committee for the moment is focused on a legislative fix. He urged Congress to work with NFTC and the coalition to come up with an acceptable legislative solution, but also not to forgo efforts to negotiate an acceptable solution with the EU.

C. Will Berry, European-American Business Council

William Berry, President of the European-American Business Council, stated that the ETI/FSC dispute is the Council's most alarming issue of concern since the Helms-Burton/Iran-Lybia Sanctions Act ("ILSA"). He believes the Administration is determined to comply with WTO findings, and will work with Congress to modify U.S. tax laws.

Berry said the Council generally supports the Thomas Bill as a positive step towards demonstrating to the EU the US is serious about compliance. He added, however, that the Council would like to see some benefits preserved, but not a replication of the ETI/FSC regime – otherwise it would invite retaliation from the EU. He added that the Council is concerned the EU will consider speedy retaliation, especially after the fallout of the U.S. Section 201 safeguards on steel. He concluded by saying it was essential to resolve the dispute as quickly as possible due to the integrated nature of the US-EU economic relationship.

D. Greg Nickerson, House Ways & Means Committee

Greg Nickerson, Tax Counsel for the House Committee on Ways and Means, and Chairman Bill Thomas in particular, highlighted the importance of compliance with WTO findings since the US is a major benefactor of WTO rules. He explained that the Thomas Bill attempts to simplify taxation of corporate earnings and provides a $94 billion in tax relief. The relief is almost twice as much as provided in the current ETI/FSC regime ($51 billion), but the scope is different – thus resulting in "winners and losers."

Nickerson said the Thomas Bill is revenue neutral. He added that the NFTC proposal suggests review of "Footnote 59" – but believes this approach would not comply with WTO rules. Furthermore, he warned that if "Footnote 59" was negotiated to preserve aspects of the ETI/FSC – the US might stand to lose on other areas of Doha Round negotiations, including on agriculture and other key sectors. He emphasized that the trade-offs and shifting dynamics of multilateral negotiations would provide no guarantees on reaching a solution among WTO Members.

Nickerson concluded by saying that Congress does not anticipate EU retaliation this year. He also believes the Thomas Bill is moving forward, and will receive more attention after the elections.

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E. Questions to Participants

1. Earnings Stripping/Inversions

Olson of Treasury responded to a question on earnings stripping, saying that the general rule provides virtually no limits on reducing U.S. overseas earnings. She says Treasury is sympathetic, but has serious concerns on the matter, saying that debt can be traced to outside groups. She also pointed out that Treasury has made a proposal to deal with inversions, and the proposal is not intended to "get back" at the EU for bringing the dispute.

2. Negotiation vs. Legislative Approaches

Panelists responded to questions on negotiation vs. legislative approaches with the EU. Olson emphasized the need to show movement to address the issue immediately, and ensure a smooth transition for companies. Nickerson stressed the legislative approach, saying that anything short of repeal could risk EU retaliation. Nickerson did not rule out bilateral negotiations with the EU, but was clearly skeptical if negotiations would buy more time in light of the WTO findings.

Reinsch acknowledged that the Thomas bill is a sincere effort and has helped delay EU retaliation. He added that the NFTC supported "large parts" of the bill, but was dismayed that the Thomas bill did not incorporate the NFTC's main recommendations. Reinsch also was skeptical if the Thomas bill would pass, and cautioned Chairman Thomas not to disregard the NFTC as a partner in the matter. Again, Reinsch suggested the bananas dispute as a compromise approach which resulted in both a negotiated and legislative approach on behalf of the US and EU, and EU legislative bodies. He also urged the US government to consider a negotiated solution in the course of the Doha Round negotiations.

3. Status of Legislative Approaches

Nickerson answered a question on the status of Congressional deliberations, saying that discussions were being held on the Thomas Bill, but Congress won't act this year – due to elections, and resistance in the Senate Finance Committee and Chairman Baucus. He emphasized that the "information/education stage" is complicated, but must result in a resolution, as there exist a real threat of retaliation to U.S. exports.

Regarding the Thomas Bill, Nickerson asserted that a $95 billion tax relief package is better than the alternative of no beneficiaries after the probable repeal of the ETI/FSC. He added that the Committee and staff have met with many companies to consider various approaches. For example, Nickerson believes that the general rule on earnings stripping is problematic and contains no effective limits – which could lead to abuse.

In addition, Berry pointed out three pending issues:

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(1) The lack of a consistent message from the Administration on the issue of inversions;

(2) Treasury needs to conduct further analytical work on various proposals on inversions and other matters;

(3) Compliance burdens are not shared among beneficiaries; there is a need for consistency.

II. Kenneth Dam Speech on FSCs and Corporate Inversions

In remarks on October 8, 2002, Deputy Treasury Secretary Kenneth Dam gave a lengthy speech on two major issues in the international tax arena: (1) WTO decision against the Extraterritorial Income Act (ETI, formerly "FSC"); and (2) the related issue of corporate inversions.

A. Dam Confirms Commitment to Comply with WTO Findings

Addressing the latter first, Dam said that any attempt to replicate the benefits of the Foreign Sales Corporation (FSC), the forerunner to the ETI, or the ETI itself is pointless. "The chances of going back to a FSC look-alike law are nil," Dam said. He said that the President is committed to complying with the WTO decision by working with Congress to develop a response that increases the competitiveness of the U.S. business. He also conceded that the final response to the WTO decision won't "replicate for each and every company the tax relief they obtained under FSC or ETI." In other words, there will be winners and losers in the end. Some may see no benefit at all, Dam predicted.

Dam said the greater problem lies with the structure and application of the American tax system. While America has a worldwide tax system that hinges on where a company is incorporated, many other nations have a territorial system. "U.S. tax is not imposed on the foreign-source income of the foreign subsidiaries of U.S. companies," Dam observed. As a result, foreign source income is not taxed until repatriated to the U.S.

Dam suggested that legislative changes to Subpart F could be enacted to limit it to "truly passive income – such as portfolio dividends, interest and the like." At the very least, Dam called for a "hard look" at the so-called active/passive dichotomy in Subpart F rules.

B. Dam Cites Corporate Inversions Encouraging Offshore Activity; Comprehensive Reform Needed

Moving to corporate inversions, Dam said that tax savings are the sole reason why a company chooses to reincorporate abroad in Bermuda or other tax havens. This process, known as an inversion transaction, moves a company's official residence offshore while generally leaving its physical presence and workforce unchanged. He said that a natural reaction is to simply prohibit the transaction. But such a response confuses the symptoms with the disease.

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Dam said a comprehensive approach is needed. He outlined three areas for policy changes: (i) earnings stripping through related-party interest deductions; (ii) income shifting through transfers of intangible and other assets, and (iii) the unintended benefits of tax treaties. Dam said the Administration supports amending section 163(j) to disallow cross-border intercorporate interest payments as deductions against U.S. tax, to the extent that the corporate group's level of U.S. indebtedness relative to assets exceeds its worldwide ratio of indebtedness to assets. He also said that the Treasury Department is examining the regulatory regime under section 482, with a particular emphasis on income shifting, especially by transfers of intangibles. He expects the Administration to report to Congress if legislation is needed in this area.

Dam said the Treasury Department is also reviewing existing tax treaties for loopholes that are intended to reduce or eliminate double taxation but function to effectively remove all the tax on certain income.

C. Others Areas of Reform

To keep American business competitive going forward, Dam said that many U.S. international tax rules need updating—not just Subpart F but in the foreign tax credit area as well. He singled out how interest allocation rules can sometimes reduce a company's ability to use the credit by allocating some of its U.S. interest expense against the assets of its foreign affiliates, even though those foreign affiliates are equally of even more highly leveraged.

Dam concluded by saying that there is no reason why a U.S.-owned firm should be acquired by a foreign-owned firm simply because of ill-designed international corporate tax rules. "When U.S. tax law treats U.S.-owned and foreign-owned firms alike, our economy will be stronger and U.S. enterprises will be more competitive around the world," he concluded.

OUTLOOK

There remain considerable differences between the Administration, Congress and U.S. industry groups regarding possible approaches to implement WTO findings against the ETI/FSC regime. Although the parties agree that the ETI/FSC regime requires a serious legislative fix, if not outright repeal, they differ on the tax relief that would be available to U.S. multinationals.

The Ways and Means Chairman Thomas and the Administration appear to lean towards a repeal of the ETI/FSC, along with serious reform of the tax code. The Senate Finance Committee and industry are reluctant towards the loss of benefits, and are encouraging both a legislative approach, and negotiations with the EU and in the context of the Doha Round mandate on the SCM Agreement. Nevertheless, on some matters, the approaches of the various parties overlap. For example, Kenneth Dam suggests a review of Subpart F of the tax code – one of the NFTC's main suggestions, which was not taken up by the Thomas Bill. Furthermore, most parties agree that the issue of corporate inversions, including general rules on earnings stripping – is in need of reform, and is all the more urgent in light of ETI/FSC compliance efforts.

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The remainder of the year will not produce effective reform or repeal of the ETI/FSC regime; furthermore, the U.S. government and industry do not believe EU retaliation is imminent. These groups do realize the urgency of the situation, but are encumbered by Congressional elections in November, and serious differences on legislative and negotiated approaches to the problem. Thus, effective action will await further analytical work and proposals of the various working groups (e.g. Legislative-Executive Working Group) on the FSC/ETI matter.

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U.S. Presents First Written Submission in the WTO Dispute on Mexico – Telecommunication Services

SUMMARY

On October 3, 2002 the United States filed its first written submission in the dispute against Mexico on Measures Affecting Telecommunication Services. The U.S. claims that Mexico has failed to honor its obligations both under the "Reference Paper" incorporated to its additional commitments and the GATS Annex on Telecommunications. The dispute is also the first in WTO jurisprudence to deal exclusively with the GATS and on telecommunications services.

The next steps in the panel proceedings will be the first written submission from Mexico, initially due on December 7, as well as from third parties to the dispute due on December 14. Mexico recently requested an extension for its first submission, which will postpone all dates by at least one week.

ANALYSIS

I. Background

On April 17, 2002 the WTO Dispute Settlement Body agreed to the establishment of a panel requested by the U.S. on certain measures affecting telecommunication services. In mid August, the parties reached an agreement on the panelists (members Ernst-Ulrich Petersmann, Raymond Tam and Bjorn Wellenius) and the panel was composed. In early October, the U.S. made its first written submission on the case – portions of which have been made public.

II. U.S. Claims Violations of the Reference Paper and Annex

In its written submission, the U.S. stated that although other Mexican suppliers have been authorized to provide international services over their networks since 1997, Telmex still has the exclusive right to establish the terms and conditions for the termination of all international calls. Also, Mexico is the only WTO Member with competitive suppliers of international facilities-based services that prohibits competitive negotiations for the termination of international calls, as per Mexican International Long Distance Rules ("IDL Rules"). Therefore, the U.S. complains that the Mexican Government has imposed restrictions on competition for the termination of international calls in violation of both the basic telecom "Reference Paper" and the GATS Annex on Telecommunications.

A. Violations of "Reference Paper" Obligations

Mexico has undertaken specific market access and national treatment commitments for basic telecommunication services in its GATS Schedule of Commitments. It has also incorporated the basic telecom "Reference Paper" into its Schedule as an additional commitment.

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The Reference Paper is a document agreed to during the telecom extended negotiations, which governs competitive safeguards (Section 1), interconnection (Section 2), universal service (Section 3), licensing criteria (Section 4), independent regulation (Section 5), and allocation and use of scarce resources (Section 6). Under WTO rules, all WTO Members must reach a consensual decision on the issues in order to have a document adopted and binding on all of them. Since not all Members were willing to commit to the terms of the Reference Paper, an Annex to the GATS on these issues could not be established. Instead, Members decided individually whether to incorporate the Reference Paper to their schedules. Mexico, along with most WTO Members party to the Basic Telecoms Agreement, chose to incorporate the Reference Paper as a part of its schedule.

The U.S. argues that Section 2.1 and 2.2 of the Reference Paper specifically require Mexico to impose certain disciplines on its major supplier of basic telecom services ("Telmex") in its dealings with other suppliers of basic telecom services that seek to interconnect with its network for the purpose of supplying these services. In particular, sections 2.1 and 2.2 require Mexico to ensure that Telmex provides interconnection at rates that are "*basadas en costos"* and "*razonable.*" Moreover, Mexico IDL Rules provide *de jure* monopolistic powers to Telmex to set the interconnection rates charged by all Mexican carriers to foreign supplier[68]. Thus, the U.S. challenges the IDL rules on issues of cost-based rates and reasonable terms and conditions.

1. Rates "*basadas en costos"*

The U.S. argues that the rates Telmex charges U.S. service suppliers for interconnection are not "*basadas en costos*", despite the fact that they have been approved by Mexico's telecommunication regulatory body "Cofetel".

The U.S. asserts that the rates Telmex charges U.S. cross-border suppliers for interconnection exceeds (i) the maximum cost Telmex could incur to provide this interconnection, (ii) the "grey market"[69] retail rates for calls into Mexico and (iii) the wholesale rates for termination of calls into other countries. The U.S. further asserts that the financial compensation procedures among Mexican operators demonstrate that the interconnection rates charged to U.S. suppliers are not cost-oriented.

2. Rates "*razonable"*

The U.S. argues that Mexico has failed to ensure that Telmex's interconnection rates are "*razonable*". Section 2 of the Reference Paper requires Mexico to ensure that interconnection with its major supplier be on reasonable terms and conditions. The US believes that it is not enough for a WTO Member to ensure that its major supplier's interconnection rate is cost-based. The US thus believes that Mexico should also ensure that the terms and conditions are

[68] First Written Submission of the United States, October 3, 2002, para.27.
[69] Arrangements which bypass the uniform settlement rates required by Mexican regulations and therefore are technically illegal in Mexico.

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"reasonable" in such a manner that the major supplier could not restrict the supply of a scheduled basic telecom service.

The Reference Paper does not provide a definition for the term "reasonable". Therefore, the term shall be interpreted according to the customary rules of treaty interpretation reflected in Article 31(1) of the Vienna Convention on the Law of the Treaties.

The U.S. argues that the ordinary meaning of "reasonable" in light of the object and purpose of the agreement would require that "they do not restrict the supply of scheduled services." [70] The U.S. further argues that interconnection obligations of Section 2 of the Reference Paper are especially important for the cross-border supply of basic telecom services – particularly in markets like Mexico, which legally bar foreign service suppliers from owning facilities and therefore force foreign suppliers to rely on the major supplier to deliver their services to the end user. The U.S. also argues that in these cases foreign suppliers have no choice but to pay a domestic service supplier (such as Telmex) an interconnection rate to terminate their calls.[71]

The U.S. argues that Mexico, through the IDL rules, precludes competitive alternatives to the interconnection at cost-based rates and reasonable terms and conditions. Rather, Mexico has given Telmex *carte blanche* to set interconnection rates, which undermine competition, harm consumers, and represent a windfall to Telmex. Therefore, the U.S. believes that Mexico's failure to meet its Section 2 obligations is not merely one of omission, but also by action, since Mexico through its IDL Rules allows its major supplier to have *de jure* monopoly power to set and maintain interconnection rates with foreign operators, and thus restrict the supply of services. For this reason, the U.S. claims that Mexico has not fulfilled its obligations under Section 2.2(b) of the Reference Paper.[72]

B. Violations of the GATS Annex on Telecommunications

The GATS Annex on Telecommunication requires WTO Members to ensure that foreign service suppliers have reasonable and nondiscriminatory access to and use of public telecommunications networks and services in order for them to supply all services inscribed in that WTO member's schedule. The U.S. argues that Section 5 (b) of the Annex specifically requires Mexico to ensure that suppliers from WTO Member can access and use private leased circuits within and across the Mexican borders.[73]

The GATS Annex on Telecommunications also addresses telecommunications as a means of transporting scheduled services, since it requires Members to ensure that users of

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[70] First Written Submission of the United States, October 3, 2002, para.159.
[71] *Idem*, para.164.
[72] *Idem*, para. 166.
[73] *Idem*, para.32.

telecommunications (*eg.* service suppliers) have access to or use of telecommunications to deliver their services free from obstacles. In this regard, the Annex represents an effort to prevent dominant telecom providers from using their control over public telecom networks and services to undermine the supply of a scheduled service. Like the Reference Paper, the obligations of the GATS Annex aim to ensure that dominant telecom suppliers cannot nullify the services commitments that their home country undertakes.

The U.S. asserts that Mexico has not fulfilled its commitments under Section 5(a) and (b) of the Annex. The U.S. cites that U.S. suppliers currently must interconnect with the Mexican network in order to ensure that they can transport their scheduled service to its final destination.

Since IDL rules require that Telmex and other Mexican carriers charge uniform interconnection rates (which the U.S. already asserts are not "reasonable"), the result is that Mexico does not provide adequate access to and use of Mexico's public telecom networks and services – and – on reasonable terms and conditions.

III. Legal Issues Raised and Guidance from GATS Jurisprudence

The U.S. complaint will require the WTO dispute settlement bodies to provide their first formal interpretation of the Reference Paper and GATS Annex on Telecommunications. The findings on the Reference Paper will be influential as most WTO Members have adopted these competitive principles in their schedules, and other Members beside Mexico are struggling to introduce competitive standards in their telecommunications sector. In addition, an interpretation of the Annex on Telecommunications will help clarify the scope of the obligations set out in the Agreement.

A. "Measures" and How They "Affect" Access to Services

For example, Item 2 of the Annex establishes that "The Annex shall apply to all *measures* of a Member that *affect* access to and use of public telecommunications transport networks and services" (Emphasis added).

The Appellate Body of the WTO has already interpreted the terms "measures" and "affect[ing]" in prior cases, including in relation to Article I of the GATS. In this regard, it has established as follows:

> "(…) no measures are excluded *a priori* from the scope of application of the GATS as defined by its provisions. The scope of the GATS encompasses any measures of a Member to the extent it affects the supply of a service regardless of whether such measure directly governs the supply of a service or whether it regulates other matters but nevertheless affects trade in services."[74]

[74] EC - Bananas III, Panel Report, W/DS27/AB/R, dated 22 May 1997, para. 7.285. The Appellate Body upheld this finding in para.216, WT/DS27/AB/R.

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The Appellate Body in the same case confirmed the Panel's finding:

> "In our view, the use of term "affecting" reflects the intent of the drafters to give a broad reach to the GATS. The ordinary meaning of the word "affecting" implies a measure that has "an effect on", which indicates a broad scope of application. This interpretation is further reinforced by the conclusions of previous panels that the term "affecting" in the context of Article III of the GATT is wider in scope than such terms as "regulating" or "governing." We also note that Article I:3 (b) of the GATS provides that "services' includes *any services* in *any sector* except services supplied in the exercice of governmental authority" (emphasis added), and that Article XXVIII (b) of the GATS provides that the " 'supply of a service' includes the production, distribution, marketing, sale and delivery of a service." There is nothing at all in these provisions to suggest a limited scope of application for the GATS. We also agree that Article XXVIII (c) of the GATS does not narrow "the meaning of the term 'affecting' to 'in respect of'". For these reasons, we uphold the Panel's finding that there is no legal basis for an *a priori* exclusion of measures within the EC banana import licensing regime from the scope of the GATS."[75]

The findings above will likely be followed in the current panel's analysis of the terms "measures" and "affect[ing]" in the Annex on Telecommunications.

Nevertheless, in a subsequent case, the Appellate Body seems to have narrowed the scope of application of the GATS, by proposing a "fundamental structure and logic"[76] of Article I:1 in relation to the rest of the GATS:

> "(…) we believe that at least two key legal issues must be examined to determine whether a measure is one "affecting trade in services": first, whether there is "trade in services in the sense of Article I:2; and second, whether the measure in issue "affects" such trade in services within the meaning of Article I:1."[77]

The last passage has provoked critical reactions from WTO experts, since it suggests that in cases where there is no trade in services at all, a violation under the GATS could not occur, even though the inexistence of such trade in services is based upon an illegal action or omission by a WTO Member. This rationale tends to be in contradiction with the object and purpose of the GATS and past GATT principles. In the current dispute, this interpretation could be relevant

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[75] Appellate Body Report, *EC - Bananas III*, WT/DS27/AB/R, para.220.

[76] Appellate Body Report, WT/DS139/AB/R and WT/DS142/AB/R, para.151 states: "In *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, we said, in the context, Article XX of the GATT 1994, that a panel may not ignore the "fundamental structure and logic" of a provision in deciding the proper sequence of steps in its analysis, save at the peril of reaching flawed results". Similarly, here, the fundamental structure and logic of Article I:1, in relation to the rest of the GATS, requires that determination of whether a measure is, in fact, covered by the GATS *before* the consistency of that measure with any substantive obligation of the GATS can be assessed." (emphasis as original, footnote omitted).

[77] Appellate Body Report, *Canada – Certain Measures Affecting the Automotive Industry*, WT/DS139/AB/R, dated 31 May 2000, para.155.

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since the U.S. argues that Mexico's actions have undermined its GATS commitments, thus resulting in diminished, or lack of services trade in telecommunications.

B. "Reasonability of Terms and Conditions

The current panel will likely provide guidance on the obligation of WTO Members to ensure access to and use of public telecommunications transport networks and services on "reasonable and non-discriminatory terms and conditions."

Regarding the definition of "non-discriminatory" access, some analogy can be made with the application of the MFN principle under Article II of the GATS. The Appellate Body has already suggested that the expression "any measure covered" in the GATS includes "treatment no less favourable" in regards to both *de jure*[78] and *de facto*[79] discrimination, independently of the situation *in casu*[80]. However, the panel's and the Appellate Body's decisions have not been consistent with regard to the scope of discriminatory measures.

One WTO observer points out that "The Appellate Body ruled that the MFN obligation in the GATS Article II should be interpreted not in the light of the national treatment obligations in GATS Article XVII or GATT Article III (as supported by the Panel in its Report), but in light of the MFN obligation in GATT Article I. Article I of GATT 1994 has also been applied, in past practice, to measures involving *de facto* discrimination"[81]. Furthermore, the Appellate Body suggests that *de facto* discrimination could be more applicable to violations of GATS Article II.

The Appellate Body has explained the approach, as follows:

> "The GATS negotiators chose to use different language in Article II and Article XVII of the GATS in expressing the obligation to provide "treatment no less favourable". The question naturally arises: if the GATS negotiators intended that "treatment no less favourable" should have exactly the same meaning in Articles II and XVII of the GATS, why did they not repeat paragraphs 2 and 3 of Article XVII in Article II? But that is not the question here. The question here is the meaning of "treatment no less favourable" with respect to the MFN obligation in Article II of the GATS. There is more than one way of writing a *de facto* non-discrimination provision. Article XVII of the GATS is merely one of many provisions in the WTO Agreement that require the obligation of providing "treatment no less favourable"(…) The obligation imposed by Article II is unqualified. The ordinary meaning of this provision does not exclude *de facto* discrimination. Moreover, if Article II was not applicable to *de facto* discrimination, it would not be difficult – and, indeed, it would be a good deal easier in the case of trade in services, that in the case of trade in goods

[78] The measure *per se.*
[79] The application, implementation or enforcement of the measure.
[80] Appellate Body Report, *EC – Bananas III*, WT/DS27/AB/R, para.234.
[81] Mattoo, Aaditya, "MFN and the GATS", *supra*, p.54.

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> – to devise discriminatory measures aimed at circumventing the basic purpose of that Article."[82]

The current panel will likely provide further guidance on *de facto* discrimination under the GATS, as in regards to access to telecommunications transport networks and services.

OUTLOOK

The U.S. in 2001 had already requested the establishment of a panel after raising a similar complaint against Mexico's telecommunications sector. The first panel was suspended after Telmex reached an agreement with WorldCom to reduce progressively its interconnection rates. Also, as part of the deal Telmex agreed to increase cooperation with Cofetel the regulator in order to introduce regulations that would allow U.S. companies to negotiate rates under more competitive terms. Since these lower rates have not yet taken effect, AT&T reportedly had pressured the U.S. government to proceed with the current dispute.

Some observers believe that the U.S. and Mexican Government may still reach another settlement before the end of the dispute – and that the dispute is yet another attempt to to pressure Telmex towards accepting more competitive conditions. In addition, some observers believe that the interpretation of the Reference Paper and Annex on Telecommunications could do more harm than good – as WTO findings will begin to interpret competition principles. These principles could expose the inherent weaknesses in GATT and GATS standards on *de jure* and *de facto* discrimination, among other issues.

Mexico is scheduled to respond to the U.S. first submission by December 7, but has requested additional time. Countries that have reserved third parties rights[83] are scheduled to present their written submissions by December 14, but that date is also likely to be shifted. In addition, the panel meeting was originally scheduled to take place on December 18, 2002 – but will likely be shifted to sometime in January 2003 due to Mexico's extension request.

[82] Appellate Body Report, *EC - Bananas III*, W/DS27/AB/R, dated 9 September 1997, para.233.
[83] Australia, Brazil, Canada, Cuba, the European Communities, Guatemala, Honduras, India, Japan and Nicaragua have joined as third parties to the dispute.

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ATTACHMENT 1

May 1, 2002

NFTC FSC-ETI COALITION
DRAFTING SPECIFICATIONS FOR UNITARY PROPOSAL
EXECUTIVE SUMMARY

The Appellate Body (AB) Report in *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities* upheld the decision of the WTO panel that the FSC Replacement and Extraterritorial Income Exclusion ("ETI") Act confers prohibited export subsidies in violation of the international trade obligations of the United States.

It will take a considerable amount of time to develop and implement an appropriate response to the WTO decision in the FSC-ETI case, one that is likely to require some combination of negotiations with the European Union and legislation.

Accordingly, the NFTC FSC-ETI Coalition has developed preliminary drafting specifications, to facilitate the discussion of legislative options for addressing the resolution of the FSC-ETI dispute in a manner that brings the United States into compliance with its international trade obligations while maintaining the international competitiveness of U.S. exporters and workers.

• *Drafting Parameters*. The WTO AB Report precludes a legislative response that merely "tinkers" with the ETI regime, and thus, it will not be possible to replicate present law.

There is, however, a limited category of transactions for which ETI-like treatment can be maintained consistent with WTO rules.

Also, and significantly, the AB decision confirms the WTO legality of legislation that would benefit exports as a way of avoiding the double taxation of foreign-source income.

Moreover, nothing in the AB decision would prevent the United States from amending rules of general application in a manner that benefits exporters, among other taxpayers.

• *Summary of Unitary Proposal.* The unitary proposal is premised on the repeal of the ETI provisions, and includes all of the following elements:

-- *Footnote 59 Exception*. —Implementing the recognized exception to the prohibition on export subsidies for measures to avoid double taxation, by excluding from U.S. tax (up to prescribed limits) foreign-source income earned by U.S. taxpayers in export transactions. The exclusion would apply to income from property manufactured within the United States and sold, leased, or licensed for direct use, consumption or disposition outside the United States, and income from services as a commission agent in connection with a sale

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or license of property for export or otherwise related and subsidiary to a sale, lease, or license of property for export.

-- *Subpart F Modification*. —Repealing certain exceptions to the general rule of deferral for active business income derived by U.S.-controlled foreign corporations ("CFC(s)") from foreign-sourced sales and services in a manner that would partially conform to the less stringent anti-deferral rules adopted by other countries (including EU member states). The general rule under U.S. tax law provides unlimited deferral of U.S. income tax on business profits earned abroad through CFCs. Deferral results from a basic structural feature of the U.S. system, namely, the treatment of a corporation and its shareholders as separate taxpayers. The anti-deferral regime of "Subpart F" is an exception to the general rule of deferral. The proposal would restrict the scope of Subpart F by repealing the provisions that define Subpart F income to include "foreign base company sales income" and "foreign base company services income." The proposal would also exempt a portion of such foreign-source earnings from U.S. tax (as permitted by the recognized exception for foreign-source income).

-- *WTO-permissible Transactions*. —Enacting an exemption for a limited category of transactions that are WTO-permissible because they are not exports under international norms.

-- *Wage-based Tax Credit*. —Providing a new wage-based tax credit of general application, for taxpayers engaged in businesses in specified North American Industrial Classification System (NAICS) industry codes. To constrain the revenue effect to the current law cost of ETI, the unitary proposal contemplates that an overall cap would be imposed on the benefits that could be obtained by use of any combination of the individual proposals.

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REGIONAL TRADE AGREEMENTS

US Launches FTA Initiative with ASEAN and Trade Facilitation and Security Initiative with APEC at APEC Leaders' Meeting

SUMMARY

Larry Greenwood, U.S. Senior Official for APEC, recently briefed the Asia Society in Washington, DC, regarding the results of the Tenth APEC Leaders' Meeting held in Los Cabos, Mexico, on October 21-27, 2002. Greenwood discussed the general results of the meeting as well as the U.S.-led trade initiatives.

The US launched the Secure Trade in the APEC Region ("STAR") initiative with APEC to enhance security while increasing trade facilitation. The US also launched the Enterprise for ASEAN Initiative (EAI), a new U.S. plan with ASEAN that provides a "roadmap" for closer trade relations between the United States and the ASEAN region. The EAI offers the "prospect" of bilateral free trade agreements (FTAs) to selected ASEAN countries.

In related news, China joined the U.S. Customs Service Container Security Initiative (CSI) "in principle" on the eve of the APEC Leaders' Meeting. Greenwood noted the historical significance of China's membership in CSI.

ANALYSIS

Larry Greenwood, U.S. Senior Official for APEC, briefed the Asia Society in Washington, DC, on October 31, 2002, regarding the results of the Tenth APEC Leaders' Meeting held in Los Cabos, Mexico, on October 21-27, 2002. The Los Cabos meeting was Greenwood's third APEC Leaders' Meeting, and he believes that the Los Cabos meeting produced the most concrete and detailed outcomes.

Greenwood stated that China's presence at the Leaders' Meeting and in the region in general is "absolutely bigger and more robust" since its accession to the World Trade Organization last December. Greenwood called China "the most important new dynamic in APEC."

In terms of the ASEAN countries, Greenwood said that they are "looking for a role" in the process. ASEAN members meet together as a group before meetings like the APEC Leaders' Meeting. He said they are very focused on investment.

Greenwood said that Japan is trying to play a more active role and that it is working very hard on intellectual property rights. This year Japan was unable to send a trade minister to the APEC Leaders' Meeting, which changed the dynamic considerably.

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I. APEC Leaders Launch STAR Initiative

On October 26, President Bush and the other APEC Leaders launched the Secure Trade in the APEC Region ("STAR") initiative. According to a White House fact sheet, the STAR initiative is intended to enhance security while increasing trade through accelerating action on screening people and cargo for security before transport; increasing security on ships and airplanes while en route; and enhancing security in airports and seaports.

APEC Leaders committed to the following plan of action:

Cargo

- Identify and examine high-risk containers, assuring in-transit integrity, and providing advance electronic information on containers to customs, port, and shipping officials as early as possible in the supply chain;
- Implement by 2005 common standards for electronic customs reporting; and
- Promote private sector adoption of high standards of supply chain security.

Ships

- Promote ship and port security plans by July 2004 and installation of automatic identification systems on certain ships by December 2004 and
- Cooperate to fight piracy in the region.

The STAR initiative complements the G8 Transport Security Action Plan and the Smart Border programs President Bush has launched with Mexico and Canada *(Please see W&C April 2002 Monthly Report, W&C July 11, 2002 Report, and W&C September 12, 2002 Report).* The STAR initiative also meshes well with the U.S. Customs Service's CSI program, which includes a number of APEC ports.

Greenwood stated that in addition to making trade more secure, the STAR initiative would make it more efficient, which is especially important for "just-in-time-delivery" in Asia. He emphasized that the US is working to increase security and efficiency at the same time, not balance them, which would involve sacrificing progress in one area for improving the other. Greenwood pointed to the U.S.-Canada border as an example of how the US has been able to make trade even more efficient than it was before September 11, 2001, while increasing border security.

II. United States Unveils Enterprise for ASEAN Initiative (EAI)

During the first day of the Los Cabos APEC Leaders' Meeting, President Bush announced the Enterprise for ASEAN Initiative, a new U.S. initiative with ASEAN that provides a "roadmap" for closer trade relations between the United States and the ASEAN region. Bush

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announced this after he met with seven of the ASEAN leaders on the sidelines of the APEC Leaders' Meeting. This was the first time since 1984 that a US president has met ASEAN Leaders for talks in a group. The ASEAN Leaders have collectively welcomed the initiative and some are expected to take up the offer to work towards FTAs soon.

The US highlighted the potential benefits of the EAI as "significant" for both the US and the ASEAN region. The EAI also offers the "prospect" of bilateral free trade agreements (FTAs) to ASEAN countries that are "committed to economic reforms and openness." The EAI seeks to create a network of bilateral FTAs to increase trade and investment and tie the U.S. and ASEAN economies closer together. In this way, the EAI seeks to help APEC reach the so-called Bogor goals established at the 1993 APEC Leaders' Meeting to reach free trade and investment in the region by 2010 for developed economies and 2020 for developing economies.

EAI Establishes a "Roadmap to FTAs"

The EAI establishes a "Roadmap to FTAs" through which the United States and individual ASEAN countries will determine if and when they are ready to launch FTA negotiations, allowing the ASEAN countries to set the pace in moving toward an FTA with the United States. The EAI is clear that the FTAs will be based on "the high standards set in the U.S.-Singapore FTA," which the US aims to conclude by the end of the year.

EAI Sets Forth U.S. Standards for Potential FTA Partners

According to a White House fact sheet, "The United States would expect a potential FTA partner to be members of the World Trade Organization (WTO), and to have concluded a Trade and Investment Framework Agreement (TIFA) with us—thus laying the groundwork for future FTA negotiations." The White House says that it will continue to support the WTO accessions of Cambodia, Laos, and Vietnam. The United States has existing TIFAs with Indonesia, the Philippines, and Thailand. In addition, ASEAN countries in the WTO, which have yet to sign framework agreements with the US, will also be given a chance to launch discussions. U.S. officials indicated that two other ASEAN countries were prime candidates for TIFAs. Analysts speculate these to be Malaysia and Brunei.

EAI Part of Overall U.S. Trade Agenda

The Administration touted the EAI as "integral" to the overall U.S. trade agenda to pursue free trade globally, regionally, and bilaterally. Greenwood stated that the EAI "has a little for everyone" since it provides support for pending WTO accessions, help with TIFAs, and a pathway for FTAs.

Several Democratic Members of Congress, Senator Max Baucus (D-Montana) in particular, have been vocal in the past few weeks about the lack of a coherent U.S. trade strategy, especially in terms of FTAs and what constitutes a potential FTA partner *(Please See W&C October 22, 2002 Report).* The critics note that USTR lacks the resources to fully dedicate the United States to FTA negotiations with numerous other counties, while it is already negotiating with Singapore and Chile and set to launch negotiations with Morocco, Central America, and the

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Southern African Customs Union. They also note that USTR is heavily occupied with the tremendous work involved in concluding both the Free Trade Area of the Americas (FTAA) and the Doha Round by January 2005.

Some analysts postulate that the Administration may be responding to these criticisms by establishing a so-called roadmap to FTAs as well as the prerequisites for potential FTA partners, at least in the context of ASEAN. However when asked how ASEAN countries with a TIFA "get in the queue for an FTA," Greenwood conceded that there is no set list of criteria, instead it is a "self-selective" process in which the countries with a TIFA approach the United States. Then they talk about the possible pathway to an FTA and what an FTA means. Greenwood was clear that for the United States, an FTA means zero percent tariffs on all products, which, he noted, would be problematic for Thailand. Thus the EAI allows for discussions to work through these issues before actually launching negotiations.

EAI One of ASEAN's Regional Integration Initiatives

In recent years, ASEAN has actively pursued regional integration initiatives with its neighboring countries, namely China, Japan, and Australia and New Zealand (the Closer Economic Relations – CER). With the EAI, ASEAN can now look towards building closer economic ties with yet another of its key trading partners.

Malaysian Trade Minister Rafidah Aziz said the USTR had proposed talks leading to a US-Malaysia FTA and informed that Malaysia was already conducting a study on the costs and benefits of such agreements with the US and other countries.

Thailand and the United States signed a TIFA on October 23, when USTR Zoellick met with Thai Minister of Commerce Adisai Bodharamik in Los Cabos. The TIFA creates a Joint Council to further facilitate and liberalize trade and investment in areas like intellectual property, information technology, biotechnology policy, and capacity building. The Joint Council is also tasked with facilitating coordination between the United States and Thailand in APEC and the WTO. The U.S.-Thai TIFA is the fruit of almost six months of discussions between the two countries following an April 4, 2002, ASEAN meeting in Thailand.

In 2001, two-way trade between ASEAN and the US totaled nearly US$120 billion, making ASEAN the third largest overseas market for America. In addition, two-way trade in services totaled US$16 billion in 2000 – up 55 percent since the WTO was set up.

III. China Joins CSI on Eve of APEC Summit

During meetings in Crawford, Texas, on the eve of the APEC Summit, Chinese President Jiang Zemin and U.S. President George W. Bush announced that China is joining "in principle" the Container Security Initiative (CSI). U.S. Customs Commissioner Robert C. Bonner stated that the US would be working with the appropriate Chinese officials to implement the program as quickly as possible. Customs has designated the ports of Shanghai and Yantian as high-priority "mega-ports" under the CSI program.

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Greenwood highlighted the "historical significance" of China's joining the CSI, praising China for its "political courage" to join and allow U.S. Customs officials at Chinese ports. Greenwood stated that Korea, Taiwan, and Thailand would be joining the CSI soon.

OUTLOOK

In terms of momentum towards the Bogor goals, Greenwood stated that APEC has made "huge progress" through, for example, major tariff reductions that have been made unilaterally in many cases. He conceded that much work remains particularly in the area of trade facilitation (*i.e.,* customs procedures). Greenwood believes that bilateral FTAs can become building blocks towards regional and global trade if they are "done right" and are comprehensive (*i.e.,* not excluding sectors like agriculture). For these reasons, Greenwood does not view the Bogor goals as impossible, and he was clear that APEC "won't be held up by the slower economies."

Greenwood outlined the priorities for Thailand in the next year as (i) "eco-tech" (*i.e.*, economy and technology); (ii) energy liberalization; and (iii) expanding information technology to rural areas. Greenwood did say that neither the United States nor Thailand is sure "where we want to go" in "the Thai year" (Thailand will host the Fifteenth APEC Ministerial Meeting and the Eleventh APEC Economic Leaders Meeting in 2003), but they are both focused on implementation as opposed to the sole statement of principles.

On the EAI, although the US is agreeable to a network of bilateral FTAs with ASEAN, they have apparently ruled out an ASEAN-wide FTA. This means that ASEAN, as a whole, is unlikely to drive or push this initiative forward since progress is dependent on the individual ASEAN countries. Added to the fact that the EAI has not laid out any new measures and is primarily a strategic move on the part of the US to counter the FTA and Closer Economic Partnership (CEP) that ASEAN is discussing with China and Japan respectively, analysts expect progress on the EAI to be slow moving.

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ITC Report Finds Possible U.S.-Taiwan FTA Would Increase Bilateral Trade; Taiwan Cautiously Optimistic

SUMMARY

The United States International Trade Commission recently released a report "U.S.-Taiwan FTA: Likely Economic Impact of a Free Trade Agreement Between the United States and Taiwan," which finds that a U.S.-Taiwan FTA would increase bilateral trade but not significantly. Taiwan was disappointed with the report's findings but remains cautiously optimistic.

Taiwan's Minister of Economic Affairs Yi-Fu Lin has stated that he will aggressively seek support from both the U.S. Congress and private sectors so that the United States will place an FTA with Taiwan among its top trade priorities. Analysts, however, note that the US is currently involved in a number of other FTA negotiations, and an FTA with the Taiwan is not among U.S. trade priorities at the moment.

ANALYSIS

I. ITC Releases Report on Possible U.S.-Taiwan FTA

In a recent report "U.S.-Taiwan FTA: Likely Economic Impact of a Free Trade Agreement Between the United States and Taiwan," the United States International Trade Commission (ITC) states that a U.S.-Taiwan FTA would increase bilateral trade. We highlight below the main findings of the report:

- The bulk of bilateral trade between the United States and Taiwan consists of manufactured products.
- The United States is a net exporter of agricultural products to Taiwan, and in 2001, Taiwan was the fifth largest market for U.S. agricultural products.
- Taiwan's average nominal tariff is currently 7.1 percent, while the average U.S. nominal tariff is 2.8 percent. Both countries maintain a number of tariff-rate quotas, especially in the agricultural sector.
- In acceding to the WTO, Taiwan improved its regulatory regime, but important nontariff barriers remain as well as insufficient intellectual property rights protection.
- The most frequently raised concern of Taiwanese exporters is the U.S. trade remedy law regime.
- The ITC estimates that both economies would likely experience relatively small economywide effects from an FTA. However, some sectoral trade flows would increase substantially. In motor vehicles, rice, fish, and other food sectors, U.S. exports to Taiwan would increase by more than 100 percent. U.S. imports from

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Taiwan from dairy, textiles, wearing apparel, leather, and certain crop commodities would also rise by more than 100 percent. The ITC points out that in dollar terms, these changes are significantly smaller because in many of the sectors, current trade is small or near zero, so the percent change is being applied to a small base.

- The removal of certain nontariff measures would have additional effects on services. For example, U.S. asset management firms and banks could expect to increase sales in Taiwan if certain nontariff barriers were removed under an FTA. The removal of these barriers might also affect U.S.-Taiwan trade or investment in textiles and apparel, vehicles, and education.

II. Taiwan Cautiously Optimistic of Possible U.S.-Taiwan FTA

In response to the ITC report, Taiwan expressed that it is "disappointed, yet still optimistic." The Board of Foreign Trade (BOFT) under the Ministry of Economic Affairs (MOEA) urged the US to look at the report from another perspective. BOFT argued, "Any increase in business opportunities and trade flow is definitely positive for the U.S. economy and, therefore, worth trying." BOFT also stated that it would coordinate with responsible government agencies to work out issues of concern to the ITC, such as intellectual property rights and restrictions on foreign investment in certain sectors.

OUTLOOK

At this time, Taiwan believes that the US is not very enthusiastic about a U.S.-Taiwan FTA. MOEA Minister Yi-Fu Lin has stated that he will aggressively seek support from both the U.S. Congress and private sectors so that the United States will place an FTA with Taiwan among its top trade priorities.

Analysts note, however, that an FTA with the Taiwan is not among U.S. trade priorities at the moment. The United States is currently negotiating FTAs with Chile and Singapore and intends to launch FTA negotiations in the near future with Morocco, Central America, and the South African Customs Union. In addition, President Bush announced at the APEC Leaders' Meeting a new U.S. initiative to negotiate FTAs with selected ASEAN countries.

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