WHITE & CASE
LIMITED LIABILITY PARTNERSHIP

Japan External Trade Organization

WTO AND REGIONAL TRADE AGREEMENTS MONTHLY REPORT

October 2005

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

TABLE OF CONTENTS

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

SUMMARY OF REPORTS

United States

House Ways and Means Committee Holds Hearing on Japan's Economic and Trade Relations with the United States

On September 28, 2005, the U.S. House of Representatives Ways and Means Committee held a hearing to discuss current United States-Japan economic and trade relations and Japan's role in the world economy. The hearing focused on Japan's economic problems (including their causes and impact), Japan's barriers to trade, Japan's role in current World Trade Organization (WTO) negotiations, and recent economic and regulatory reforms. The hearing included on-the record oral testimony from panelists representing government and business interests. We review below this testimony and the discussion between the Committee and the hearing witnesses.

Full text of the witnesses' statements are available at the House Ways & Means Committee website: http://waysandmeans.house.gov/hearings.asp?formmode=detail&hearing=443.

New U.S. Trade Facilitation Officer Will Work with U.S. Businesses to Ensure Favorable Business Climate

On September 30, 2005, the United States-China Business Council (USCBC) held a round-table discussion with Ira Belkin, Senior Trade Compliance Officer, U.S. Embassy- Beijing Trade Facilitation Office, on Belkin's work with U.S. companies to ensure a favorable business climate in China. Belkin discussed what work and policy issues on which his office will concentrate and offered his **off-the-record** answers to questions posed by USCBC members. We review below this discussion.

GAO Reports on Exon-Florio Weaknesses, Strengths, and Recommendations

On September 28, 2005, the Government Accountability Office (GAO) released a report outlining the problems with the Committee on Foreign Investment in the United States' (CFIUS) that undermine the effectiveness of U.S. laws on foreign investment. The GAO report found that CFIUS practices suffered from three weaknesses and included a list of potential improvements for congressional consideration. The report also outlined strengths that the CFIUS has exhibited since a 2002 GAO analysis of the Committee.

The GAO report comes at a critical time as the Bush Administration and the Office of the United States Trade Representative (USTR) pursue more bilateral free trade agreements (FTA). More U.S. exposure to international markets means more interaction between U.S. and foreign companies. Foreign acquisitions of U.S. companies - the crux of CFIUS reviews - will most likely increase in conjunction with more bilateral FTAs and with greater multilateral trade liberalization, making CFIUS reviews more common.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

GAO Explores Issues and Effects of Continued Dumping and Subsidy Offset Act

On September 26, 2005, the Government Accountability Office (GAO) released a report on the issues and effects of implementing the Continued Dumping and Subsidy Offset Act (CDSOA), also known as the "Byrd Amendment." Between 2001 and 2004, CDSOA provided over $1 billion funded from import duties to U.S. companies deemed injured by unfair trade practices. To date, 11 World Trade Organization (WTO) Members have lodged a complaint to the WTO against the United States over the law. The GAO report assesses CDSOA components including: (i) key legal requirements guiding and affecting agency implementation of CDSOA; (ii) problems in CDSOA implementation; (iii) which companies have received CDSOA payments and its effects; and (iv) the status of the WTO decision on CDSOA. GAO also outlined several recommendations for Congressional consideration specific to CDSOA's status quo, modification or repeal. We review here the report and those recommendations. The full report is available online at http://www.gao.gov/new.items/d05979.pdf.

United States Highlights

We want to alert you to the following United States developments:

- USTR Calls for IPR Review Submissions
- U.S. Senators Introduce Resolution Calling on U.S. Trade Negotiators to "Protect U.S. Trade Laws"
- U.S. Will Appeal WTO Ruling on FSC/ETI
- National Association of Manufacturers Supports China Trade Bill
- U.S. International Trade Commission Issues Affirmative Section 421 Determination on Steel Pipe from China
- USTR Turns Down Industry Advisory Committee's Call to Slow Down FTAs
- Treasury Delays Report on Currency Manipulation as Snow Travels to Japan and China
- USTR Requests Public Comments on Generalized System of Preferences (GSP) and it's Renewal
- President Bush Announces Intent to Nominate Schwab as Deputy USTR
- Senators Urge USTR Action on U.S. Beef Ban in Japan
- Snow Urges China to Reform Market, Currency
- Trade Policy Staff Committee Requests Comments on Caribbean Basin Economic Recovery Act

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

- U.S. Expects Japan to End Beef Ban in November, Will Otherwise Consider "Alternative Measures"
- USTR Fills General Counsel, Advisor and Public Post Positions
- Commerce Prepared to Impose CVDs Against China
- Treasury Will Change CFIUS Process But Not with New Legislation

Free Trade Agreements

House Ways and Means Committee Holds Hearing on Free Trade Agreement between Bahrain and the United States

On September 29, 2005, the U.S. House of Representatives Ways and Means Committee held a hearing to discuss the implementation of the Free-Trade Agreement (FTA) between the United States and Bahrain. The hearing focused on the positive and negative aspects that the FTA would bring to the United States and Bahrain. The hearing included on-the record oral testimony from panelists representing government and business interests. We review below this testimony and the discussion between the Committee and the hearing witnesses.

The full text of the witnesses' statements is available on the Committee website at: http://waysandmeans.house.gov.

Senate Finance Committee Holds U.S.-Bahrain FTA Hearing

On October 6, 2005 the U.S. Senate Finance Committee held a hearing to review implementation of the United States-Bahrain Free Trade Agreement (FTA). Committee Chairman Sen. Charles Grassley (R-IA) was not present, but Sen. Craig Thomas (R-WY) presided over the hearing, which included **on the record** oral testimony from U.S. Government and business representatives. Full text of the witnesses' statements is available at the Senate Finance Committee website: http://finance.senate.gov/sitepages/hearing100605a.htm. We review below these statements.

Assistant USTR Provides Insight on Fifth Round of U.S.-Thailand FTA

On October 6, 2005, the U.S.-ASEAN Business Council hosted a briefing on United States-Thailand Free Trade Agreement (FTA) negotiations with Barbara Weisel, Assistant United States Trade Representative (USTR) for Asia-Pacific and Pharmaceutical Policy. Weisel provided **off-the-record** comments on the focal points of the U.S.-Thai FTA fifth round negotiations. Weisel also commented on the status of other FTA (and potential FTA) negotiations currently underway, including the Andean, UAE, Malaysia, and Vietnam FTAs. We review the discussion below.

Free Trade Agreements Highlights

We want to alert you to the following FTA developments:

- House and Senate Committees Hold U.S.-Bahrain FTA Hearings
- United States and Oman Complete FTA
- United States and Thailand Complete Fifth Round of FTA Negotiations
- U.S.-SACU Negotiations Resume
- Senators Urge Elimination of Truck Tariffs from U.S.-Thai FTA
- Portman: TPA Expiration will Dictate Future Free Trade Agreements
- U.S., China Report Progress in Most Recent Round of Textile Talks
- ITC Finds the 2004 Impact of Andean Trade Preference Act on the United States to be "Negligible"
- Nicaragua Approves DR-CAFTA
- U.S. and Malaysia Conclude Third Trade and Investment Framework Agreement Meeting
- U.S. and China Fail to Reach Textile Trade Agreement
- United States Signs MRAs with Iceland, Liechtenstein and Norway
- Substantial Work Remains To Conclude U.S.-Andean FTA
- Peruvian Ambassador: U.S.-Andean FTA Can Provide Increased Access to Mercosur
- Ecuador Trade Minister: Tough Issues Remain Between Ecuador and the United States

Multilateral

Senate Agriculture Committee Holds Hearing to Review Status of WTO Agriculture Negotiations

On September 21, 2005, the U.S. Senate Agriculture, Nutrition and Forestry Committee held a hearing to review the status of World Trade Organization (WTO) negotiations on agriculture. Committee Chairman Sen. Saxby Chambliss (R-GA) presided over the hearing. It included **on the record** oral testimony from U.S. Government and business representatives, such as United States Trade Representative (USTR) Rob Portman and U.S. Secretary of Agriculture Michael Johanns. Full text of the witnesses' statements is available at the Senate Agriculture, Nutrition

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

and Forestry Committee website: http://agriculture.senate.gov. We review below these statements.

Assistant USTR Discusses Latest Developments in WTO Services Negotiations

On October 07, 2005 the Coalition of Service Industries (CSI) hosted a conference call with Christine Bliss, Acting Assistant United States Trade Representative (USTR) for Services and Investment. Bliss briefed CSI members on the latest developments in the World Trade Organization (WTO) services negotiations following last week's third services "cluster" meeting in Geneva. We review below her update.

United States Submits Formal Agricultural Reform Proposal to Move WTO Negotiations Forward

On October 10, 2005, the Office of the United States Trade Representative (USTR) submitted a formal proposal for multilateral agricultural reforms meant to move World Trade Organization (WTO) agricultural negotiations forward and to "unleash the full potential of the Doha Development Agenda." Portman announced the plan in a Financial Times editorial piece, and the Office of the USTR published the plan's details shortly thereafter. We review here that proposal.

European Union Submits Conditional Proposals during Zurich Multilateral Trade Negotiations

On October 10, 2005, European Union (EU) Trade Commissioner Peter Mandelson released the EU's conditional negotiating proposals for the World Trade Organization (WTO) Doha Development Round. The proposals were circulated to Ministers at the WTO Doha Round Informal Ministerial in Zurich. Mandelson noted that the proposals are entirely contingent on reciprocity from other parties. We review below the EU's proposals.

WTO Panel Finds Certain Mexican Taxes on Soft Drinks and Sweeteners Are Inconsistent with Mexico's National Treatment Obligations Under the GATT

A WTO panel has found that certain Mexican taxes on soft drinks and sweeteners are inconsistent with Mexico's national treatment obligations under the GATT. The Panel rejected Mexico's argument that its measures were necessary to secure compliance by the United States with U.S. obligations under the NAFTA.

WTO Compliance Panel Finds U.S. Jobs Act WTO Inconsistent in FSC Case

A WTO "compliance panel" has found that the United States has failed to implement the WTO rulings in the longstanding EC-U.S. dispute over tax breaks provided through U.S. "Foreign Sales Corporations" (FSCs). The United States had argued that the *American Jobs Creation Act of 2004* (the "Jobs Act"), which was passed by the U.S. Congress last year, had eliminated the WTO-inconsistent subsidies to U.S. exporters. However, the compliance panel found that as a result of the transitional and "grandfathering" provisions of the Jobs Act, the United States

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

remained in breach of its WTO obligations. Unless reversed on appeal, this decision clears the way for the re-imposition of up to U.S. $4 billion of trade sanctions on U.S. imports into the EU.

Pascal Lamy Assumes Leadership of the Doha Round; WTO Members Intensify Preparations for Hong Kong Ministerial

In his first month as Director General of the WTO, Pascal Lamy has made it clear that his entire focus in the lead-up to the Hong Kong Ministerial Conference on 13-18 December will be on the preparations for that meeting, which he has called "the last and best chance" to conclude the Doha Round by the end of 2006. Many routine meetings of WTO committees have been suspended to permit full concentration on the Round, and the agriculture negotiators have been put permanently "on call" for continuous negotiations. The sense of urgency is strong, but there is no clear sense yet of the way through to success in Hong Kong.

Multilateral Highlights

We want to alert you to the following Multilateral developments:

- Senator Chambliss Provides Insight on U.S. Domestic Farm Support, Doha Round
- United States Submits Formal Proposal on WTO Agriculture Negotiations
- Senators Demand Reciprocal Response to U.S. Agricultural Proposal
- Portman and Johanns Comment on WTO Negotiations in Zurich
- European Union Submits Conditional Proposals during Zurich Multilateral Trade Negotiations
- G-20 Offers Market Access, Domestic Support Proposal while Portman 'Disappointed' by Other Trade Offers
- Mandelson Reiterates General Council Backing of EU Negotiators
- United States Calls for New EU Offer on Market Access; EU Will Move Only If Others Reciprocate
- G-20 Proposal on Sensitive Farm Products Parallels U.S. Proposal
- Russia Sets New Target Date for WTO Accession
- Negotiating Group Reviews in Detail Proposals on Trade Facilitation Measures; Discusses Report for Hong Kong Ministerial

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

REPORTS IN DETAIL

UNITED STATES

House Ways and Means Committee Holds Hearing on Japan's Economic and Trade Relations with the United States

SUMMARY

On September 28, 2005, the U.S. House of Representatives Ways and Means Committee held a hearing to discuss current United States-Japan economic and trade relations and Japan's role in the world economy. The hearing focused on Japan's economic problems (including their causes and impact), Japan's barriers to trade, Japan's role in current World Trade Organization (WTO) negotiations, and recent economic and regulatory reforms. The hearing included on-the record oral testimony from panelists representing government and business interests. We review below this testimony and the discussion between the Committee and the hearing witnesses.

Full text of the witnesses' statements are available at the House Ways & Means Committee website: http://waysandmeans.house.gov/hearings.asp?formmode=detail&hearing=443.

ANALYSIS

On September 26, 2005, the U.S. House of Representatives Ways and Means Committee held a hearing on current economic and trade relations between Japan and the United States and Japan's role in the world economy. The last hearing the Committee held on Japanese trade relations occurred in 1998. Congressman Bill Thomas (R-CA), Chairman of the Committee on Ways and Means, presided over the hearing, which included testimony from other Congressmen on the Committee and panelists representing different U.S. government and business interests. The hearing's core issues were: the Japanese embargo on U.S. beef, Japanese "protectionism" and its consequences on U.S. businesses, and Japanese regulatory and economic reform:

- **Representative Jerry Moran (R-KA)** focused on the Japanese prohibition of beef imports from the United States. He stated that the United States has instituted a rigorous surveillance program to ensure that U.S. beef is not infected with Bovine Spongiform Encephalopathy (BSE), but the Japanese government has yet to allow U.S. beef imports. Moran further stated that the Japan has delayed ending the ban on U.S. beef following an October 2004 agreement between the two governments that Japan would do so. According to Moran, the Japanese government must respect this agreement and must allow U.S. beef imports or the United States will lose $1.7 billion annually - the amount of the Japanese export market for U.S. beef. Members of the Committee agreed with Moran's view that Japan must urgently resolve this matter.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

- **Wendy Cutler, Assistant United States Trade Representative (USTR) for Japan, Korea and Asia-Pacific Economic Cooperation Affairs**, discussed the current United States-Japan economic relationship and stated that although the nations have made progress, "there remains substantial inertia" to overcome. Cutler focused on U.S. beef imports and the privatization of the Japanese Postal Savings and Postal Life (Kampo), which also serves as a state-run monopoly insurance provider. Cutler stated that the Office of the USTR has repeatedly brought up the issue of allowing beef imports to enter Japan. Cutler also assured the Committee that USTR was strongly urging the Japanese government to privatize Kampo, thus providing U.S. insurance companies with the chance to compete in the Japanese market. The Committee responded that "there needed to be more action and less rhetoric" and presented a series of questions to Cutler, including: (i) why Japan had placed an embargo on US beef; (ii) whether Japanese sanitary standards complied with World Trade Organization (WTO) standards; and (iii) whether the United States should initiate a WTO dispute settlement claim related to the beef ban.

- **David Loevinger, Deputy Assistant Secretary of the Treasury-Africa, Middle East and Asia,** discussed several aspects of Japan's protectionism, including high tariffs and embargos and how they affect the United States' trade balance with Japan. He also discussed the Department of Treasury's attempts to urge Japan to allow U.S. beef imports and privatization of the Kampo. Loevinger believed that the recent elections indicate that this reform will occur. The privatization would allow a "level playing field and further competition for insurance companies in Japan" and would result in economic growth and growth in imports. Members of the Committee brought up the point that recent U.S. concentration on China may have taken away from the political momentum needed to spur Japan on postal system privatization.

- **A. Ellen Terpstra, Administrator of the Foreign Agricultural Service**, discussed the harmonization of sanitary standards of agricultural products between the United States and Japan. Terpstra asserted that a discrepancy in standards exists and must be fixed. Japan must also open up its agricultural markets to U.S. imports. Terpstra also discussed the United States' recent success in its WTO dispute with Japan on apple imports and stated that the case's outcome has made international standards and trading rules more credible. When asked by members of the Committee if Japanese beef complied with WTO sanitary standards, Terpstra replied that they did not. The Committee then asked Terpstra's opinion on whether the United States planned to present a claim to the WTO on beef. Terpstra replied that the United States should work bilaterally with Japan before taking any WTO action.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

- **G. Mustafa Mohatarem, Chief Economist at General Motors Corporation**, stated that "the legacy of Japan's unfair and protectionist trade policies" has created challenges for American auto manufacturers. He also stated that the focus on China as the United States' main threat has allowed Japan to continue its protectionism. In 2004, the United States imported $46 billion in Japanese vehicles and auto vehicles while Japan only imported $1.8 billion in U.S. vehicles and parts. Japan's regulatory system on safety and emission standards further widened this imbalance. The system is "clearly designed for the convenience of Japanese automakers and makes it expensive, difficult, and time-consuming to sell imported cars in Japan." Mohatarem believes that these unfair practices have increased Japanese companies' profits at the expense of U.S. automakers, and that Japan must dismantle these protectionist measures to allow U.S. automakers to sell their vehicles in Japan.

- **Frank Keating, President and CEO of the American Council of Life Insurers,** discussed the need for Japan to privatize its postal system. According to Keating, the Kampo acts as a monopoly and limits competition from other life insurers, thus impairing U.S. life insurers' presence in the Japanese market. Furthermore, the Kampo is state-run and, unlike other life insurers, is exempt from certain high taxes and premiums. Keating opined that the recent elections in Japan and the United States' pressure on Japan to pursue reforms would enable U.S. life insurers to compete fairly in the Japanese market. He also stated that the Kampo's current existence is "inconsistent with longstanding bilateral understandings" and that partial reforms will not work; the privatization must be whole and needs to occur in the near future. Should the Kampo not privatize, U.S. life insurers could lose the $38 billion annually that they receive in policy premiums.

At the conclusion of the hearing, Thomas dismissed the panels and several members of the Committee. He also reasserted the urgency of these matters and the need to work with Japan in dismantling its protectionist measures. Should bilateral negotiations yield little results, Thomas stated that the United States would have to explore other options, such as restricting Japanese beef imports or bringing a WTO dispute against Japan, to ensure that U.S. interests are protected.

OUTLOOK

After years of comity between the United States and Japan, recent U.S-Japan trade conflicts have cast Congress' spotlight once again upon the countries' economic relationship. According to U.S. Government and industry representatives, "Japanese protectionism" is hurting U.S. business interests, particularly the U.S. beef, agriculture, auto and insurance industries. The recent U.S. focus on China as its main economic threat may have diminished the political momentum needed to press Japan on revising its trade practices. To ensure the success of U.S. business interests in Japan, the U.S. Government may refocus some of its attention on Japanese

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

economic and trade policies and must work with the Japanese Government to end what it believes are "protectionist" measures. The failure of bilateral negotiations to alleviate the United States' trade concerns will likely force the United States to decide whether to pursue alternative, more painful, approaches, such as WTO dispute settlement or staunch economic countermeasures.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

New U.S. Trade Facilitation Officer Will Work with U.S. Businesses to Ensure Favorable Business Climate

SUMMARY

On September 30, 2005, the United States-China Business Council (USCBC) held a round-table discussion with Ira Belkin, Senior Trade Compliance Officer, U.S. Embassy- Beijing Trade Facilitation Office, on Belkin's work with U.S. companies to ensure a favorable business climate in China. Belkin discussed what work and policy issues on which his office will concentrate and offered his **off-the-record** answers to questions posed by USCBC members. We review below this discussion.

ANALYSIS

On September 30, 2005, the United States-China Business Council (USCBC) held a round-table discussion with Ira Belkin, Senior Trade Compliance Officer, U.S. Embassy- Beijing Trade Facilitation Office, on Belkin's work with U.S. companies to ensure a favorable business climate in China. Mr. Belkin focused on the work his office will conduct in the coming months:

- **Mission**. Mr. Belkin stated that his office's mission was to help American companies cross legal and institutional barriers in China that cause problems for American businesses.

- **Priorities**. Mr. Belkin stated that his office had a priority issues list that includes: (i) protection of American intellectual property rights (IPR); (ii) anti-monopoly issues; and (iii) standards and regulations issues. Mr. Belkin also stated that his office's work would be more policy-oriented.

- **Program work**. Mr. Belkin noted several programs his office would address in the coming months: (i) holding seminars on IPR issues; (ii) meeting with the National People's Congress to discuss legislative-drafting of IPR regulations; and (iii) holding a conference on anti-monopoly law and transparency.

Following his presentation, USCBC members raised issues that they felt deserved the Trade Facilitation Office's attention. The main concern was the sporadic implementation of Chinese regulations, especially on IPR, which has led to corruption, redundancy, inconsistency, and increased costs to American businesses. According to Mr. Belkin, current Chinese regulation on IPR is "outdated" and "not really a code, more a general set of guidelines." He also opined that China lacks a court system that can "efficiently resolve conflicts American businesses might encounter while in China." Mr. Belkin stated that he would work with the Chinese towards creating a more favorable business climate with codified standards and regulations. He also indicated that his office would focus in the near-term on IPR issues, including copyright infringement and piracy. Mr. Belkin stated that the "long-term" goal of his work is to create more market-openness in China for American businesses.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

OUTLOOK

With a full staff and new focus on standards, regulations, and intellectual property rights, Belkin will attempt to align the goals of the U.S. Trade Facilitation Office with U.S. businesses' greatest concerns. According to Belkin, this move should create more market-openness and facilitate trade between the two countries. Belkin noted, however, that facilitation will only occur after China has updated its standards and regulations and has created a more modern court system that can address these conflicts brought up by American businesses in China.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

GAO Reports on Exon-Florio Weaknesses, Strengths, and Recommendations

SUMMARY

On September 28, 2005, the Government Accountability Office (GAO) released a report outlining the problems with the Committee on Foreign Investment in the United States' (CFIUS) that undermine the effectiveness of U.S. laws on foreign investment. The GAO report found that CFIUS practices suffered from three weaknesses and included a list of potential improvements for congressional consideration. The report also outlined strengths that the CFIUS has exhibited since a 2002 GAO analysis of the Committee.

The GAO report comes at a critical time as the Bush Administration and the Office of the United States Trade Representative (USTR) pursue more bilateral free trade agreements (FTA). More U.S. exposure to international markets means more interaction between U.S. and foreign companies. Foreign acquisitions of U.S. companies - the crux of CFIUS reviews - will most likely increase in conjunction with more bilateral FTAs and with greater multilateral trade liberalization, making CFIUS reviews more common.

ANALYSIS

In 1988, Congress passed the Exon-Florio Amendment[1] to the Defense Production Act that authorizes the President to suspend or prohibit foreign acquisitions, mergers, or takeovers of U.S. companies that may harm national security. The Committee on Foreign Investment in the United States (CFIUS) – an interagency committee established in 1975 to monitor and coordinate U.S. policy on foreign investment in the United States – was delegated the investigative authority of Exon-Florio. The Secretary of the Treasury chairs CFIUS.

Exon-Florio establishes a four-step process for CFIUS investigations on foreign acquisition of U.S. companies: (i) a voluntary notice by the companies of the acquisition; (ii) a 30-day CFIUS review to identify whether national security concerns exist; (iii) a 45-day CFIUS review to determine whether those concerns require a recommendation to the President for possible action; and (iv) a presidential decision to permit, suspend, or prohibit the foreign acquisition. The President has 15 days to reach a decision. Companies that have submitted their voluntary filing are free to withdraw that notification at any time prior to the President's decision. In response to concerns about CFIUS's lack of transparency, Congress in 1992 passed the Byrd Amendment to Exon-Florio that requires a report to Congress if the President makes any decision regarding a proposed foreign acquisition.

The GAO report analyzed CFIUS' weaknesses and strengths and proffered congressional recommendations to enhance Exon-Florio's effectiveness:

1. **Weakness: Threats to National Security Are Narrowly Defined**. The GAO report found that under the statute, the President or the President's

[1] 50 U.S.C. app. § 2170.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

designee may launch an investigation to determine whether a foreign acquisition threatens U.S. national security. The statute, however, does not define "national security" and "permits a broad interpretation of the term." Although the statute provides factors for determining a national threat, consideration of these factors is not mandatory. GAO reported that Treasury and some other agencies have defined these threats "in the traditional and more narrowly defined sense," specifically focusing on a U.S. company's possession of export-controlled technologies or items, classified contracts, critical technology, and specific derogatory intelligence on the foreign company. This narrow definition of a "threat" has caused agencies to "resist using Exon-Florio to mitigate the concerns" of other agencies that apply a broader threat definition. Other agencies have stated that the narrow definition "is not sufficiently flexible" to allow for other factors that might define a threat to U.S. national security.

2. **Weakness: Investigation Standard Limits Number of Investigations**. GAO found that the CFIUS has been "reluctant" to begin investigations of foreign companies to avoid a negative image of the investigation and the need for a presidential decision. "As a result, the Committee has initiated few investigations." According to the report, the Committee received 470 notices for proposed or completed acquisitions between 1997 and 2004, but it only investigated eight transactions. GAO noted that the Committee avoids launching investigations because of the negative connotations associated with an investigation that can lower investor confidence the company's stock price: "The Committee's goal is to implement Exon-Florio without chilling foreign investment in the United States." In order to avoid investigations, the Treasury Department, as Committee Chair, has applied strict criteria for initiating investigations that other Committee member agencies have found to be inappropriate and overly strict.

3. **Weakness: Withdrawals Bypass Regulatory Timeframes**. CFIUS guidelines require member agencies to inform the Committee of concerns by the 23rd day of the 30-day review period. GAO found that for more complex cases, the 23-day rule does not allow enough time to complete reviews of foreign acquisitions and address concerns. In the event that agencies need more time to gather information to mitigate national security concerns, the Committee suggests that companies withdraw their notification. Companies that have not concluded their acquisition at the time of withdrawal have incentive to "resolve any outstanding issues and refile as soon as possible." If an acquisition has been concluded, however, GAO reports that "there is less incentive to resolve issues and refile" and national security concerns brought up by Committee member agencies remain unresolved.

4. **Strengths**: GAO also reported that the Committee has improved several functions since the 2002 GAO. The Committee has created concrete

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

timeframes for implementing provisions under the statute and has established detailed actions that it will take if the foreign company fails to comply with Committee requirements. In the software, telecommunications and electronics sectors, companies are now required to "adopt and implement mandatory procedures and policies [made by the Committee following investigations] to ensure compliance within 90 days." The Committee has also provided specific offices within Committee agencies to which companies are to report. GAO found that the Committee has included "strong language concerning the consequences of noncompliance with the terms of agreements" that includes raising concerns of this non-compliance with the President and various government agencies.

5. **Congressional Recommendations:** GAO included a list of matters for Congressional consideration in light of the weaknesses presented in the report. These include: (i) amending Exon-Florio "by more clearly emphasizing factors that should be considered in determining potential harm to national security"; (ii) eliminating the distinction between a review and an investigation and making the entire 75-day period available for review; (iii) revisiting the criteria for reporting the circumstances of CFIUS cases to Congress; and (iv) requiring that the Treasury Department, as Committee Chair, "establish interim protections where specific concerns have been raised," set specific timeframes for refiling, and track any company actions taken during the withdrawal period.

OUTLOOK

The GAO report found that "the effectiveness of Exon-Florio as a safety net depends on the manner in which the broad scope of it authority is implemented." Narrow interpretations of a "threat," the Committee's reluctance to launch investigations, and time constraints that do not permit proper investigation result in foreign companies' withdrawal of their acquisition notices. If a company completes its acquisition and withdraws its notice, it has no further incentive to refile, and thus the Committee "may lose visibility over the transaction" which can lead to unaddressed (potential) national security threats. The weaknesses that GAO outlined limit the scope of CFIUS and can allow threats to slip through its primary reporting mechanism. GAO's suggestions would strengthen CFIUS functions but are dependent on Treasury's willingness to restructure the Committee and it's the Department's position as Committee Chair. Because Treasury has already disagreed with the GAO report's findings, it is unlikely that the Department will follow the GAO's suggestions. Moreover, although the GAO suggests that the Committee adopt its suggestions to make its activities more transparent to Congress and the public, it seems that Treasury is hesitant to make all Committee activities transparent because of the delicate nature of national security concerns involved.

GAO Explores Issues and Effects of Continued Dumping and Subsidy Offset Act

SUMMARY

On September 26, 2005, the Government Accountability Office (GAO) released a report on the issues and effects of implementing the Continued Dumping and Subsidy Offset Act (CDSOA), also known as the "Byrd Amendment." Between 2001 and 2004, CDSOA provided over $1 billion funded from import duties to U.S. companies deemed injured by unfair trade practices. To date, 11 World Trade Organization (WTO) Members have lodged a complaint to the WTO against the United States over the law. The GAO report assesses CDSOA components including: (i) key legal requirements guiding and affecting agency implementation of CDSOA; (ii) problems in CDSOA implementation; (iii) which companies have received CDSOA payments and its effects; and (iv) the status of the WTO decision on CDSOA. GAO also outlined several recommendations for Congressional consideration specific to CDSOA's status quo, modification or repeal. We review here the report and those recommendations. The full report is available online at http://www.gao.gov/new.items/d05979.pdf.

ANALYSIS

Congress enacted the CDSOA on October 28, 2000, as part of the Agriculture, Rural Development, Food and Drug Administration and Related Agencies Appropriations Act. The CDSOA had three goals: (i) to strengthen the remedial nature of U.S. trade laws; (ii) to restore conditions of fair trade; and (iii) to assist domestic producers. Two U.S. administrative agencies implement the CDSOA. The International Trade Commission (ITC) is responsible for developing a list of producers that are potentially eligible to receive CDSOA benefits. ITC distributes this list to Customs and Border Protection (CBP), which is responsible for distributing antidumping and countervailing duties (AD/CVD) to the domestic producers that petitioned for trade relief.

- **CBP Faces Problems Implementing CDSOA.** According the GAO report, CBP faces three problems implementing the CDSOA: (i) CBP processing of CDSOA claims and disbursements is labor intensive, and CBP will face a "dramatic increase" in 2005 workload in both back-logged and current claims; (ii) CBP does not systematically verify claims and is not sure it appropriately distributes disbursements; and (iii) CBP disbursed only half of the potential funds available in 2004 because of ongoing problems collecting duties.

- **CDSOA Payments Disbursed to Few Companies to Mixed Effects.** Between 2001-2004, CBP has disbursed nearly $1 billion in CDSOA payments to 770 companies, with a significant majority of payments distributed to a select few companies. Forty-three percent of total CDSOA distributions went to only four companies: The Timken Company received 20 percent of these payments ($205 million); the Torrington Company (later acquired by the Timken Company) received 13 percent ($135 million); and

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

the Candle-lite company and MPB Corporation received 5 percent each ($55-57 million). **Moreover, almost two-thirds of total CDSOA distributions went to just three domestic industries: bearings, candles, and iron and steel mills.** Companies reported mixed effects from CDSOA payments. Top recipients reported positive effects in terms of net income and employment, but non-recipients reported that they were made less competitive compared to companies receiving CDSOA monies.

- **Retaliation Against U.S. Producers.** Despite a 2003 ruling of the World Trade Organization's (WTO) Appellate Body (AB) that the CDSOA is inconsistent with WTO rules, the United States has yet to repeal the law or otherwise comply with the AB's decision. Congress has failed repeatedly to enact legislation to repeal or to amend the CDSOA. In 2004, the WTO authorized eight complaining Members to suspend concessions and other WTO obligations to the United States. Since then, Canada, the EU, Mexico, and Japan have added retaliatory tariffs to U.S. imports; the four other authorized Members are to follow.

The GAO report noted that "Congress' stated purposes in enacting CDSOA were to strengthen the remedial nature of U.S. trade laws, restore conditions of fair trade, and assist domestic producers."[2] Judged against this standard, the CDSOA's implementation has been more effective in some areas than others. The CDSOA provides financial benefits to U.S. producers who petition for relief, but all other U.S. producers in the petitioners' industry receive few or no benefits. Therefore, CDSOA benefits a small number of companies but can hurt a particular industry in general, as evidenced by the retaliatory tariffs placed on U.S. producers' CDSOA monies. CBP's problems in processing and verifying CDSOA claims and collecting duties also undermine the effectiveness of the law.

In response to these issues, the GAO report recommends that the Secretary of Homeland Security direct the Commissioner of CBP to enhance processing and verification of CDSOA claims and payments; to monitor duty collection; and to extend the 60-day deadline for CDSOA disbursement. The report also recommends that CBP work closely with the ITC to formalize and update a standard list of CDSOA-eligible producers. GAO also suggests that CBP implement a plan to systematically verify CDSOA claims and make sure that companies receiving CDSOA disbursements are accountable for the claims they make. GAO also recommends that CBP constantly report to Congress on the factors that have impaired the agency's effective collection of duties, as well as any proposals to increase efficiency.

OUTLOOK

The GAO report exposes significant flaws in the CDSOA's implementation. First, a few companies receive an overwhelming portion of total CDSOA disbursements, potentially making

[2] Government Accountability Office, Issues and Effects of Implementing the Continued Dumping and Subsidy Offset 44, (Government Accountability Office, September 2005)

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

non-recipients in those industries less competitive. Thus, the CDSOA has the potential effect of supporting ailing companies (injury or threat of injury is a necessary precursor to AD/CVD relief) at the expense of their more competitive domestic counterparts – an impact clearly not envisioned by U.S. trade remedy laws. Moreover, the WTO's adverse ruling and complaining WTO Members' resultant retaliation also harms non-petitioning companies that are not receiving CDSOA compensation that could offset the effect of the retaliation. Generally speaking then, CDSOA implementation *does* help petitioning companies but can end up harming the industry in general because it adversely impacts non-petitioning, more competitive domestic firms that did not need protection. These issues, coupled with CBP's problems in collecting duties and monitoring CDSOA claims and payments, indicate that the Act is performing less effectively than what was originally intended. Although these problems provide Congress with further reason to repeal or amend the CDSOA, the law still receives broad support in both the House and Senate because of the significant benefits it provides to politically influential domestic industries like steel and bearings. Thus, Congress has again rejected the 2005 legislation aimed at repealing or amending the CDSOA[3]. Should WTO Members' retaliation continue and/or increase in 2006, the prospects for repeal will likely improve.

[3] The House Ways & Means Committee is considering inserting H.R. 1121, which would repeal the Continued Dumping and Subsidy Offset Act of 2000, into the Miscellaneous Trade Bill. The Miscellaneous Trade Bill is currently under review by the Committee but H.R. 1121 has ignited strong opposition from U.S. companies benefiting from the CDSOA.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

United States Highlights

USTR Calls for IPR Review Submissions

On September 29, 2005, the Office of the United States Trade Representative (USTR) announced in the Federal Register that it seeks written public submissions concerning acts, policies and practices of Russia, Canada, the Philippines and Indonesia regarding intellectual property rights (IPR). Section 182 of the 1974 Trade Act requires the USTR to identify countries that deny adequate and effective protection of IPR and to determine a "Priority Country List." USTR has placed Russia, Canada, Philippines, and Indonesia on that list. The submissions will help USTR conduct its IPR reviews of these different countries.

Submissions to USTR are due by December 2, 2005.

The full Federal Register notice can be found at http://a257.g.akamaitech.net/7/257/2422/01jan20051800/edocket.access.gpo.gov/2005/05-19490.htm

U.S. Senators Introduce Resolution Calling on U.S. Trade Negotiators to "Protect U.S. Trade Laws"

In anticipation of December's World Trade Organization (WTO) talks in Hong Kong, Senators Larry Craig (R-Idaho) and John Rockefeller (D- W. Va) introduced on September 29, 2005 S.Con.Res.55, which calls on U.S. trade negotiators not to weaken U.S. trade laws during the ongoing "Doha Round" of WTO negotiations. The round includes negotiations on trade remedies (antidumping, countervailing duty and safeguards measures), and the resolution reflects U.S. legislators' concerns that the talks may result in "weakened" U.S. trade laws. Although the resolution is non-binding, the Senators expect that, if passed, it could serve as a guideline for U.S. trade negotiators.

The resolution is further indication that many members of Congress are focused on the upcoming Hong Kong talks and wish to influence the Doha negotiations from Washington, DC. In September, the Senate rejected Senator Byron Dorgan's (D-ND) amendment to the Commerce, State, Justice FY 2006 Appropriations bill that sought to prevent U.S. trade negotiators from entering into any trade agreement which would alter any U.S. trade remedy law. Although the amendment failed, 39 Senators voted in support. Presently, 27 Senators have signed the Craig-Rockefeller resolution.

U.S. Will Appeal WTO Ruling on FSC/ETI

United States Trade Representative (USTR) Rob Portman stated October 3, 2005, that the United States would appeal last week's World Trade Organization (WTO) panel ruling that the U.S. foreign sales corporation/extraterritorial income tax (FSC/ETI) regime remained inconsistent with WTO rules. Portman stated that the WTO findings "produced errors of law that provide grounds for appeal to the Appellate Body." The earliest date for an Appellate Body

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

ruling would be Spring 2006. The European Community (EC) lodged the complaint, and the WTO ruled that the United States had failed to implement WTO recommendations and rulings to withdraw the prohibited subsidies.

Although Portman claims that the United States "should keep the doors open for negotiation," USTR's appeal of the WTO ruling may make future negotiations more difficult. Resumption of the FSC/ETI dispute provides further evidence that the trade tensions between the United States and the EU continue, despite the conciliatory rhetoric from Portman and his EU counterpart, Commissioner Peter Mandelson, during Mandelson's visit to Washington in September. Compounding these tensions are the burgeoning Boeing/Airbus subsidies dispute at the WTO and continued intransigence in the parties' Doha negotiations on Agricultural subsidies.

National Association of Manufacturers Supports China Trade Bill

On September 28, 2005, the National Association of Manufacturers' (NAM) board of directors endorsed Senate bill S. 1421, "The United States Trade Rights Enforcement Act," which would, among other things, authorize the U.S. Department of Commerce to apply countervailing duties (CVDs) on subsidized imports from non-market economies. The bill, introduced by Senator Susan Collins (R-ME), is similar to H.R. 3283, the broad-ranging China trade measure that the House of Representatives passed in July. Both bills also require the Office of the United States Trade Representative (USTR) to monitor China's commitment in protecting intellectual property rights (IPR) and would suspend bonding privileges for new shippers.

Congressional insiders have indicated that the bill's passage in the Senate is far from certain. Substantively, many in the Senate have expressed doubts that the bill's CVD and bonding provisions are consistent with WTO rules. On a practical level, the Senate might not have time to address the bill before the end of the 2005 session. The Senate's Fall agenda includes Hurricane Katrina relief, a new Supreme Court nomination and several appropriations measures, leaving little room for a China bill that would consume significant amounts of valuable floor time and would include several amendments. Moreover, the legislation must wait for the Treasury Department's report on currency manipulation, due in late October. If Treasury labels China as a currency manipulator, Congress might adopt a tougher attitude towards China, and the bill might move forward. If China is not listed in the report, China and the United States will most likely take the "bilateral talks" route, further inhibiting the bill's passage in the Senate.

U.S. International Trade Commission Issues Affirmative Section 421 Determination on Steel Pipe from China

On October 3, 2005 the U.S. International Trade Commission (ITC) voted 4-to-2 that Chinese imports of certain circular welded non-alloy steel pipes were threatening U.S. steel pipe producers and recommended that the United States provide import relief to the domestic industry. The ITC will send its remedy proposal to the Office of the U.S. Trade Representative (USTR) and the President by October 21, after which the USTR will make a recommendation to President Bush. President Bush will make the final determination on whether to impose import

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

relief and in what form. Seven U.S. steel pipe firms initially filed the petition under Section 421 of the 1974 Trade Act, which addresses market disruption created by Chinese imports.

In five previous cases, domestic industries use of Section 421 did not result in the imposition of import restrictions. The ITC failed to find market disruption in two of the cases. In the other cases, the ITC found market disruption, but the President did not grant import relief. It is unclear whether the Government Accountability Office's (GAO) recently released report on Section 421 will alter the President's decision in this case. The September 29, 2005 GAO report found that the President's refusal to grant import relief under Section 421 has "generated controversy" and resulted in an unsuccessful lawsuit which alleged that "the president had exceeded his authority" in denying relief.

USTR Turns Down Industry Advisory Committee's Call to Slow Down FTAs

On October 3, 2005, United States Trade Representative (USTR) Rob Portman rejected a call from U.S. companies to delay the United States' pursuit of bilateral Free Trade Agreements (FTAs) until after the December World Trade Organization (WTO) ministerial in Hong Kong. The industry request came in a September letter to both Portman and Secretary of Commerce Carlos Gutierrez, drafted by the Industry Advisory Committee on Services and Finance Industries (ITAC-10), a committee of leading U.S. companies and business associations created to advise the USTR and other government agencies. In the letter, ITAC-10 stated that "WTO negotiations are the most important element of the U.S. trade agenda" and that "the USTR's limited resources should be focused on achieving successes in that undertaking."

Portman countered that slowing down U.S. pursuit of new "promising bilateral agreements...would be a mistake" and stated that the United Stated needs to move faster on new FTAs because the president's trade promotion authority (TPA), which requires Congress to vote on trade agreements without amendments, will expire on July 1, 2007. Portman stated that USTR has the necessary resources to pursue FTAs and negotiate at the WTO ministerial (Portman's "parallel liberalization" strategy). Portman also noted that FTA talks with Egypt were proceeding well and that the United States was "very close" to concluding a FTA with the United Arab Emirates.

Treasury Delays Report on Currency Manipulation as Snow Travels to Japan and China

Treasury Secretary John W. Snow will visit Japan and China from October 10-16, 2005 for meetings in Beijing with the Group of 20 (G-20) finance ministers and central bank governors. Secretary Snow will first meet with Japanese Finance Minister Tanigaki in Tokyo to discuss economic growth and development in the region. From October 11-13, Secretary Snow will travel to Shanghai to meet with Asia-based financial sector leaders and to visit both the Shanghai Stock Exchange and a new operations office for China's foreign exchange trading system. Secretary Snow will then visit Chengdu for one day to observe economic reform progress in areas outside of China's major coastal centers. He will also join other finance ministers and central bank governors in Grand Epoch City, outside Beijing, on October 14 for

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

the G-20 meetings. Following the G-20 meetings, Secretary Snow will lead the U.S. delegation at the U.S.-China Joint Economic Commission (JEC).

According to press reports, Secretary Snow's trip has delayed the release of the Treasury Department's Congressional report on international exchange rate policy from October 15 to early November. The last Treasury report "sharply criticized" China's exchange rate policy, and in it, the Department threatened to cite China for exchange rate manipulation in the next report "in the absence of major changes in China's currency regime." Treasury officials stated that they have delayed the report's release to allow Secretary Snow to focus on his China agenda.

The report's delay will likely delay the U.S. Senate's consideration of S. 1421, "The United States Trade Rights Enforcement Act," which would, in its current, form authorize the U.S. Department of Commerce to apply countervailing duties (CVDs) on subsidized imports from non-market economies. The House passed its version of S. 1421 in July. Both bills also require the Office of the United States Trade Representative (USTR) to monitor China's commitment in protecting intellectual property rights (IPR) and direct Customs to suspend bonding privileges for new shippers. Congressional insiders have indicated that the Senate will probably not consider the China bill until after the Treasury report's release, as the report's conclusions on Chinese currency would likely affect many Senators' votes.

USTR Requests Public Comments on Generalized System of Preferences (GSP) and its Renewal

The United States Trade Representative's (USTR) Trade Policy Staff Committee (TPSC) has requested public comments and testimony on the Generalized System of Preferences (GSP) for a public hearing on November 2, 2005. USTR has requested that comments focus on whether GSP program operation should be modified so that beneficiaries that were not previously major traders increase their GSP participation and whether some GSP beneficiaries that are sufficiently competitive should no longer be designated beneficiaries. The TPSC is also seeking comments on the period for which the Congress should reauthorize the GSP program, which is currently set to expire on December 31, 2006.

President Bush Announces Intent to Nominate Schwab as Deputy USTR

President Bush announced October 7, 2005 that he intends to nominate Susan C. Schwab to be Deputy United States Trade Representative (USTR). Dr. Schwab - most recently President and CEO of the University System of Maryland (USM) Foundation - succeeds outgoing Deputy USTR Peter F. Allgeier.

Dr. Schwab received her Bachelor's degree in political economy from Williams College, a Master's degree in Development Policy from Stanford University, and a Ph.D. at the George Washington University School of Business and Public Management. She began her career as a USTR agricultural trade negotiator in 1977 followed by positions at the U.S. Embassy in Tokyo, the office of Senator John Danforth (R-MO), as Assistant Secretary of Commerce and Director General of the US & Foreign Commercial Service in the Bush I Administration, and as Director of Corporate Business Development for Motorola, Inc. Between 1995 and 2004, as President of

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

the USM Foundation, Schwab served as Dean of the University of Maryland's School of Public Policy.

USTR Portman praised the President's nomination of Schwab, noting that she "is a tremendous leader and widely recognized as a trade expert," and that she will be "a great asset in developing and implementing the President's trade agenda to help open foreign markets to U.S. exports and level the playing field."

The Office of USTR still has a vacancy for U.S. Chief Agricultural Negotiator.

Senators Urge USTR Action on U.S. Beef Ban in Japan

On October 7, 2005, Senator Pat Roberts (R-KS) and 20 other Senators urged the Office of the United States Trade Representative (USTR) to impose economic sanctions on Japan for their 21-month U.S. beef ban. In a letter addressed to USTR Rob Portman, the Senators stated that it was "clear that Japan is simply using this issue to maintain an unwarranted and unjustified trade barrier" and requested that USTR "employ retaliatory economic measures against Japan." According to the letter, the U.S. beef industry loses $100 million each month that the Japanese market remains closed and has lost about $6 billion since Japan enacted the ban. Although the Senators did not outline specific retaliatory measures in the letter, they did state that retaliation should "be at a level comparable to the losses incurred in the beef industry."

The letter arrived shortly after speculation arose that Japan may lift the beef ban by the end of the year because of a Food Safety Commission (FSC) Prion Expert Committee determination that the risk of BSE contamination in U.S. beef from cattle aged less than 20 months is low. It also comes after the September 20th Senate vote to continue a U.S. import ban on Japanese beef until Japan cancels its ban on U.S. beef. During a Sept. 28 House Ways and Means Committee hearing, members of Congress from both parties strongly criticized Japan for maintaining its ban and for "restricting other U.S. exports through non-tariff barriers and other measures." In October 2004, the United States and Japan reached a provisional framework agreement that outlined resumption of the beef trade. Japan has not yet completed regulatory proceedings it says are necessary to reopen its beef market.

The letter's signatories include Senators Burns (R-MT), Baucus (D-MT), Salazar (D-CO), Thune (R-SD), Conrad (D-ND), Inhofe (R-OK), Craig (R-ID), Talent (R-MS), Bond (R-MS), Brownback (R-KS), Crapo (R-ID), Dorgan (D-ND), Enzi (R-WY), Cornyn (R-TX), Lott (R-MI), Johnson (D-SD), Allard (R-CO), Coleman (R-MN), Hutchison (R-TX), and Thomas (R-WY).

Snow Urges China to Reform Market, Currency

On October 12, 2005, U.S. Treasury Secretary John Snow visited the Shanghai Stock Exchange and offered his thoughts on China's currency: "China has made great, even historic strides in liberalizing its currency but needs to act further for meaningful reform." Snow met with Chinese central bank leadership and key financial sector officials as part of his tour to push the Bush Administration's message that China's currency policy must be more market-oriented. Economists and critics maintain that China's strict peg of the Chinese yuan to the dollar has kept

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

the currency artificially low, giving China an unfair trade advantage over the United States in labor and other costs. Critics believe that the currency policy has exacerbated the United States' growing trade deficit with China. Snow stated that the goal of his trip is to "encourage more flexibility down the path" although Chinese officials stated on October 11 that China would follow its own timeline in releasing its currency peg. Snow is also encouraging Chinese officials to continue implementing market reforms and investor protection adding that "it's in China's interest to do everything that leads to financial market modernization."

Despite a modest revaluation in July, China's currency policy remains a significant issue for many members of Congress, most notably Senator Chuck Schumer (D-NY), who see the policy as providing China with an unfair trade advantage. Snow's visit is the Bush Administration's most recent attempt to use "quiet diplomacy" - the avoidance of persistent, public pressure - to ensure China's cooperation. Despite the Administration's intent to follow this approach towards China, the U.S. Congress continues to express vocal concern over China's "undervalued" currency, pressuring Snow to elicit a change China's currency policy. The Senate may still consider S. 1421, "The United States Trade Rights Enforcement Act," which would, in its current form, authorize the U.S. Department of Commerce to apply countervailing duties (CVDs) on subsidized imports from non-market economies. The House passed its version of S. 1421 in July. Congressional insiders have noted that the Senate will probably not consider the China bill until after Treasury releases its report on currency manipulation, which Treasury has delayed until Snow returns from China. A Treasury report that reflects any change in China's monetary policy created by Snow's visit would likely quash the Senate's consideration of the China bill.

Trade Policy Staff Committee Requests Comments on Caribbean Basin Economic Recovery Act

On October 12, 2005, the Trade Policy Staff Committee (TPSC) announced in the Federal Register that it is seeking public comments on the operation of the Caribbean Basin Economic Recovery Act (CBERA) as amended by the Caribbean Basin Trade Partnership Act (Notice 59389 Volume 70, Number 196). Comments should reflect beneficiary country performance under the Act and will be used for a report to Congress.

Submissions to TPSC are due by November 4, 2005.

U.S. Expects Japan to End Beef Ban in November, Will Otherwise Consider "Alternative Measures"

On October 18, 2005, nominated Deputy United States Trade Representative (USTR) Karan Bhatia stated that the United States expects Japan to lift its two-year-long ban on U.S beef imports by mid-November when President Bush meets with Japanese Prime Minister Junichiro Koizumi. Bhatia added that the United States will consider "alternative measures" if Japan does not remove the ban by the meeting and will have to work on "prompting the Japanese to open their market." President Bush will meet PM Koizumi on his way to the annual leaders' meeting of the Asia-Pacific Economic Cooperation (APEC) in South Korea. The two-year ban on U.S.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

beef imports began in 2003 after one case of bovine spongiform encephalopathy (BSE) was discovered in the United States. Recently, Members of Congress have expressed concerns over the costs to the U.S. beef industry that the ban has created and over other market access issues. They have called on the Administration to impose economic sanctions on Japan if the ban is not lifted and have passed an amendment to the 2006 Agriculture Appropriations bill prohibiting the importation of Japanese Beef into the United States until Japan lifts its current ban.

USTR Fills General Counsel, Advisor and Public Post Positions

On October 19, 2005, United States Trade Representative (USTR) Rob Portman appointed James E. Mendenhall USTR general counsel, Matt Niemeyer a USTR principal advisor, and Justin McCarthy Assistant USTR for Intergovernmental Affairs and Public Liaison.

- **James E. Mendenhall, General Counsel**. Mendenhall has been serving as acting general counsel since February 2005 and prior to that served as Assistant USTR for Services, Investment, and Intellectual Property. Between 2001 and 2003, Mendenhall served as USTR deputy general counsel after working as a partner in the law firm Powell, Goldstein, Fraser & Murphy LLP.

- **Matt Niemeyer, Principal Advisor**. Since April 2003, Niemeyer has served as Assistant USTR for Congressional Affairs. According to Portman, Niemeyer also led USTR's efforts to encourage passage of congressional implementing legislation for the Dominican Republic-Central America Free Trade Agreement (DR-CAFTA) and FTAs with Australia, Chile, Morocco, and Singapore.

- **Justin McCarthy, Assistant USTR for Intergovernmental Affairs and Public Liaison**. McCarthy served as director of government relations since 2003 for Pfizer Inc. and was Pfizer's assistant director for government relations from 2001 to 2003. According to the Office of USTR, McCarthy's responsibilities will include "advancing USTR priorities at external events" and organizing outreach efforts to state and local governments, labor, consumer, and environmental groups, and agricultural communities.

Commerce Prepared to Impose CVDs Against China

On October 18, 2005, nominated Undersecretary of Commerce for International Trade Franklin Lavin indicated that the U.S. Department of Commerce (DOC) is prepared to consider petitions from domestic industries to impose countervailing duties (CVDs) on Chinese imports. He added that his "interpretation" of U.S. law is that DOC is allowed to impose CVDs on specific Chinese imports that the Chinese Government unfairly subsidizes. Currently, the DOC does not accept CVD petitions in cases involving non-market economies (NMEs) like China.

Although Lavin noted that DOC would evaluate CVD petitions, he acknowledged that a "trade-off existed" in imposing CVDs on NMEs which might limit DOC actions under the U.S.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

antidumping law. Indeed, DOC has for over 20 years held - and the U.S. courts have affirmed - that subsidization is a market phenomenon that can only occur where markets exist. The current antidumping methodology for NMEs, however, does not examine home market sales (instead relying on "surrogate" markets) because state command and control precludes market behavior (*i.e.*, because markets do not exist). Under DOC's current policy, therefore, a finding of subsidization in an NME country would wholly contradict the basis for DOC's methodology in NME dumping cases. Moreover, as a June 2005 Government Accountability Office (GAO) study pointed out, DOC has refrained from applying CVDs to NME imports because of the difficulties in calculating subsidization that central planning creates. The GAO study also found that problems would arise with "double-counting" - imposing two sets of duties to compensate for the same unfair trade practice - which would require DOC to make corrections to avoid this practice and could violate World Trade Organization rules. DOC has procedures for avoiding such "double-counting" in market economy cases, but has no experience in non-market economy cases because of the previous policy of not imposing CVDs on such countries. The House has already approved H.R. 3238, which would enable U.S. companies to file CVD petitions against imports from NMEs, but the Senate has yet to consider its version of the bill. There is much speculation that if the Senate were to consider the bill, it would likely remove the CVDs provision because of the aforementioned problems it would create.

Treasury Will Change CFIUS Process But Not with New Legislation

On October 20, 2005, Deputy Secretary Robert Kimmit stated that the U.S. Treasury Department and other federal agencies would begin considering improvements in the Committee on Foreign Investment in the United States' (CFIUS) review of foreign purchases of U.S. companies. CFIUS is an interagency panel that reviews foreign acquisitions of U.S. companies and their national security implications. Kimmit's statement follows a September 2005 Government Accountability Office (GAO) report criticizing the review process. However, during a hearing of the Senate Banking, Housing, and Urban Affairs Committee, Kimmit noted that the current legislation overseeing the review process is "sufficiently flexible" to protect national security, and that he hoped Congress would allow the agencies to correct CFIUS deficiencies rather than propose new legislation. The GAO report found that Treasury - which chairs CFIUS - uses an "overly narrow view of national security," discourages investigations of foreign acquisitions, and provides too short a deadline (30 days) for other federal agencies to review the foreign acquisition.

Senator Richard Shelby (R-AL), chairman of the Senate Banking Committee, reiterated his position that the CFIUS process must change and has proposed an amendment to the defense authorization bill (S. 1797 "Foreign Investment Security Act of 2005") that would extend the 30-day review period to 60 days and would provide for a congressional vote on foreign transactions after CFIUS has approved them. He also stated that "changes may be necessary" through legislation, including: (i) requiring CFIUS to consider certain aspects of national security; (ii) requiring greater information sharing with Congress; and (iii) mandating less usage of the withdrawal process that companies can use to remove proposed transactions. Treasury and business groups have opposed Shelby's suggestions, and Kimmit stated that lengthening the review to 60 days would "cause CFIUS to spend more time on cases that do not pose any threat."

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

Representatives from six other CFIUS departments, including the Department of Commerce and the Department of Homeland Security, also attended the hearing and voiced their opposition to the review extension. Kimmit denied that Treasury uses a "narrow definition" of national security, stating that "[national security] is a dynamic concept that defies static definition."

Although neither the House nor Senate has introduced stand-alone legislation to change CFIUS procedures, it is possible that Senator Shelby will move for legislation encompassing his suggestions when the Senate reconvenes in 2006. Opposition from prominent business groups and the Treasury Department, however, might prevent passage of such legislation or significantly dilute a final version. Thus, administrative mechanisms, rather than new legislation, may prove the most effective and realistic means to alter current CFIUS procedures.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

Free Trade Agreements

House Ways and Means Committee Holds Hearing on Free Trade Agreement between Bahrain and the United States

SUMMARY

On September 29, 2005, the U.S. House of Representatives Ways and Means Committee held a hearing to discuss the implementation of the Free-Trade Agreement (FTA) between the United States and Bahrain. The hearing focused on the positive and negative aspects that the FTA would bring to the United States and Bahrain. The hearing included on-the record oral testimony from panelists representing government and business interests. We review below this testimony and the discussion between the Committee and the hearing witnesses.

The full text of the witnesses' statements is available on the Committee website at: http://waysandmeans.house.gov.

ANALYSIS

On September 29, 2005, the U.S. House of Representatives Ways and Means Committee held a hearing to discuss the implementation of the FTA between the United States and Bahrain. Rep. Bill Thomas (R-CA), Chairman of the Committee on Ways and Means, presided over the hearing, which included testimony from other Congressmen on the Committee and panelists representing U.S. Government and business interests. The hearing's core issues were: (i) the benefits of the FTA in terms of relations between the United States and the Middle East; (ii) the benefits of the FTA for U.S. businesses in the region; and (iii) the costs of the FTA due to weak labor reform in Bahrain:

- In his opening statement, **Congressman Bill Thomas (R-CA)** stated that Bahrain is a "leader in political freedom, free-trade policies and open markets in the Middle East." Bahrain, Thomas opined, is a critical addition to the United States-Middle East Free Trade Area (USMEFTA), which the Bush administration wants to implement by 2013. Thomas stated that Bahrain should be commended for reforming its labor laws to allow for the FTA's passage and for lifting its boycott of Israel. Thomas also stated that the only way to move the FTA forward would be to ensure Bahrain's commitment to labor reforms and proper follow-up.

- **Shaun Donnelly, Assistant United States Trade Representative for Europe and the Mediterranean,** stated that "Bahrain has made legally binding commitments to liberalize trade with the U.S." and that once the agreement takes place, 100 percent of consumer goods and 81 percent of U.S. agricultural exports will enter Bahrain duty-free. Donnelly also stated that the FTA would provide a high level of intellectual property rights (IPR) protections. He commended Bahrain for updating labor laws that now fall

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

in line with United Nations International Labor Organization (UN ILO) standards. Donnelly stated that the FTA is the first step in pursuing the USMEFTA. Committee members asked Donnelly what "sticky points" were left to discuss in the FTA. Donnelly listed several discussion areas the United States must still work out with Bahrain including: the creation of a labor consultation mechanism, clarification of labor regulations, educational advancement, and continued government reforms. When asked by Committee members if the United States-Bahrain FTA was based on geopolitical concerns, Donnelly responded that Bahrain's geopolitical situation was part of the FTA-creation, and that the United States hoped Bahrain would serve as a model for other Middle Eastern nations.

- **John Clancey, Chairman of Maersk, Inc.** and a member of the **United States-Bahrain Free Trade Agreement Coalition,** discussed Bahrain's importance as a "hub for upper Gulf region shipments." He also stated that although U.S. exports to Bahrain totaled only $300 million in 2004, the opportunities for American businesses to operate in Bahrain could yield greater U.S. exports.

- **Eric Caplan, President of Brunswick Commercial and Government Products,** stated that the FTA "sends a strong signal to U.S. companies that Bahrain is committed to transparent, fair and open trade and gives [U.S. companies] a higher level of assurance of doing business there."

- **Harold Bernsen, retired United States Navy Officer** and **Director of the American Bahraini Friendship Society,** stated that the FTA "has encouraged other Gulf countries such as Oman, the United Arab Emirates, and Qatar to reach out to the United States in the hopes of establishing FTAs of their own." He also noted that Bahrain has one of the best-regulated banking systems in the Middle East.

- **Lionel Johnson, Vice President of International Government Affairs, Citigroup,** stated that the FTA would liberalize both the Bahraini and Middle Eastern banking sectors. He also opined that Bahrain is the "economic gateway to the Gulf" and that the FTA offers the United States "meaningful security benefits."

- **Thea Lee, Policy Director of the American Federation of Labor-Congress of Industrial Organizations (AFL-CIO),** condemned the FTA, stating that the "Bahrain FTA provides precisely the wrong answers to the challenges faced in Bahrain and the United States." Lee said that workers' rights provisions are still weak in Bahrain, and that the Bahraini Government did not consult with workers and unions on FTA provisions. Lee stated that the AFL-CIO is opposed to expanding trade with Bahrain because: (i) Bahraini workers do not have the right to organize; (ii) trade

unions are prohibited from engaging in political activities; (iii) and Bahraini law does not provide for collective bargaining.

OUTLOOK

While U.S. exports to Bahrain are relatively small, the creation of the United States-Bahrain FTA serves other purposes. Bahrain is geopolitically important, and the FTA has pushed other Middle Eastern nations to pursue their own FTAs with the United States. The FTA will likely serve as a template for future Middle Eastern FTAs resulting from the Bush Administration's pursuit of USMEFTA. Moreover, the FTA and Bahrain's strong banking regulations may allow Bahrain to become an economic portal to the Middle East and to enhance thereby its role as a major non-NATO ally of the United States. U.S. and Bahraini negotiators, however, may have to address labor reforms in Bahrain before the United States will implement the FTA. If negotiators can do this, it is not out of the question that Congress will approve the FTA before the end of the year because Congress has delayed its target adjournment until November 18, 2005.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

Senate Finance Committee Holds U.S.-Bahrain FTA Hearing

SUMMARY

On October 6, 2005 the U.S. Senate Finance Committee held a hearing to review implementation of the United States-Bahrain Free Trade Agreement (FTA). Committee Chairman Sen. Charles Grassley (R-IA) was not present, but Sen. Craig Thomas (R-WY) presided over the hearing, which included **on the record** oral testimony from U.S. Government and business representatives. Full text of the witnesses' statements is available at the Senate Finance Committee website: http://finance.senate.gov/sitepages/hearing100605a.htm. We review below these statements.

ANALYSIS

On October 6, 2005 the U.S. Senate Finance Committee held a hearing to review implementation of the United States-Bahrain Free Trade Agreement (FTA). Sen. Craig Thomas (R-WY) presided over the hearing, and Sen. Jeff Bingaman (D-NM) opened the hearing by stressing the importance of the FTA and the labor concerns associated with the agreement.

- **Ambassador Shaun Donnelly, Assistant U.S. Trade Representative (USTR) for Europe and the Mediterranean** stated the FTA would support ongoing political, economic, and social reform in Bahrain and could signal the benefits of market liberalization to the Middle East region. He also noted that the FTA would help create the U.S.-Middle East Free Trade Area (USMEFTA). When asked by the Committee how the FTA would affect the U.S. trade balance with Bahrain, Donnelly opined that the balance would remain unaffected. The Committee also asked if the FTA had more important political, as opposed to economic, ramifications, to which Donnelly responded that the FTA's economic aspects were just as important as its political ones. When asked by the Committee if the FTA's labor provisions were a "step backward," Donnelly responded that the provisions were actually stronger than in the U.S.-Jordan FTA thanks to Bahrain's labor reforms, but work was still necessary.

- **Megan Aslaksen, Global Trade Specialist, Hewlett-Packard Company** stated that the FTA would allow U.S. companies to share innovations and life-saving devices with Bahrain. She also noted that the FTA was important to the U.S. high-technology sector since Bahrain serves as a high-technology hub in the region.

- **Mr. Lionel C. Johnson, Vice President and Director, International Government Affairs, Citigroup, and Co-Chair, U.S.-Bahrain Free Trade Agreement Coalition** stated that "if the United States does not interact with Bahrain, our competitors will at our expense." He also noted that Bahrain is an "economic gateway" to Persian Gulf Coast and Southwest

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

Asian countries, and that the FTA could help the United States further interact with these regions.

- **Ms. Barbara Spangler, Executive Director, Wheat Export Trade Education Committee** stated that the FTA could serve as an important link to other bilateral and multilateral negotiations in the Middle East.

- **Mr. Bob Baugh, Director, AFL-CIO Industrial Union Council** stated that labor concerns are at the FTA's forefront. He noted that Bahrain's "2002 labor reforms do not mean the job is done," and that the Bahraini reforms are a step backwards from the U.S.-Jordan FTA. Among Baugh's list of concerns were; (i) limits to collective bargaining; (ii) limits on strikes; (iii) a lack of a minimum wage; and (iv) the vulnerabilities faced by foreign workers who make up two-thirds of the Bahraini labor force. Baugh stated that adequate consultation and monitoring was necessary to ensure a proper FTA.

OUTLOOK

The U.S.-Bahrain FTA seems to be receiving support from both government and industry alike. For industry, the FTA opens another market and may turn Bahrain into the "economic gateway" to, and high-technology hub of, the Middle East. Thus, the FTA would allow U.S. businesses to gain access to both the Bahraini and other markets and in the region. For the Government, the FTA's completion is one step closer to creation of the USMEFTA, and the FTA could spur other regional economies to model themselves after Bahrain. Labor issues, however, are still a "sticking point" and may have to be addressed before the Congress will pass the FTA. Depending on how many Congressmen see labor as an important component of the FTA, the Administration's hopes to pass and sign the FTA by the end of this year might be replaced by a 2006 deadline. On the other hand, Congress has passed previous FTAs with far greater (and more vocal) congressional opposition based on labor concerns. Indeed, given the Bush Administration's current focus and drive regarding bilateral FTAs (through its stated policy of "competitive liberalization") and Congress' extended Fall calendar, passage of the Bahraini FTA before the end of the year now seems probable.

Assistant USTR Provides Insight on Fifth Round of U.S.-Thailand FTA

SUMMARY

On October 6, 2005, the U.S.-ASEAN Business Council hosted a briefing on United States-Thailand Free Trade Agreement (FTA) negotiations with Barbara Weisel, Assistant United States Trade Representative (USTR) for Asia-Pacific and Pharmaceutical Policy. Weisel provided **off-the-record** comments on the focal points of the U.S.-Thai FTA fifth round negotiations. Weisel also commented on the status of other FTA (and potential FTA) negotiations currently underway, including the Andean, UAE, Malaysia, and Vietnam FTAs. We review the discussion below.

ANALYSIS

On October 6, 2005, the U.S.-ASEAN Business Council hosted a briefing on the current status of United States-Thailand FTA negotiations with Barbara Weisel, Assistant USTR for Asia-Pacific and Pharmaceutical Policy. Weisel provided a discussion of focal points of the U.S.-Thai FTA fifth round negotiations and outlined the status of different sector negotiations:

- **Timing**. Weisel stated that the United States and Thailand had a "really, really good round" and that both groups felt dynamics had improved. She also stated that the United States would like to finish the FTA by Spring 2006 so that Congress can vote on the FTA before the August summer recess. Both sides have agreed to meet tentatively on November 14 for the next round and also agreed to hold the January 2006 meeting in Thailand.

- **Agriculture**. Weisel stated that talks went well in the agriculture sector and that both sides will present their priority lists by October 25, 2005 before the next group meeting in London. Weisel also stated that there were still several areas to work on, including **Rules of Origin**. **The sides did not meet on textiles but hope to do so in November.**

- **Customs**. Weisel stated that the fifth round was the initial meeting for both sides on customs issues. She also opined that there were several customs areas where the U.S. delegation needed more information.

- **Services**. Weisel stated that the Thais are "being constructive" on services issues and highlighted the "de-linkage" of Financial Services from general Services negotiations as a primary reason for the talks' advancement. She stated that there has been no major movement, and that the Thai delegation was seeking services safeguards – a position consistent with their position at the WTO. Weisel also stated that the Thai delegation found Most Favored Nation (MFN) status problematic because they did not want to set a precedent for MFN treatment in other FTAs.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

- **Investment**. Weisel pointed out that there was no movement on investment, but that Thai negotiators will be arriving to the United States in the first week of November to further investment talks. The Thais also presented new questions on the "investor state."

- **Financial Services**. Weisel noted that there had been "positive development" in financial services discussions, and that the existence of a financial services text is a big advance. She also stated that the Thai delegation acknowledged that an agreement on financial services will not be separate from the rest of the FTA, another positive step. Although the financial services team is separate from the rest of the Thai delegation, Weisel stated that they were far more constructive and willing to hear out the U.S. position than in past meetings.

- **Intellectual Property Rights (IPR)**. Weisel noted that both sides now have a consolidated text and have removed brackets on enforcement and other issues. Copyright and data protection issues still remain, however. The Thai delegation will wait to see the U.S. text on these issues and in the meantime, have hired a consultant to create a public relations campaign on the benefits of the U.S.-Thai FTA.

- **Sanitary and Phytosanitary (SPS) Issues**. Weisel stated that the U.S. delegation has given the Thai side all their information on Decree 11 and has asked for a response by November 1, 2005.

- **Technical Barriers to Trade (TBT)**. Weisel stated that the TBT agreement is almost finished.

- **Competition Policy**. Weisel stated that both sides had a long discussion, and that Thai ownership of numerous state-owned enterprises could prove problematic for negotiations.

- **Labor/Environment**. Weisel noted that the Council of State (Thai Parliament) is currently considering labor reforms. She also stated that although there were positive discussions on environment issues, the text still needed work.

- **Science/Technology**. Weisel stated that science and technology issues have been tabled for the time being.

- **Capacity Building.** Weisel stated that the capacity building group did not meet during the negotiations.

Weisel also discussed the impact of other FTAs on the U.S.-Thai FTA. She stated that the **Andean Free Trade Agreement** will likely be the first non- Middle East FTA to be completed, perhaps by the end of the year. Weisel mentioned that both the United States and the

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

United Arab Emirates (UAE) were trying to wrap up FTA discussions by November 14, 2005. In terms of a **Malaysia FTA**, Weisel will hold meetings in Malaysia on October 10-11, 2005 where both sides will discuss a full range of issues. She also stated that the Malaysian delegation has shown interest, but they first need to understand fully the issues the United States will bring to the table. Weisel mentioned **Vietnam** WTO accession negotiations were moving smoothly but that the United States was concerned about the bilateral trade agreement, particularly on trading rights.

Weisel also noted that, to her knowledge, USTR is not suffering from "FTA fatigue", and that there is high enthusiasm in Congress on the U.S.-Thai FTA. Weisel opined that the Congressmen who voted against CAFTA-DR see the U.S.-Thai FTA as a chance to reassert themselves as "free traders" and that they will support the FTA provided its terms do not offend their constituents.

OUTLOOK

Weisel's briefing indicates that the U.S. and Thai delegations took positive steps in the last round of negotiations. The strong U.S.-Thai cooperation on several key issues seems to be moving the FTA along. Particularly, gains in IPR and Services issues prove both sides are willing to complete the FTA by 2006. As Weisel noted, however, there are several areas that still need work, and Weisel's failure to mention sugar or trucks – two extremely contentious issues for the Thai FTA – may denote little or no progress in those important areas. The timeline for the FTA's completion is also uncertain, with the United States shooting for Spring 2006 and the Thais thinking Summer-Fall 2006. With the United States pursuing or completing other FTAs, USTR's schedule may prove too ambitious, thereby delaying the Thai FTA's completion. Weisel's point, however, that USTR lacks "FTA fatigue" indicates that the Bush Administration seeks to complete the FTA as soon as possible. Weisel's comments on the other FTAs (and potential FTAs) also indicates that the United States has no intention of limiting bilateral negotiations before December's WTO ministerial in Hong Kong.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

Free Trade Agreements Highlights

House and Senate Committees Hold U.S.-Bahrain FTA Hearings

On September 29, 2005, the U.S. House of Representatives Ways and Means Committee held a hearing to discuss the implementation of the Free-Trade Agreement (FTA) between the United States and Bahrain. On October 6, 2005 the U.S. Senate Finance Committee also held a hearing to review implementation of the United States-Bahrain FTA. Both hearings focused on the positive and negative aspects that the FTA would bring to the United States and Bahrain. The hearing's core issues were: (i) the benefits of the FTA in terms of relations between the United States and the Middle East; (ii) the benefits of the FTA for U.S. businesses in the region; and (iii) the costs of the FTA due to weak labor reform in Bahrain.

The U.S.-Bahrain FTA seems to be receiving support from both government and industry alike. For industry, the FTA opens another market and may turn Bahrain into the "economic gateway" to, and high-technology hub of, the Middle East. Thus, the FTA would allow U.S. businesses to gain access to both the Bahraini and other markets and in the region. For the Government, the FTA's completion is one step closer to creation of the USMEFTA, and the FTA could spur other regional economies to model themselves after Bahrain. Labor issues, however, are still a "sticking point" and may have to be addressed before the Congress will pass the FTA. Depending on how many Congressmen see labor as an important component of the FTA, the Administration's hopes to pass and sign the FTA by the end of this year might be replaced by a 2006 deadline.

United States and Oman Complete FTA

United States Trade Representative (USTR) Rob Portman and Omani Minister of Commerce and Industry Maqbool Bin Ali Sultan announced the completion of the United States-Oman Free Trade Agreement (FTA) today, October 3, 2005. Oman is the fifth Middle Eastern country to negotiate a FTA with the United States. Portman stated that the FTA will "provide a secure, predictable legal framework for U.S. investors operating in Oman, provide for effective enforcement of labor and environmental laws, and protect intellectual property."

Portman noted that the U.S.-Oman FTA is based upon existing agreements with Israel, Jordan, Morocco and Bahrain. He also mentioned that the United States would negotiate a FTA with the United Arab Emirates (UAE).

Completion of the FTA furthers the Bush Administration's goal of creating the United States-Middle East Free Trade Area (USMEFTA) by 2013. The U.S.-Oman FTA is a part of an aggressive FTA schedule that Portman has pursued, and his signal that U.S.-UAE FTA negotiations will soon begin indicates that the Administration does not plan to stem its FTA campaign.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

The full version of the USTR release on the FTA completion is available at http://www.ustr.gov/Document_Library/Press_Releases/2005/October/United_States_Oman_Conclude_Free_Trade_Agreement

United States and Thailand Complete Fifth Round of FTA Negotiations

On September 30 2005, the United States and Thailand concluded the fifth round of Free Trade Agreement (FTA) negotiations in Honolulu, Hawaii. President Bush and Thai Prime Minister Thaksin Shinawatra pledged on September 19 "vigorous efforts to conclude the FTA." The fifth round reflected that pledge, as the parties made significant progress on investment, financial services, and other issues. The teams announced that they will meet in November to continue the negotiations.

The immediate scheduling of another round of negotiations, this round's progress, and both leaders' enthusiasm regarding FTA completion are positive indicators that the United States and Thailand will complete the FTA sooner rather than later. Nevertheless, until the parties resolve sensitive issues, such as sugar, light trucks and truck parts, and intellectual property rights, the timeframe for the FTA's completion is unclear.

U.S.-SACU Negotiations Resume

On September 28-29, 2005, the United States resumed free trade agreement (FTA) negotiations with South African Customs Union (SACU) countries. Negotiations fell apart in 2004 when SACU countries announced their unwillingness to accept U.S. demands on intellectual property rights (IPR), investment, and services. Both the SACU nations (Botswana, Lesotho, Namibia, South Africa and Swaziland) and the United States, however, agreed in July to explore "non-controversial" issues during the September talks focused primarily on industrial tariffs.

SACU went through a similar breakdown with the European Free Trade Association earlier this year, but both parties now appear ready to sign a deal that does not contain provisions on IPR and investments. Although SACU has resumed negotiations with the United States, IPR and investment issues are central to the United States' FTA agenda, and it remains to be seen if the United States will agree to a deal that does not focus on these key issues. The resumption of bilateral negotiations provides further indication that the United States will continue to pursue FTAs in parallel with multilateral negotiations in advance of the December WTO Ministerial in Hong Kong

Senators Urge Elimination of Truck Tariffs from U.S.-Thai FTA

In a September 28 letter to United States Trade Representative (USTR) Rob Portman, 13 senators - including Senate Majority Leader Bill Frist (R-TN) and Ranking Ways and Means Committee Member Max Baucus (D-MT) - urged USTR to eliminate the 25 percent import tariff on pick-up trucks during its negotiations on the U.S.-Thailand Free Trade Agreement (FTA). In the letter, the senators noted that the United States has eliminated truck tariffs in recently completed FTAs, including CAFTA-DR. The senators also expressed concern that if the

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

elimination does not occur in the U.S.-Thai FTA, Thailand "might press to carve out issues the U.S. cares about such as financial services, high technology, and agriculture." The senators also stressed that the tariff is not in line with the United States' general trade policy, and its elimination could help support nearly 500,000 U.S. jobs related to selling international vehicles.

The letter conflicts with a March letter to acting USTR Peter Allegeier in which 36 Democrats and four Republicans called on USTR to remove the truck tariff from the Thai FTA negotiations. These letters provide a clear indication that light trucks and truck parts will likely be a contentious issue during not only USTR's FTA negotiations (with Thailand and other countries), but also Congressional consideration of the completed agreement.

Signatories to the letter were Senators Bill Frist (R-TN), Richard Lugar (R-IN), Max Baucus (D-MT), Jim DeMint (R-SC), Johns Ensign (R-NY), Lamar Alexander (R-TN), Larry Craig (R-ID), Jon Kyl (R-AZ), Kitt Bond (R-MO), Wayne Allard (R-CO), John Sununu (R-NH), Mike Crapo (R-ID), and Conrad Burns (R-MT).

Portman: TPA Expiration will Dictate Future Free Trade Agreements

On October 3, 2005, United States Trade Representative (USTR) Rob Portman stated that any decision to launch free trade agreements (FTAs) with other countries will be based on whether the President can sign the FTAs before his Trade Promotion Authority (TPA) expires in 2007. Portman noted that TPA's reauthorization took nine years and stated that the United States "needs to be cognizant that we have a window here, and that window is until the middle part of 2007 to sign these agreements." The President's negotiating authority, as provided by the Bipartisan Trade Promotion Authority Act of 2002 (19 U.S.C. §3741), is currently set to expire on June 30, 2007.

Portman also discussed the status of ongoing and potential FTA negotiations. He stated that USTR hopes to start **U.S.-Egypt FTA** negotiations, but the United States must first make an assessment of whether the agreement can be signed before TPA expires. Portman noted that members of Congress see "great potential" for a deeper relationship with Egypt through the U.S.-Egypt FTA. Portman also opined that the **Oman FTA** would not meet much congressional resistance because Oman maintains "good labor and environmental standards." On the **U.S.-Bahrain FTA**, Portman stated that he hopes Congress will pass the agreement this year. Portman noted that the United States is still negotiating with the **United Arab Emirates (UAE)** on several issues, and that he hopes the parties can complete the agreement before the end of the year.

Portman's statements on the "TPA window" help explain why USTR has increased the pace and number of FTA negotiations, as USTR may be attempting to complete as many FTAs as possible before TPA (potentially) expires. Portman may also intend his statements to pressure Congress into considering FTAs more quickly than it has in the past. Indeed, as CAFTA-DR demonstrated, delay in a FTAs passage provides the agreement's opposition with valuable time to mobilize and to arm congressional members with reasons to oppose the FTA. Finally, USTR has indicated a willingness to enter into formal FTA talks with Switzerland, Malaysia, and Korea. It remains to be seen, however, if USTR will actively pursue these agreements or table them for

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

a future date, in light of TPA's approaching expiry and the delays that will inevitably occur during the 2006 election cycle.

U.S., China Report Progress in Most Recent Round of Textile Talks

On September 28, 2005, the United States and China completed the third round of textile negotiations, with both sides reporting progress after the first two rounds' failure. Both China and the United States are attempting to create a bilateral agreement that would restrain U.S. imports of Chinese textiles. The latest round of negotiations focused on the calculation of the base import level amount. Although the sides did not reach an agreement, David Spooner, special textile negotiator at the Office of the United States Trade Representative (USTR) stated that both parties "were able to make progress, particularly with product coverage and quota levels." Industry insiders report that the two sides have agreed on 13 products that will be "constrained under the pact."

On October 5, 2005 - a week after the third round's conclusion - the Bush Administration announced that it would consider a request by the U.S. textile industry to renew import limits in 2006 on nine Chinese textile and apparel goods and would also consider a request to impose new import restrictions on four separate products. The industry filed the requests under the China textile safeguard mechanism, which allows World Trade Organization (WTO) members to limit Chinese imports. Under the mechanism, the Committee for the Implementation of Textile Agreements (CITA) will accept petition comments for 30 days followed by a 60-day decision period. CITA will issue, therefore, its decision on the safeguard petitions in January 2006 at the earliest. If the United States and China continue to progress in textile negotiations and reach a bilateral agreement, the terms of the agreement may supersede the safeguard requests.

ITC Finds the 2004 Impact of Andean Trade Preference Act on the United States to be "Negligible"

On October 7, 2005, the United States International Trade Commission (ITC) released its eleventh report on the Andean Trade Preference Act (ATPA), concluding that "the overall effect of ATPA-exclusive imports (those ineligible for other tariff preferences) on the U.S. economy and consumers continued to be negligible in 2004." ATPA provides trade preferences to Colombia, Peru, Bolivia, and Ecuador and was expanded by the Andean Trade Promotion and Drug Eradication Act (ATPDEA) in 2002. ATPA's goal is to promote development of sustainable economic alternatives to drug crop production by offering alternative Andean products more access to the U.S. market.

The ITC report found that total imports from ATPA beneficiary countries in 2004 totaled $15.5 billion, with roughly 55 percent of that total [$8.4 billion] entered under the ATPA. The value of imports entered under ATPA in 2004 rose 43 percent, but the ITC determined that this increase primarily reflected increased imports and prices of petroleum-related products. The report stated that "imports of petroleum-related products and apparel articles accounted for about three-fourths of imports under the program in 2004 and represented 10 of the top 20 U.S. imports under ATPA." The report also listed several U.S. industries that may be experiencing

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

displacement by ATPA imports, including asparagus, fresh-cut roses, chrysanthemums, carnations, anthuriums, and orchids. Although the ITC reported that the overall effect of ATPA imports was negligible in 2004, it found that the growth in imports might indicate that the Andean economies are growing and benefiting from the ATPA. ITC also reported that coca eradication reached a record high and net coca cultivation a record low in 2004, although these were only slight changes from 2003 levels.

The ITC report may have a tangential affect on U.S.-Andean Free Trade Agreement FTA negotiations. Several members of Congress have indicated during the FTA talks that Andean negotiators should not presume congressional renewal of the ATPA in 2006. U.S. trade negotiators may be able to use the ITC report's findings as evidence that the ATPA will expire in 2007 and thereby to pressure Andean negotiators to complete the FTA more quickly.

The report is available on the ITC's website at http://hotdocs.usitc.gov/docs/pubs/332/pub3803.pdf.

Nicaragua Approves DR-CAFTA

On Monday, October 10, 2005, Nicaragua's legislature approved the Dominican Republic-Central American Free Trade Agreement (DR-CAFTA) by a vote of 49 to 37. The Agreement will take effect after Nicaraguan President Enrique Bolanos directs that it be published in the official gazette. Legislators from the ruling Constitutionalist Liberal Party joined with independents to support the measure, which saw opposition from the communist Sandinista Party. DR-CAFTA will eliminate trade barriers between the United States and the Dominican Republic, Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua. Secretary of Industry Azucena Castillo called the Agreement "the first document in 20 years that opens the door to Nicaraguan economic revitalization." DR-CAFTA's opponents, however, suggest that the poorer Central American nations' inability to compete with U.S. imports, especially agricultural products, will drive Central American farmers off their land and lead to overcrowded cities and illegal immigration to the United States.

Monday's passage marks another victory for the Free Trade Agreement that has been the subject of battles in both U.S. and Central American legislatures. Nicaragua, which many thought would not ratify the agreement before it enters into force on January 1, 2006, joins the Dominican Republic, El Salvador, Guatemala, Honduras and the United States in approving DR-CAFTA. Only Costa Rica has yet to ratify the agreement, but the Bush Administration insists that DR-CAFTA will enter into force on January 1 between the countries that have ratified it, regardless of whether all signatories have approved the deal.

U.S. and Malaysia Conclude Third Trade and Investment Framework Agreement Meeting

On October 10, 2005, U.S. and Malaysian trade officials met to discuss automotive market access, intellectual property rights (IPR), and investment issues during the third "Trade and Investment Framework Agreement" (TIFA) meeting. Barbara Weisel, assistant United States Trade Representative (USTR) for Southeast Asia and Pacific Affairs led the U.S.

delegation and Dato Sidek Hassan, Secretary General of Malaysia's Ministry of International Trade and Industry was the Malaysian lead. The bilateral talks covered: (i) improving automotive, financial services, and agricultural market access; (ii) increasing IPR protection; (iii) upgrading customs procedures; and (iv) creating trade-capacity building projects.

The bilateral talks come after USTR Rob Portman's comments that Malaysia is a candidate for a future Free Trade Agreement (FTA) and form a component of the Bush Administration's "Enterprise for ASEAN Initiative," which encourages FTA pursuit with members of the Association of Southeast Asian Nations (ASEAN) who are WTO Members and have signed TIFAs with the United States. The "positive environment" of the meetings provides a positive indication of the United States' willingness to enter into formal FTA negotiations with Malaysia. Moreover, automotive market access and IPR issues would certainly be among the United States' biggest concerns during future FTA negotiations. Progress on these issues under the TIFA, therefore, may provide the United States with evidence of Malaysia's willingness to comply with future U.S. demands.

U.S. and China Fail to Reach Textile Trade Agreement

On October 13, 2005, David Spooner, special textile negotiator with the Office of the United States Trade Representative (USTR), announced that the United States and China failed to reach an agreement on Chinese textile imports during fourth round negotiations in Beijing. Spooner stated that both sides "have not come to an agreement that meets the needs of our domestic manufacturers" through the restraint of U.S imports of Chinese textiles and apparel. In the absence of an agreement, Spooner stated that the United States will continue utilizing safeguards on ten categories of Chinese textiles. A decision on these safeguards investigations is due in November 2005. Representatives from the National Council of Textile Organizations (NCTO) and the American Manufacturing Trade Coalition (AMTAC) attended the negotiations and stated that China "insisted on terms of agreement that were impossible for the U.S. Government to accept and that would have been extremely damaging to the U.S. industry and its workers." A Chinese Foreign Ministry Spokesman responded that "given that Sino-U.S. trade relations are developing so quickly, it's normal for some disagreements and friction to occur." The two sides have not set a date for further negotiations.

The textile negotiations focus on five issues: (i) the number of products that would be restrained under the agreement; (ii) the allowed growth of the restrained imports; (iii) the baseline level of imports that would be used to calculate import growth; (iv) the length of the agreement; and (v) whether the United States would be able to continue using safeguards on Chinese textile and apparel products not covered by the agreement. Industry sources have said that the two sides have agreed on none of the five issues, with agreement length the most contentious aspect. China wants the agreement to last through 2007, but the United States wishes to extend it through 2008. Insiders have reported that China is willing to have the agreement last through 2008 but is seeking "significant concessions" by the United States in return. The negotiations' failure likely means that the United States and China will not reach an agreement by the end of 2005. Depending on the status of Treasury Secretary Snow and Federal Reserve Chairman Alan Greenspan's upcoming talks with Chinese officials on currency issues

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

and Treasury's upcoming release of a report on Chinese currency, the failure to reach a bilateral agreement on Chinese textiles and apparel might spur more anti-China sentiment in Congress.

United States Signs MRAs with Iceland, Liechtenstein and Norway

On October 17, 2005, the United States signed mutual recognition agreements (MRAs) with Iceland, Liechtenstein and Norway on telecommunications equipment, electromagnetic compatibility, recreational craft, and marine equipment. The three countries are members of the European Free Trade Association (EFTA) and the European Economic Area (EEA). United States Trade Representative (USTR) Rob Portman stated that the MRAs "will build upon our successful approaches with the European Union to facilitate transatlantic trade and promote regulatory cooperation." According to USTR, the agreements are very similar to the MRAs that the United States signed with the 25 EU countries. They will allow U.S. laboratories to conduct compliance standards testing on designated products according to EEA EFTA requirements, and vice versa.

The MRAs are just a small part of a packed USTR schedule that has U.S. trade negotiators working diligently on bilateral and regional FTAs, and bilateral agreements and the multilateral WTO negotiations as part of the Doha round. The MRAs provide further indication that USTR will not stop negotiating other agreements to focus on the WTO's December ministerial in Hong Kong and will attempt to conclude as many agreements as possible before the Trade Promotion Authority (TPA) Act expires in 2007.

Substantial Work Remains To Conclude U.S.-Andean FTA

On October 4, 2005, the Council of the Americas held an event featuring Deputy Assistant USTR for Latin America Bennet Harman, one of the U.S. negotiators for the proposed US-Andean FTA.

Mr. Harman focused on the results of the twelfth round of negotiations held in Cartagena, Colombia in September, where the parties finalized the following chapters: (i) technical barriers to trade, (ii) trade capacity building, (iii) safeguards, (iv) transparency, (v) customs procedures, and (vi) financial services. Mr. Harman noted, however, that various issues remain unresolved, including: (i) agriculture, (ii) sanitary and phytosanitary measures, (iii) market access, (iv) rules of origin, (v) services, (vi) investment, (vii) intellectual property rights, (viii) labor, (ix) environment, (x) government procurement, and (xi) telecommunications.

With respect to agriculture, Mr. Harman stated that much work remains, in particular with regards to market access. The labor chapter is also an issue of concern to the United States because Ecuador's labor laws fall short of the International Labor Organization's (ILO) standards. Recently, the United States warned Ecuador that it risks being excluded from the U.S.-Andean FTA if it fails to reform its labor laws.

Mr. Harman concluded by acknowledging that the Andean region is very important for the United States and that the Bush administration is strongly committed to finishing the negotiations before the end of the year. Mr. Harman emphasized that even though the parties

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

have not set a formal deadline for concluding the negotiations, they have a narrow window of opportunity to finish the talks before the administration gears up for the December Hong Kong WTO Ministerial and several of the Andean countries turn their attention to upcoming presidential elections.

Peruvian Ambassador: U.S.-Andean FTA Can Provide Increased Access to Mercosur

On October 19, 2005, Eduardo Ferrero, Ambassador of Peru to the United States, stated that the United States could use its anticipated trade partnership with Peru - as part of the U.S.-Andean Free Trade Agreement (FTA) - to strengthen relations with the Southern Common Market (Mercosur) whose members include Argentina, Brazil, Paraguay and Uruguay. Speaking at a forum at George Washington University, Ferrero also expressed hope that the U.S.-Andean FTA would be completed in November, stating that "it is critical that it be approved as soon as possible" for the FTA to achieve its goals.

The United States is currently negotiating the U.S.-Andean FTA with Colombia, Peru and Ecuador, with Bolivia acting as an observer. Negotiators are meeting in Washington this week to "move talks forward" and have scheduled further negotiations on November 14 with the hope of completing the negotiations before Thanksgiving, November 24. As of October 19, Ferrero noted that eight of 21 working groups have completed their work: customs administration, technical barriers to trade, financial services, and competition policy with work still necessary on market access to agricultural products, textiles, and industrial goods as well as services issues. He also noted the need for the United States to remain flexible because "Andean countries must be able to defend themselves from subsidized U.S. agricultural products." As it stands, the four countries negotiating the FTA with the United States receive limited unilateral trade preferences from the United States under the Andean Trade Promotion and Drug Eradication Act (ATPDEA), set to expire on December 31, 2006. Observers have indicated that note that the FTA is near completion with Colombia and Peru, but that Ecuador's political instability might delay or prohibit its inclusion in the final agreement. Completion of the Andean FTA, with or without Ecuador, will most likely occur before the end of 2005, but Congressional consideration will not begin until 2006, with passage uncertain.

Ecuador Trade Minister: Tough Issues Remain Between Ecuador and the United States

On October 20, 2005, Ecuador's Minister of Trade Jorge Illingworth offered his views on the status of the U.S.-Andean Free Trade Agreement (FTA) negotiations from Ecuador's perspective:

- **Improving Ecuador's Rule of Law**. The U.S.-Andean FTA will benefit Ecuador by providing foreign investors with clear rules and a legal framework. Ecuador has been plagued with political malaise, and the FTA is a unique opportunity to enhance the country's "rule of law' and make Ecuador's public administration more efficient and professional.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

- **Enhancing Ecuador's Competitiveness**. The FTA will allow Ecuador exploit its trade relations with other Latin American countries that have bilateral FTAs with the United States. According to Minister Illingworth, the most important gain from the FTA will be a significant improvement in Ecuador's competitiveness relative to its Latin American neighbors.

- **Tough Negotiating Issues Remain**. Regarding the ongoing trade negotiations, Minister Illingworth noted that the United States and Ecuador have yet to complete negotiations on several tough issues:

    1. *Agriculture*-Ecuador is seeking "balanced treatment" in the agreement due to competitive asymmetries with the United States in the agricultural sector. The Ecuadorian government is seeking to negotiate long phase-out periods and safeguards, and to exclude some "sensitive products" (*e.g.*, rice) in the final agreement.

    2. *Intellectual Property Rights*-Minister Illingworth noted that Ecuador takes this issue very seriously, but it continues to be a contentious area that the parties will probably leave until the end of the negotiations.

    3. *Tuna*-Ecuador is seeking to increase its tuna exports to the United States under the FTA. According to Minister Illingworth, the issue of tuna has nothing to do with market access or negotiated preferences; the core issue is the Rules of Origin (ROO) applied to canned tuna. The United States is offering duty-free treatment only to canned tuna caught by Ecuadorian tuna-fishing vessels. Ecuador - the largest tuna producer among the Andean countries - rejects this approach because it would reduce its exporting capacity by 50 percent. The parties have not yet reached an agreement on this issue.

    4. Labor and Environmental provisions-Minister Illingworth stated that Ecuador and the United States are still trying to reach an agreement on labor and environmental issues.

Minister Illingworth noted that the Andean countries are holding talks with the United States this week and will meet again during the week of November 14, 2005. As it stands, the four countries negotiating the Andean FTA with the United States receive limited unilateral trade preferences from the United States under the Andean Trade Promotion and Drug Eradication Act (ATPDEA), set to expire on December 31, 2006. Observers have indicated that the FTA is near completion with Colombia and Peru, but that Ecuador's political instability might delay or prohibit its inclusion in the final agreement. Completion of the Andean FTA, with or without Ecuador, will most likely occur before the end of 2005, but Congressional consideration will not begin until 2006, with passage uncertain.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

MULTILATERAL

Senate Agriculture Committee Holds Hearing to Review Status of WTO Agriculture Negotiations

SUMMARY

On September 21, 2005, the U.S. Senate Agriculture, Nutrition and Forestry Committee held a hearing to review the status of World Trade Organization (WTO) negotiations on agriculture. Committee Chairman Sen. Saxby Chambliss (R-GA) presided over the hearing. It included **on the record** oral testimony from U.S. Government and business representatives, such as United States Trade Representative (USTR) Rob Portman and U.S. Secretary of Agriculture Michael Johanns. Full text of the witnesses' statements is available at the Senate Agriculture, Nutrition and Forestry Committee website: http://agriculture.senate.gov. We review below these statements.

ANALYSIS

On September 21, 2005, the U.S. Senate Agriculture, Nutrition and Forestry Committee held a hearing to review the status of World Trade Organization (WTO) negotiations on agriculture. With the December's WTO Hong Kong ministerial meeting rapidly approaching, Committee Chairman Saxby Chambliss [R-GA] stated that he was "eager to hear from Secretary Johanns and Ambassador Portman the status of negotiations and what will need to happen in the coming days and weeks to reach a successful outcome." Chambliss also noted that agricultural exports were a dynamic portion of the American economy, and that the "key to future success will be the extent to which countries provide new market access by lowering tariffs, eliminate export subsidies and reducing barriers to trade, namely sanitary and phytosanitary requirements." Chambliss concluded that his "advice and counsel to the Administration is that the United States should not accept a deal in Hong Kong unless it provides tangible and real rewards for [the U.S.] agricultural sector":

- **U.S. Secretary of Agriculture Michael Johanns** outlined U.S. aims in the negotiations, stating the U.S. wanted to "level the playing field for farmers and ranchers" and was seeking "progress in all three pillars of the negotiations: market access, trade-distorting domestic support, and export competition." Johanns stated that export subsidy elimination, trade barrier reduction, and domestic support reduction were the three main goals of U.S. negotiations.

- **United States Trade Representative (USTR) Robert Portman** stated that the United States "will not consider changes to U.S. programs unless the other WTO Members commit to open their markets to U.S. goods and agree to further reduce their own subsidy and trade-distorting programs." Portman also noted his desire to see stronger bipartisan consensus on trade issues that would strengthen U.S. trade policy. Portman stated that free trade

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

agreements (FTAs) between the United States and other countries "build momentum for broader and more comprehensive talks at the multilateral level," and by opening new markets, FTAs can facilitate the movement of goods – including agriculture – across borders. Portman called on the Committee to communicate to farmers and ranchers that terminating domestic agricultural support will serve their long-term interests and highlighted that "negotiations must substantially reduce the disparity that exists between the United States and the European Union on allowed levels of trade-distorting domestic support."

- **Audrae Erickson, Co-Chair of AgTrade** stated that her organization views the current negotiations as the President's most important agenda item. Erickson stated that "generating new farm and food exports has a positive multiplier effect throughout the U.S. economy," and meaningful agricultural achievements at the ministerial meeting ensure continued positive impact. AgTrade's members believe that market access improvement must be a key negotiating objective and Erickson re-asserted the importance of issues such as food aid, elimination of state trading enterprises, and duty and tariff elimination.

- **Allen Helms, Vice Chairman of the National Cotton Council** reiterated the importance that all negotiations be resolved in a "single undertaking" to ensure proper compliance. Helms also stated that "equitable levels of cuts in domestic supports and tariffs will not necessarily result in equitable results in the negotiation if the underlying framework is not equitable" and called on the Committee to ensure that a level playing field would be created between the United States and other countries. Helms expressed concern that "if the United States is able to redefine the blue box [WTO terminology referring to "production-limiting subsidies considered to distort production and trade"] to its satisfaction, some of the lost domestic support could be regained through counter-cyclical payments" but that not all support could be regained, essentially meaning higher loss and higher production limits for farmers.

- **Mark Viso, Vice President of Operations of World Vision** expressed concern that "restrictions on food aid could be adopted that would limit the availability of food aid to help the poor and hungry." Viso stated that U.S. opposition to such restrictions is critical. Viso also stated that WTO Members should not use food aid should as bargaining chip to spur other gains during the negotiations, and that the Administration should keep the needs of the poor in mind during Hong Kong.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

OUTLOOK

The upcoming Hong Kong ministerial will provide the United States with an opportunity to create tangible economic gains for its farmers and ranchers. Negotiators, however, must find a way to communicate to these farmers and ranchers that eliminating domestic support will actually help them in the long-term. Such a campaign could prove even more contentious if the United States' trading partners refuse to eliminate their own subsidy programs to corresponding levels. As USTR Portman noted, the United States' recent string of FTAs might prove beneficial on the multilateral front by establishing solid, friendly ground upon which the United States can negotiate its interests, the most important of which is reducing the disparity between U.S. and EU agricultural subsidy levels. The U.S. FTA partners' provision of such support at the multilateral level (in Hong Kong and beyond) would provide the Bush Administration with evidence that "competitive liberalization" is indeed effective.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

Assistant USTR Discusses Latest Developments in WTO Services Negotiations

SUMMARY

On October 07, 2005 the Coalition of Service Industries (CSI) hosted a conference call with Christine Bliss, Acting Assistant United States Trade Representative (USTR) for Services and Investment. Bliss briefed CSI members on the latest developments in the World Trade Organization (WTO) services negotiations following last week's third services "cluster" meeting in Geneva. We review below her update.

ANALYSIS

On October 07, 2005 CSI hosted a conference call with Christine Bliss, Acting Assistant USTR for Services and Investment. Bliss briefed CSI members on the latest developments in WTO services negotiations following last week's third services "cluster" meeting in Geneva and focused on a negotiations overview, discussion elements, and upcoming events.

Bliss stated the last week's cluster meeting displayed a "high level of engagement on services and a concerted effort to create a work plan" for the December WTO ministerial in Hong Kong. The cluster focused on fleshing out elements of the services work plan, including; (i) a statement on the level of market access ambition; (ii) a package on domestic regulations; and (iii) the status of rules issues discussions. She also stated the cluster worked on a schedule for post-Hong Kong negotiations. Bliss noted that although many friends group meetings had occurred, no bilateral meetings had taken place. She also noted the creation of a new "core" group of services co-chaired by the United States and India and gave a general overview of elements discussed during the meetings:

- **Market Access.** Bliss stated that market access proposals focused on the multilateral process and the building of groups to focus on key issues and sectors. She discussed the EC's mandatory targets proposal and how 80 other countries, led by Brazil, disliked the proposal. This disconnect, Bliss stated, created a rift in the negotiations. Bliss also noted that the United States was trying to "bridge that rift" by listening to both Brazil and EC and working with the group as a whole. She described the set of principles that India had derived as a basis for trade ministers to move forward. Key items included the improvement on existing commitments, the encouragement of a multilateral approach, and the encouragement of Least Developed Countries' (LDCs) participation on target issues. Bliss stated that the principles follow the three levels on which the cluster is presently working: (i) building up on sector-specific issues; (ii) maintaining the bilateral request process; and (iii) working multilaterally. Bliss did note, however, that the EC was "working unrealistically" in its proposal of target percentages for market access. Bliss also noted the appearance of the "plurilateral" approach - a new term for an approach built on work among different friends groups. Canada has taken the lead on the "plurilateral" approach and has proposed that "group requests" be made in addition to individual

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

country requests regarding market access. Bliss stated that while the "plurilateral" approach encourages group cooperation and can work to the United States' advantage, it might not work in certain sectors because of differences in demand and activity.

- **Package on Domestic Regulations**. Bliss stated there were no substantiated discussions on proposals for domestic regulations but did opine that U.S. transparency laws would most likely form the core of the group proposal. She also noted that India had "put the brakes" on negotiations while they assessed the impact of domestic regulations on their own economy. Bliss opined that a concrete statement would not be delivered to the WTO ministerial in Hong Kong, and that the group was working on a general statement.

- **Rules Discussion**. Bliss stated that procurement and subsidies issues are languishing and that safeguards issues are still very political, making it difficult for the group to create a concrete statement. Again, Bliss opined that general language would instead be sent to the Hong Kong ministerial.

- **Post-Hong Kong Schedule.** Bliss mentioned that a negotiations schedule following the Hong Kong ministerial has not been created.

- **Upcoming Events**. Bliss noted that on Monday, October 10, 2005, USTR Portman will make an announcement that the United States is willing to cut domestic farm subsidy support in order to "move negotiations along." Bliss anticipates that there will be an EC backlash and mixed reaction from Capitol Hill. She requested that CSI issue a statement supporting USTR by noting the "good" that could come from the agriculture cuts. She highlighted the Trade Negotiations Committee's (TNC) November meeting and its series of meetings leading up to the December ministerial. Bliss also noted the upcoming Asia Pacific Economic Cooperation (APEC) meeting and how its ministers can support statements presented at the WTO ministerial.

OUTLOOK

Although Bliss highlighted the positive steps taken at last week's cluster meeting, she did point out several barriers that must be overcome. Chief among these is the EC's strict target proposals demand and the rift it has created with Members like Brazil that view the proposal as too demanding. India's proposed set of principles might smooth out some differences, as it may encourage multilateral cooperation. The new "plurilateral" approach might also prove beneficial in fostering consensus, but, as Bliss noted, the approach will only work if enough momentum has been achieved and if every country is on board. Nevertheless, a significant amount of work still remains before the December's WTO ministerial in Hong Kong, and Bliss' comments provide

little reason for optimism that real progress (*i.e.* specific negotiating frameworks, rather than general statements) on services will occur in Hong Kong.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

United States Submits Formal Agricultural Reform Proposal to Move WTO Negotiations Forward

SUMMARY

On October 10, 2005, the Office of the United States Trade Representative (USTR) submitted a formal proposal for multilateral agricultural reforms meant to move World Trade Organization (WTO) agricultural negotiations forward and to "unleash the full potential of the Doha Development Agenda." Portman announced the plan in a Financial Times editorial piece, and the Office of the USTR published the plan's details shortly thereafter. We review here that proposal.

ANALYSIS

On October 10, 2005, the United States announced a two-step agricultural reform package meant to move WTO agricultural negotiations forward. USTR Portman announced the proposal, which calls for the immediate reduction and eventual elimination of agricultural tariffs and farm subsidies, in a Financial Times editorial, and the Office of the USTR published the plan's details shortly thereafter. Stage 1 of the proposal would involve "substantial reductions of trade-distorting support measures and tariffs" and would eliminate export subsidies over a five-year period. Stage 2 would occur after Stage 1's five-year implementation window and would "deliver the elimination of remaining trade distorting policies in agriculture." Portman identified the specific measures that the United States proposes WTO Members undertake in each of the three pillars of agricultural negotiations:

- **Market Access:** The proposal calls for an aggressive tariff reduction, following both the "tiered formula" agreed to in the July 2004 WTO framework and the formula created by the Group of 20 (G-20) developing countries, including India and Brazil. According to the proposal, by 2010, developed countries will: (i) cut their tariffs by 55-90 percent (lowest tariffs cut by 55 percent and highest cut by 90 percent); (ii) establish a "tariff cap" ensuring that no tariff is higher than 75%; (iii) limit tariff-lines subject to "sensitive product" treatment to 1% of total dutiable tariff lines; and (iv) offer lesser cuts and longer phase-in periods for developing countries.

- **Export Competition:** The proposal calls for the rapid elimination of export subsidies as well as the establishment of the following disciplines on other forms of export support by 2010: (i) eliminating all agriculture export subsidies; (ii) establishing disciplines on export credit programs; (iii) installing new disciplines on export State Trading Enterprises that end monopoly export privileges, prohibit export subsidies and expand transparency; (iv) ending discriminatory tax provisions that encourage processed food exports; and (v) establishing disciplines on food aid shipments that guard against commercial displacement.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

- **Domestic Support:** The proposal also calls for significant reduction in trade-distorting domestic support with countries that provide larger subsidies making deeper cuts. The proposal calls for U.S. enactment of the following measures within five years: (i) a 60 percent cut in "Amber box" trade distortionary domestic support; (ii) a cap at 2.5 percent of agricultural production value for "Blue box" support; (iii) a 53 percent reduction in overall trade-distorting domestic support; (iv) reduce "*de minimis"* allowances for trade-distorting support by 50% and (iv) the establishment of a "peace clause" to protect farm-programs should a country keep trade-distorting support below agreed levels.

The proposal calls for the cuts Aggregate Measurement of Support (AMS) of Amber Box payments based on the following parameters:

Bound AMS level (billion U.S. dollars)	**Reduction**
$25 -	83%
$12 - $25	60%
$0 - $12	37%

Under these parameters, the EU and Japan would cut their Amber box domestic support by 83 percent. According to the United States, "This provides for a more equitable balance by reducing the disparity in allowed AMS between the United States and the EU from a ratio of 4:1 to a ratio of 2:1."

The U.S. proposal also calls for the *overall* reduction in trade-distorting domestic support (*i.e.* the sum of the allowed level of the amber box, blue box, product-specific *de minimis,* and non-product-specific *de minimis*) based on the following parameters:

Overall allowed level (billion U.S. dollars)	**Reduction**
$60 -	75%
$10 - $60	53%
$0 - $10	31%

Under these parameters, the EU and Japan would reduce overall trade distorting support by 75 and 53 percent, respectively.

In outlining the proposal, Portman stated "the United States is committed to breaking the deadlock in multilateral talks on agriculture, and unleashing the full potential of the Doha

Round," and that "the U.S. offer is conditional on other countries reciprocating with meaningful market access commitments and subsidy cuts of their own."

OUTLOOK

The U.S. proposal follows the Doha Development Agenda's July 2004 Framework and demonstrates the United States' willingness to move negotiations along at the expense of politically sensitive domestic issues. Indeed, Congressional sources indicate that Portman spent weeks working with Congressional leaders to determine the political limits on subsidy reductions and elucidate what other WTO Members must concede for the deal to garner congressional approval. In that regard, Portman has stated that the United States will only make cuts if its negotiating partners reciprocate. WTO Members' trade negotiators have responded favorably to the U.S. proposal and view it as a significant first step to a final agriculture deal. EU Trade Commissioner Peter Mandelson welcomed the proposal and promised that the EU proposal, due later this week, will go even further than the U.S. cuts. This momentum, however, could be derailed by a memorandum insisting that EU trade negotiators consult with Member States prior to offering any multilateral farming concessions. French agricultural minister Dominique Bussereau circulated the memorandum, and 13 EU Member States, including Italy, Ireland and Spain, have signed in support. Portman has invited 15 WTO members, including the EU, Australia, Brazil and Canada, to a special session in Zurich to vote on the U.S. proposal. The three-day session of intense trade negotiations begins today with the goal of breaking the current impasse in farm talks.

A USTR Fact Sheet that outlines the proposal is available on the USTR website at: http://www.ustr.gov/assets/Document_Library/Fact_Sheets/2005/asset_upload_file636_8128.pdf.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

European Union Submits Conditional Proposals during Zurich Multilateral Trade Negotiations

SUMMARY

On October 10, 2005, European Union (EU) Trade Commissioner Peter Mandelson released the EU's conditional negotiating proposals for the World Trade Organization (WTO) Doha Development Round. The proposals were circulated to Ministers at the WTO Doha Round Informal Ministerial in Zurich. Mandelson noted that the proposals are entirely contingent on reciprocity from other parties. We review below the EU's proposals.

ANALYSIS

On October 10, 2005, EU Trade Commissioner Peter Mandelson released the EU's conditional negotiating proposals for the WTO's Doha Development Round. The proposals were circulated to Ministers at the WTO Doha Round Informal Ministerial in Zurich to be discussed during the next two weeks. Mandelson stated that the proposals are entirely contingent on reciprocity from other WTO Members, and that there must be "real offers providing forward movement." The EU's proposals focused on: (i) domestic support in agriculture; (ii) market access in agriculture; (iii) a maximum agricultural tariff; and (iv) minimum recourse to sensitive agricultural products. The proposals also included non-agriculture market access (NAMA), services, and development issues, but Mandelson noted that "agriculture is the engine for an ambitious and balanced result at [the December WTO ministerial in] Hong Kong."

- **Domestic Agricultural Support:** The EU proposed to provide a 70 percent cut in its Aggregated Measurement of Support (AMS), also known as "Amber box" support, with an additional 65 percent reduction in '*de minimus*' support. It also proposed possible reductions in maximum agreed levels of "Blue box" payments. On this issue, Mandelson indicated that the EU's "negotiating flexibility on that ceiling is limited, but [that] there is some room."

- **Market Access:** Mandelson stated that the EU has accepted the Group of 20's (G20) proposal of 'non-linear bands with linear cuts' with four bands for developed countries in which the top band would contain all tariffs higher than 90 percent.

- **Maximum Agricultural Tariff:** Mandelson also noted that the EU is prepared to accept a 100 percent cap for all agricultural tariffs for developed countries (with a 150 percent cap for developing countries).

- **Sensitive Products:** Regarding sensitive products, Mandelson stated that "the greater the flexibility given in linear tariff cuts in each band, the fewer total number of sensitive products it would seek." Mandelson noted that it would be important to negotiate whether sensitive products would be treated

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

through tariff reductions and Tariff Rate Quotas (TRQs) "which would secure market access in these areas."

- **Export subsidies:** Mandelson stated that the EU is committed to ending all export subsidies and is ready to negotiate a phase-out schedule. He did note, however, that "the elimination of [the EU's] export subsidies must be matched by the removal of other trade-distorting practices in export competition" especially by Canada, Australia, New Zealand and the United States.

- **NAMA:** Mandelson stated that the EU "seeks to achieve an understanding on full modalities for market opening in Hong Kong" on NAMA issues. The EU proposed that industrial tariffs be capped at 10 percent using a Swiss Formula. Mandelson noted that the EU is ready to extend the principle of less than full reciprocity to other developing countries with an understanding that this would open more market access.

- **Services:** Mandelson noted that services negotiations had been ineffective and were languishing. The EU proposed to establish certain minimum numbers of sectors to be covered and to produce schedules as aspirational benchmarks.

- **Antidumping:** Mandelson stated that "the objective of the DDA negotiations in this area must be to ensure that reductions in tariffs are not frustrated by inappropriate recourse to antidumping, and to ensure that antidumping duties do not remain in force longer than is justified." The EU is proposing that the negotiators should agree on the most important problems for the December ministerial and on broad guidelines in treating them.

- **Development:** The EU proposed implementation of its "Everything But Arms" program, which would extend tariff- and quota-free access to all imports, except weapons, from LDCs. Mandelson also reiterated the EU's support for a "Round for Free" for LDCs, in which developed countries would make asymmetrical tariffs cuts without a reciprocal cuts from LDCs.

OUTLOOK

The list of proposals offered by Mandelson hit all the major targets on which the Zurich meeting ministerial focused. The 70 percent AMS cut proposal followed the United States' October 10 proposal and indicates that the EU is ready to make substantive advances in the stalled multilateral agriculture negotiations. On the other hand, the lack of a substantive figure for 'blue box' cuts in the EU proposal might become a "sticking point" during negotiations, and the EU's 70 percent "amber box" reduction proposal is lower than both the United States and the influential G20 bloc of developing countries would like. Moreover, the EU must make a specific

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

proposal on market access before any real negotiations can begin, as the issue is the key to U.S. cooperation and reciprocity on domestic support. Until the EU makes such a proposal, Mandelson and the other ministers in Zurich will likely be unable to complete the agriculture agenda before the Hong Kong Ministerial in December, dealing the ministerial – and the Doha Round more generally- a significant blow.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

WTO Panel Finds Certain Mexican Taxes on Soft Drinks and Sweeteners Are Inconsistent with Mexico's National Treatment Obligations Under the GATT

SUMMARY

A WTO panel has found that certain Mexican taxes on soft drinks and sweeteners are inconsistent with Mexico's national treatment obligations under the GATT. The Panel rejected Mexico's argument that its measures were necessary to secure compliance by the United States with U.S. obligations under the NAFTA.

ANALYSIS

The decision of the Panel in *Mexico - Tax Measures on Soft Drinks and Other Beverages* (DS308) was released on October 7, 2005.

I. National Treatment Claims

This dispute concerned tax measures imposed by Mexico on soft drinks that used sweeteners other than cane sugar. (According to the United States, in Mexico, cane sugar is "almost exclusively a domestic product.") The United States challenged three measures:

- a twenty per cent "soft drink tax", imposed on the transfer or importation of soft drinks that used any sweetener other than cane sugar;
- a twenty per cent "distribution tax", imposed on services for transferring soft drinks that used sweetener other than cane sugar; and
- the "bookkeeping requirements" (with respect to matters such as the consumption of the goods and the corresponding tax) which were imposed on taxpayers subject to the soft drink tax and the distribution tax.

The United States argued that these measures were inconsistent with the national treatment obligations of Mexico under GATT Article III. Mexico elected not to respond to the U.S. national treatment claims, and to base its defence exclusively on GATT Article XX(d), as discussed below. The Panel nonetheless examined the impugned measures and concluded they were inconsistent with GATT Article III.

The Panel considered the U.S. claims under Article III:2 (which prohibits additional charges on imports in excess of those imposed on domestic like products) and Article III:4 (which prohibits "non charge" forms of discriminatory treatment against imports).

Article III:2 provides in part that:

> The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

> taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products.

The Panel found that the soft drink tax and the distribution tax were inconsistent with this provision, as imported U.S. beet sugar, soft drinks and syrups were subject to internal taxes in excess of those applied to like domestic sweeteners.

Article III:2 also provides that no WTO Member shall otherwise apply internal taxes or other internal charges to imported or domestic products so as to afford protection to domestic production. The Panel found that U.S. corn syrup was being "taxed dissimilarly" compared with the directly competitive or substitutable products, so as to afford protection to the Mexican domestic production of cane sugar.

Article III:4 states in part that:

> The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use.

The Panel found that U.S. beet sugar and corn syrup were accorded less favourable treatment than that accorded to like products of national origin. It also ruled that under Mexico's bookkeeping requirements, the affected imports were accorded less favourable treatment than that accorded to like products of national origin.

II. Mexico's measures not "necessary to secure compliance" with laws or regulations

Panel rejects Mexico's preliminary ruling request to decline jurisdiction

As a preliminary matter, Mexico had asked the WTO Panel to decline to exercise its jurisdiction in the case, in favour of the Arbitral Panel established under the NAFTA. The Panel rejected Mexico's request on the grounds that under the WTO Dispute Settlement Understanding, it did not have the discretion "to decide not to exercise its jurisdiction in a case that has been properly brought before it." It added that even if it had such a discretion, it did not consider that the circumstances of this case would justify declining to exercise its jurisdiction.

Mexico seeks to induce U.S. compliance with NAFTA

GATT Article XX allows certain exceptions to GATT obligations. Article XX(d) provides in part that nothing in the GATT shall "prevent the adoption or enforcement by any contracting party of measures...necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement...."

Mexico argued that its tax measures were justified under GATT Article XX(d) as measures "necessary to secure compliance" by the United States with U.S. obligations under the

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

NAFTA. Mexico claimed that its measures were intended to secure U.S. compliance with its obligations established in a treaty authorized by Article XXIV of the GATT 1994 and, to that extent, was justified under Article XX(d) of the GATT 1994. Mexico described the taxes as "temporary and proportionate measures" intended to induce the United States to comply with its NAFTA commitments regarding market access conditions for Mexican sugar.

International countermeasures not within the scope of measures to "secure compliance"

The Panel said that "to secure compliance" meant "to enforce compliance." It reasoned that Article XX(d) addressed compliance with "laws or regulations", and that these "characteristically concern obligations rather than requests", as "compliance is secured by enforcement through the use of force by the authorities, if necessary."

By contrast, the Panel said the context of Mexico's action was "essentially international." It said that countermeasures had "an intrinsic inter-state character, and there is no concept of private action against a state being justifiable on this basis." It stated that the notion of enforcement "contains a concept of action within a hierarchical structure that is associated with the relation between the state and its subjects...which is almost entirely absent from international law." The panel noted that the "possibility for states to take countermeasures, that is, to try by their own actions to persuade other states to respect their obligations, is itself an acknowledgment of the absence of any international body with enforcement powers."

As context, the Panel also pointed to the references in Article XX(d) to customs, monopolies, patents, trade marks, copyright and deceptive practices, which were "in essence matters regulated under domestic law."

The Panel therefore concluded that the phrase "to secure compliance" in Article XX(d) did not apply to "measures taken by a Member in order to induce another Member to comply with obligations owed to it under a non-WTO treaty."

Applying these principles to Mexico's measures, the Panel stated that when enforcement action is taken within a Member's legal system, there was "normally no doubt...that it will achieve that target." By contrast, "the effectiveness of [Mexico's] measures in achieving their stated goal - that of bringing about a change in the behaviour of the United States - seems to the Panel to be inescapably uncertain."

Mexico had argued during the proceedings that its measures had the effect of "attracting the attention" of the United States. The Panel stated that "[a]ttracting the attention of a Member is not equivalent to securing compliance of that Member with a law or regulation." The Panel said that the outcome of international countermeasures, such as those adopted by Mexico, were "inherently unpredictable", and that they were "therefore not eligible to be considered as measures 'to secure compliance' within the meaning of Article XX(d)." The Panel added that the fact that the measures afforded protection to Mexico's domestic production undermined Mexico's claim that its measures were designed to secure compliance with laws or regulations.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

For these reasons, the Panel concluded that Mexico had not demonstrated that the challenged tax measures were designed "to secure compliance with laws or regulations" within the meaning of Article XX(d).

III. Significance of Decision /CommentarySugar is one of the most contentious sectors in the Mexico-U.S. trading relationship, and this WTO case is one of numerous dispute settlement proceedings that have occurred under both the WTO and the NAFTA.

The current WTO proceedings arose from taxes imposed by the Mexican Congress in 2002, in response to what Mexico claimed was:

(i) the U.S. failure to comply with its NAFTA obligations for trade in sugar. Mexico argued that the United States restricts access to the U.S. market for Mexican sugar in manner inconsistent with U.S. NAFTA obligations; and

(ii) the U.S. refusal to submit the case to NAFTA dispute settlement. Although Mexico requested the establishment of a NAFTA Panel in August 2000, this Panel has still not been composed, as the United States has refused to engage in the required panel selection process.

Before the WTO Panel, Mexico did not contest the U.S. claims that the tax measures were inconsistent with Mexico's national treatment obligations under GATT Article III. Instead, Mexico pointed to GATT Article XX(d), which allows WTO Members to take measures "necessary to secure compliance" with GATT-consistent "laws or regulations." In Mexico's view, the NAFTA was a GATT-consistent law with which it sought compliance by the United States. Mexico argued before the WTO Panel that "WTO agreements cannot be considered in technical isolation from international law."

The Panel rejected this Mexican defence, reasoning that the phrase "to secure compliance" did not apply to "measures taken by a Member in order to induce another Member to comply with obligations owed to it under a non-WTO treaty." In the Panel's view, the "laws" referred to in this provision were domestic laws, for which compliance could be enforced. By contrast, the use of international countermeasures, such as those contemplated by Mexico, were "inherently unpredictable." The Panel found that the Mexican measures breached Article III, and that the Article XX(d) exemption did not apply.

This case highlights the comparative advantages of the WTO over the dispute settlement systems established under some regional trade agreements such as NAFTA. NAFTA provides that a trilaterally-agreed roster of panellists was to have been established by January 1, 1994, and set out a mechanism for automatic selection of panellists from the roster in the event of disagreement between the disputing parties. However, this roster has never been established, which means that panellists for NAFTA Chapter Twenty disputes must be agreed on a case-by-case basis. If a party refuses to appoint panellists in an individual dispute - as the United States has done in the current Mexico-U.S. sugar dispute - then the NAFTA has no mechanism to break the deadlock. This left Mexico with no means under the NAFTA to address its NAFTA claims. By contrast, the WTO provides for the appointment of panellists by the Director General

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

if the disputing parties cannot agree on the names. The type of institutional paralysis that has occurred in the NAFTA sugar dispute could not occur in the WTO.

* * *

For further information, please contact Brendan McGivern in Geneva (bmcgivern@whitecase.com). Thank you.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

WTO Compliance Panel Finds U.S. Jobs Act WTO Inconsistent in FSC Case

SUMMARY

A WTO "compliance panel" has found that the United States has failed to implement the WTO rulings in the longstanding EC-U.S. dispute over tax breaks provided through U.S. "Foreign Sales Corporations" (FSCs). The United States had argued that the *American Jobs Creation Act of 2004* (the "Jobs Act"), which was passed by the U.S. Congress last year, had eliminated the WTO-inconsistent subsidies to U.S. exporters. However, the compliance panel found that as a result of the transitional and "grandfathering" provisions of the Jobs Act, the United States remained in breach of its WTO obligations. Unless reversed on appeal, this decision clears the way for the re-imposition of up to U.S. $4 billion of trade sanctions on U.S. imports into the EU.

ANALYSIS

The decision of the compliance panel in United States - Tax Treatment for "Foreign Sales Corporations": Second Recourse to Article 21.5 of the DSU by the European Communities (DS108) was released on September 30, 2005.

I. Background

In 2000, the original panel in this dispute found that the FSC legislation provided prohibited export subsidies, in breach of the WTO *Agreement on Subsidies and Countervailing Measures* (SCM Agreement), and violated the export subsidy disciplines of the *Agreement on Agriculture*. These findings were upheld by the Appellate Body.

In November, 2000, the U.S. Congress passed the *FSC Repeal and Extraterritorial Income Exclusion Act of 2000* (the "ETI Act"), which the United States claimed fully implemented the WTO rulings. The ETI Act included transition and grandfathering provisions for certain transactions of existing FSCs. In 2001, an Article 21.5 compliance panel found that the ETI Act failed to implement the WTO rulings, a finding upheld by the Appellate Body in 2002.

The 2004 Jobs Act provided for the repeal of the income tax exclusion provisions of the ETI Act, although it retained certain transitional and "grandfathering" provisions, as described below.

II. Analysis

Basis for EC challenge: "transition" and "grandfathering" provisions

The EC argued that two provisions of the Jobs Act were WTO-inconsistent:

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

- the "transition provision", which provides for a two-year continuation of a percentage of ETI benefits (80 per cent in 2005 and 60 per cent in 2006); and

- the "grandfathering provision", which exempted certain transactions (those entered into before September 17, 2003) indefinitely from the repeal of the ETI scheme.

The "guiding principles" for the compliance panel process: original DSB rulings "remain operative"

Under Article 21.5 of the WTO Dispute Settlement Understanding (DSU), a compliance panel has the mandate to rule on the WTO-consistency of the "measures taken to comply" with the original DSB rulings.

The panel in the present dispute set out certain "guiding principles" that apply under DSU Article 21.5. Among other things, it said that a "measure taken to comply" within the meaning of Article 21.5 may "be different from the original measure, and inconsistent with WTO obligations in ways different from the original measure." However, it stressed that:

> While the *measures* may change from the original to the compliance proceedings, the obligation to implement the DSB recommendations and rulings *does not*. A "measure taken to comply" should be *fully consistent* with a Member's WTO obligations. In terms of prohibited subsidy disputes, this requires the withdrawal of the prohibited subsidy. A Member's obligation to withdraw a prohibited subsidy is constant. It remains until *full* implementation of the DSB recommendations and rulings is achieved. [original emphasis]

It added that Article 21.5 compliance panel proceedings formed part of a "continuum of events", with "the operative recommendations and rulings for the purposes of Article 21.5 compliance proceedings being those adopted by the DSB in the *original* proceedings. These remain operative through compliance panel proceedings under Article 21.5 of the DSU until the 'problem' is entirely 'fixed', in terms of *full* withdrawal of the prohibited subsidy [original emphasis]."

A "never-ending cycle" of compliance periods would "entirely undermine" the WTO dispute settlement system

The Panel therefore rejected the U.S. argument that in order for the United States to be under an obligation to withdraw the relevant parts of the ETI Act, it would have been necessary for the previous Article 21.5 compliance panel to have made a new recommendation to withdraw the ETI Act. The compliance panel asked: "Why would it be necessary for a panel to again tell a Member to remove a situation of WTO-inconsistency that it has already been told to remove?"

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

The compliance panel also reasoned that a new recommendation by an Article 21.5 panel would give an additional time period to the implementing party to bring itself into compliance. It rejected the notion of "repeated extensions of the implementation period" through compliance panel proceedings. It concluded that "[s]uch an approach might lead to a potentially never-ending cycle, whereby a Member continues to adopt non-compliant measures in order to win more time to comply with adopted DSB recommendations and rulings." In the view of the compliance panel, this would "entirely undermine the effective operation of the WTO dispute settlement system."

U.S. obligated to comply with the DSB rulings in the original dispute

Applying these "guiding principles" to the facts of this case, the compliance panel noted that the operative DSB recommendations and rulings within the meaning of DSU Article 21.5 were those adopted by the DSB in 2000 in the original dispute. In the view of the compliance panel, these remained operative throughout the first compliance panel proceedings on the ETI in 2001/2002, and continued to apply in the present proceedings on the Jobs Act.

The compliance panel recalled the U.S. position that no obligation was imposed on the United States to withdraw the prohibited ETI scheme because the 2001/2002 Article 21.5 panel process had not made a new recommendation to withdraw the ETI Act. The current compliance panel rejected this U.S. argument on the basis that the operative recommendations and rulings remained those adopted by the DSB in the original proceedings in 2000. It stressed that, "[i]n a prohibited subsidies case, the obligation upon a WTO member to implement original DSB recommendations and rulings does not disappear until that Member has fulfilled the obligation by *fully* withdrawing a prohibited subsidy [original emphasis]."

U.S. transitional and "grandfathering" provisions maintain the WTO-inconsistencies

The compliance panel considered the "transitional" provisions of the Jobs Act, under which ETI benefits remain available throughout 2005 and 2006 (although at reduced percentages) and indefinitely in the case of certain transactions. It stated that the WTO-inconsistencies remained.

It also pointed to the "indefinite grandfathering of the original FSC subsidies for certain transactions", through the continued operation of a provision of the ETI Act. The compliance panel stated that, "[i]n substance, these are the very same prohibited export FSC subsidies" found to be WTO-inconsistent in the original dispute. Furthermore, "in both substance and form, these are the very same ETI Act provisions grandfathering the original prohibited export FSC subsidies" found to be WTO-inconsistent in the 2001/2002 compliance panel proceedings. It said that the United States had confirmed that nothing in the Jobs Act had modified, "implicitly or explicitly", these transitional rules for FSC subsidies.

The compliance panel also emphasized that this WTO obligation to withdraw prohibited subsidies was unaffected by contractual obligations that a Member may have assumed under its domestic law. It added that this WTO obligation similarly could not be affected by "contractual

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

arrangements which private parties may have made in reliance on laws conferring prohibited export subsidies."

Therefore, the compliance panel concluded that to the extent that the United States maintained prohibited FSC and ETI subsidies through transitional and grandfathering measures, it "continues to fail to implement fully the operative DSB recommendations and rulings with withdraw the prohibited subsidies" and to bring the measures into conformity with U.S. WTO obligations.

III. Significance of Decision/Commentary

There was little doubt that the U.S. legislation at issue in this case would be found to be WTO-inconsistent. The 2004 Jobs Act specifically retained certain provisions that the Appellate Body had already found to provide illegal subsidies. The Act retained these measures either on a temporary basis (through transitional provisions) or indefinitely (through "grandfathering").

The retention in the new legislation of these WTO-inconsistent measures left the United States virtually without a defence in the compliance panel proceedings. Indeed, the principal U.S. argument in this dispute was a procedural one, that it was under no obligation to withdraw the WTO-inconsistent subsidies because an earlier (2001/2002) compliance panel process had not resulted in a recommendation to the United States do so. However, the current compliance panel found that the operative WTO rulings dated back to the original dispute, in 2000. Once this procedural U.S. defence had been rejected, the compliance panel concluded that the United States was in continuing breach of its obligation to remove the WTO-inconsistent subsidies.

The "FSC" provisions of the U.S. Internal Revenue Code are among the most extensively-litigated provisions in the history of WTO dispute settlement. (FSCs are subsidiaries of U.S. companies that conduct export sales on behalf of their U.S. parents. The FSC provisions of U.S. law establish a complex system of tax relief for U.S. companies involved in export activities). Leaving aside the GATT antecedents, there have been six WTO decisions to date on the FSC scheme. Yet this dispute is no closer to resolution, and it remains one of the most difficult and contentious issues in the U.S.-EC trading relationship.

In fact, the EC has already been granted authorization by the WTO to impose "appropriate countermeasures", or trade sanctions, against the United States for its failure to comply with the original WTO rulings. A 2002 arbitral panel authorized the EC to impose retaliation worth up to U.S. $4.043 billion per year, the single largest retaliation award ever granted by the WTO. The EC began imposing sanctions in 2004, but then suspended its retaliation in early 2005, pending the completion of the current compliance panel process on the WTO-consistency of the Jobs Act. The EC Council Regulation that suspended the retaliation provides that the trade sanctions will be re-imposed on January 1, 2006, or 60 days following the adoption of any compliance panel/Appellate Body report finding that the Jobs Act failed to comply with U.S. WTO obligations.

Thus, absent an appeal, this decision returns this dispute from the legal to the political arena. The compliance panel decision will anger many in the U.S. Congress, as U.S. legislation

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

on this issue has now been rejected three times by the WTO. At the same time, few in the EC will welcome the prospect of imposing $4 billion in trade sanctions on U.S. imports, which could potentially impose as much economic pain on European economies as it would on the United States. It seems very likely that the United States will appeal this decision, and an appeal will remove this as an immediate, front-burner U.S.-EC political issue in the critical weeks before the Hong Kong Ministerial Meeting in December.

* * *

For further information, please contact Brendan McGivern in Geneva (bmcgivern@whitecase.com). Thank you.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

Pascal Lamy Assumes Leadership of the Doha Round; WTO Members Intensify Preparations for Hong Kong Ministerial

SUMMARY

In his first month as Director General of the WTO, Pascal Lamy has made it clear that his entire focus in the lead-up to the Hong Kong Ministerial Conference on 13-18 December will be on the preparations for that meeting, which he has called "the last and best chance" to conclude the Doha Round by the end of 2006. Many routine meetings of WTO committees have been suspended to permit full concentration on the Round, and the agriculture negotiators have been put permanently "on call" for continuous negotiations. The sense of urgency is strong, but there is no clear sense yet of the way through to success in Hong Kong.

ANALYSIS

I. Recent Developments in the Doha Development Round

The Trade Negotiations Committee

Mr. Lamy has taken up the Chair of the Trade Negotiations Committee (TNC), which will certainly become a more effective instrument for management of the Round as a result. In the TNC and elsewhere he has identified objectives to be agreed at Hong Kong : in agriculture, a termination-date for export subsidies and figures for "slashing" trade distorting domestic support and improving market access; in NAMA, figures that will produce substantial cuts in tariffs on manufactures; in services, new approaches leading to more and better commitments. In dumping and subsidies, draft agreements should "as near as possible" be negotiated by Hong Kong. He has laid great stress on the development aspect of the Round: at the Annual Meeting of the IMF and the World Bank he called for an Aid for Trade Initiative to increase trade-related technical assistance to least-developed countries. Lamy held out the possibility of a draft Ministerial Declaration being tabled in mid-November. Ideally this would contain negotiated, though not final, texts on all subjects under negotiation. In mid-October an overall evaluation of progress will be made.

Agriculture

Objectives

At the September meeting of the TNC, DG Lamy defined the key goal for the agriculture talks in the Hong Kong Ministerial as being agreement on full "modalities". The modalities would set out the core elements of a final agreement on agriculture i.e. the formulae and figures for reducing tariffs, farm subsidies and other forms of support. Lamy noted that reaching agreement on modalities would require Members to make the following decisions pertaining to each of the three pillars of the negotiations:

- **Export Competition:** Members will need to set an end date for elimination of export subsidies and disciplines for other forms of domestic support.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

- **Domestic Support**:

  - *Figures for reduction commitments*: Members will need to agree on the figures and tiered formula for reduction of the final bound total "Aggregate Measurement of Support" (AMS).

  - *Clarification of disciplines on the use of "blue box"*[4] *subsidies*: Additional disciplines on blue box subsidies are particularly important for the U.S., which is looking to ensure that the billions of dollars that it pays out to U.S. farmers in the form of counter-cyclical payments can be categorized under the blue box.

- **Market Access**: This is the most contentious area of the discussions and also one where minimal progress has been achieved.

  - *Figures & Formulae for Reduction Commitments*: Members are looking to agree upon a tiered tariff reduction formula and the number of bands under the formula.

  - *Treatment of "sensitive" and "special products"*[5]: Members have yet to decide on the identification of sensitive and special products and the type of safeguard mechanism that may be allowed to stem surging imports.

Latest Developments

The latest round of agriculture negotiations took place in Geneva the week of September 12-16. No new initiatives were put forward; the talks focused more on process rather than on substantive issues. In particular, the Chair of the negotiations, Ambassador Crawford Falconer of New Zealand, asked Members to reflect on three questions, crucial for determining the direction and pace of the talks:

- Whether a comprehensive approach should replace an incremental issue-by-issue approach, so that Members could consider a range of issues at the same time?

- Should such an approach include talks on the level of ambition in modalities such as numbers for reducing tariffs and subsidies, and if so, when should these discussions begin?

[4] The "Blue box" exempts WTO Members from the rule that all agricultural subsidies linked to production must be reduced or be kept within defined *de minimis* levels.

[5] Developing country members will have the flexibility to designate an appropriate number of products as "special products" based on criteria such as food security, livelihood security and rural development needs.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

- What are the linkages between the three agricultural negotiating pillars and non-agricultural issues on the Doha round agenda, and when should this issue be discussed?

The Chair announced that Members were increasingly becoming open to adopting a more comprehensive approach to the negotiations rather than examining issues in isolation. Such an approach would include talks on the overall ambition of the negotiations as well as on the trade-offs that may be required between agriculture and non-agricultural issues. A shift in approach on the part of Members would indeed mark a much-needed turning point in the negotiations.

The beginning of discussions between the EU and U.S. towards the resolution of their differences on key negotiating issues marks another noteworthy development in recent weeks. EU-U.S. differences have served as one of the key impediments to progress in the agriculture talks. The U.S. has been particularly defensive on the reduction of domestic support while the EU has been resistant to committing on market access concessions. A reconciliation of EU-U.S differences is crucial, as real progress in the talks will depend on key political inputs from these two key players rather than through continued technical discussions in Geneva. Ambassador Falconer has put the Committee permanently "on call" for continuous negotiations, but has made it clear that a political lead is needed, essentially from the EU and the U.S.

In Paris on 22-24 September a series of meetings on agriculture took place at Ministerial level. Discussions between the EU and the U.S. were followed by meetings of the Quad and later of the "Five Interested Parties", which also include Australia. Argentina, Canada, China, Malaysia and Switzerland joined the talks on 24 September. Ambassador Falconer attended the meetings. They were said to be substantive and useful; several new proposals on the tariff reduction formula were exchanged.

Since the Paris mini-Ministerial meeting, delegates have been engaged in intense negotiations on the different scenarios for reduction in tariffs and domestic support. We provide below an overview of the most significant developments in these talks:

A. Domestic Support

Differences persist over domestic support, on which the US is under pressure from the EU and other WTO members to make concessions.

EU	US
In an informal proposal the EU has offered to reduce its overall domestic support by 65% from its current WTO permitted ceiling of $80.1 billion per year. According to the EU proposal, the EU and Japan standing at the first tier would make the deepest cuts in their **total bound level of Aggregate Measure of Support (AMS)** (65%), followed by the U.S. at the second tier (55%), other industrialized countries at the third tier (45%) and	The U.S. calls for enactment of the following measures within five years: (i) reduce **overall permissible levels of trade-distorting support** by 53% for the U.S., 75% for the EU and 53% for Japan. (ii) cut in total bound level of **Aggregate Measure of Support** (AMS) by 60 percent for the U.S., and 83% for the EU and Japan; (iii) a cap at 2.5 percent of the value of agricultural production for **"Blue box"** support; (iv) reduce ***"de minimis"***

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

finally developing countries at the fifth tier (30%).	allowances for trade-distorting support by 50% and (v) the establishment of a **"peace clause**" to protect farm-programs should a country keep trade-distorting support below agreed levels.

B. Market Access

The EU is not willing to accept the US proposal on market access which it considers could lead to cuts at least as deep as those under earlier US proposals based on the harmonizing "Swiss formula" (which cuts higher tariffs more steeply).

	EU	US	G-20 and other groups
Tariff Reduction	The EU presented **four scenarios** or "outline proposals" which set out the degree to which the EU is willing to cut tariffs while maintaining flexibility to protect sensitive products. The EU based the scenarios on a paper presented by the G-20 countries at the Dalian mini-ministerial earlier this year, which proposes four tariff reduction bands, with countries required to make deeper cuts on tariffs falling under the higher bands. The average reductions in the four scenarios ranged from **24.5 to 36.4 percent**. Developing countries would be allowed to make cuts two-thirds the size of those made by developed countries for	The US has presented a **single scenario** with significantly higher cuts, ranging between **55 percent and 90 percent** depending on the level of the current tariff.	The G-20 countries are planning to refine their proposal at an October 10 meeting in Zurich. Developed country members of the Cairns Group, on the other hand, supported the US proposal.
Tariff Ceilings	The EU accepts the G-20 proposal.	The US proposes capping developed country tariff lines at 75 percent and developing countries at 100 percent.	The G-20 countries have proposed capping developed country tariff lines at 100 percent and those of developing countries at 150 percent.

Additional Flexibility	The EU proposed adding "pivots" to the formula, which means that tariffs on some products could be reduced by less than the standard percentage cut within a band if this was compensated by a higher-percentage cut for other products within the same band.	The US proposed a harmonizing element that would see progressively increasing tariff cuts on products from the low to the high end of each band.	
Sensitive Products	The EU perceives a trade-off between the extent of flexibility in the form of pivots and the number of items it would seek to designate as "sensitive products", which would be subject to tariff cuts smaller than those required by the formula.	The US calls for limiting tariff lines subject to "sensitive product" treatment to 1% of total dutiable tariff lines. The US has proposed that in the case of sensitive products with existing tariff rate quotas (TRQs), the quotas should be expanded, in-quotas brought down to zero, and tariffs outside the quotas halved. The U.S. would like to see potential sensitive products without TRQs remain that way, and suggested other options to provide a measure of protection, such as	The US, Australia and New Zealand expressed doubts about the EU's approach, arguing that it would grant countries double flexibility both within the tariff reduction formula and outside it.

C. Export Subsidies

Both the EU and the U.S. have said that they will agree to a "date certain" for the elimination of export subsidies, the third "pillar" of the negotiations, but there will be difficult negotiations before that date is decided. In a proposal presented on October 10, the U.S. has called for the elimination of export subsidies as well as the establishment of disciplines on certain other forms of export support by 2010. As for the EC, Commissioner Peter Mandelson announced at a press conference in Washington D.C. in mid-September that the EU would be willing to "front-load" the elimination of export subsidies. In other words, the EU would be prepared to undertake larger cuts in export subsidies in the early rather than the latter years of the elimination period.

The next official "agriculture week" will begin on 17 October. An informal mini-ministerial will be held in Zurich on 10 October to further discuss issues raised at the Paris meetings.

Non-Agricultural Market Access

The negotiations on industrial tariffs have made no significant progress towards agreement on modalities at Hong Kong. They involve three key issues – **the tariff-reduction formula, the degree of flexibility to be accorded to developing countries** in their application of the formula and the **treatment of unbound tariffs**. Following meetings on September 21-23 sharp differences persisted on all three, to the extent that there was no agreement to discuss them together within an integrated framework, as proposed by the Chairman, Ambassador Stefan Johannesson of Iceland. There is little sign of convergence on the tariff formula. Tactical linkage with agriculture is partly responsible, but there is also a clear North-South aspect to this negotiation, symbolized by the US-led "Friends of Ambition" on one side, and Argentina, Brazil and India – the "ABI Group" on the other. The main concern of many smaller developing countries is to defend existing preferences; they thus have no interest in reducing the MFN tariffs of preference-giving countries. The problem of unbound tariffs is also essentially one for those developing countries – not including the Latin Americans, who have bound all their tariffs - which have most unbound tariffs and wish to avoid the full application of the tariff-cutting formula to them.

There have been a number of sectoral initiatives. Hong Kong, Japan, Taiwan, Singapore, Thailand and the U.S. have proposed "zero-for-zero" elimination of tariffs on gems and jewellery. Taiwan has made a similar proposal on sports goods and bicycles. Japan and Korea had earlier proposed sectoral negotiations on electronics and automotive parts. These would also be "critical mass" agreements, in which the participants would agree to reduce tariffs to zero if a sufficient number – the critical mass – of Members did likewise.

Services

The Chairman of the services negotiations, Ambassador Alejandro Jara of Chile, became a Deputy Director-General of the WTO on 1 October, and was replaced in the Chair by Ambassador Fernando de Mateo of Mexico. Ambassador de Mateo will have an uphill struggle to animate the services negotiations, which are now generally recognized as lagging dangerously behind other major elements of the Round. The danger lies in the fact that poor results in services will make it difficult for the EU, Japan and others, probably including the U.S., to deliver reform in agriculture. On present form the results will be poor: both in number and in their trade-liberalizing effects the commitments so far offered are seriously disappointing. The basic procedure of bilateral request-offer negotiations is seen to have failed. And time is desperately short; it will not be possible, if agreement on agriculture and tariff modalities is delayed much longer, to carry out the difficult and time-consuming negotiation and drafting of services schedules in the few months that will remain.

For this reason countries seeking progress have proposed various supplementary approaches designed to set agreed targets or formulae for liberalization. Informal proposals by

Australia, Japan, Korea and the EU would all have the effect of setting minimum target levels, usually in terms of the number of service sectors and/or the number of modes of supply to be covered by offers. For example, it might be agreed that of the 156 sub-sectors into which the service industries are conventionally divided, each Member should commit a given number: different targets might be set for different levels of development. The EU has linked its proposals to liberalize the movement of personnel – mode 4 – to liberalization of access for investment in services – mode 3. New Zealand, Taiwan and Switzerland have proposed methodologies for assessment and quantification of the coverage and value of offers.

Other proposals envisage intensified negotiations among groups of countries interested in particular services – the so-called "Friends Groups" – which would result in agreement to liberalize by a critical mass of Members. This technique resulted in the groundbreaking agreement on telecommunications in 1997.

The "benchmarking" proposals, now under discussion in the Special Council, have been strenuously opposed by a number of developing countries who claimed that any mandatory targets would require more movement from them, since in general they have opened far fewer sectors than the developed countries making the proposals. This is true, but it was always obvious that any acceptable result on services in the Doha Round would entail greater efforts by at least the more advanced developing countries, given their limited offers in the Uruguay Round. The idea of plurilateral or critical mass agreements has also caused concern among developing countries that fear that they will be unable to participate effectively but may still be pressed to accept the results. The agreed procedures for the Round however provide for plurilateral processes and it is hard to see how, without new approaches, the negotiations can produce any worthwhile results. Pascal Lamy, in his first statement as TNC Chairman, called on the negotiators to "develop different approaches in services, leading to an increased number and to an enhanced quality of commitments".

At the Paris meeting of the Quad it was agreed to set up a "core group" of countries, co-chaired by India and the U.S., to "re-energize" the services negotiations. It was agreed to consider complementary approaches, in addition to the request-offer approach. This was part of a commitment by the four governments to work together for success in Hong Kong and in the Doha Round. Brazil has hitherto been a hesitant participant in the services negotiations, explicitly subordinating them to agriculture.

Trade Facilitation

This negotiation is thought to be making good progress. Several developing countries have recently submitted proposals, and all the proposals submitted since February are under detailed analysis. Technical and financial assistance to developing countries will be an important part of any agreement, and on this Pakistan and Switzerland have jointly proposed a mechanism to ensure that aid provided for the implementation of facilitation commitments is effectively administered and used.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

Negotiations on Rules

Mr. Lamy has suggested that the objective for Hong Kong should be draft negotiated texts on anti-dumping, subsidies and countervailing measures and fishing subsidies. Work has proceeded steadily but slowly on all three, and there is said to be a strong link with progress in agriculture and NAMA.

II. Dispute Settlement Activities

On 12 and 13 September, for the first time, panel hearings in a WTO dispute were made open to the public. The case in question was the EU's complaint against the continued sanctions by the U.S. and Canada in retaliation for the EU's ban on hormone-treated beef. All three parties had requested to hold the hearings in public, and this was done through a closed-circuit television relay. Diplomats, academics and representatives of NGOs attended the hearings. The U.S. in particular has favored for some years opening up the dispute settlement process, which is often attacked as being secretive and "undemocratic". This precedent having been set, it is likely to be followed in many future cases, but not all Member governments are happy about it. Some developing countries have argued that while NGOs and civil society representatives from the industrialized world will attend the hearings and will gain knowledge and influence as a result, their own representatives will not be able to afford to do so. In this case, meetings on 14 September were not open to the public because some of the "third parties" who were heard on that day – Australia, Brazil, China, Chinese Taipei, India, Mexico, New Zealand and Norway – wished them to remain closed. The final session on 15 September was again open.

Three disputes in the agricultural sector illustrate the urgency of reform of agricultural policies and the conflicts that can be expected if the Round fails. First, Australia and Brazil complained to the Dispute Settlement Body on 27 September against a reported EU plan to reclassify and export six million tonnes of surplus sugar previously classified for domestic consumption. They claimed that this would be in breach of a DSB decision in April that the EU should reduce its subsidized exports of sugar to 1.273 million tonnes. Other developing countries have complained that such sales would damage them by forcing down international sugar prices.

Secondly, Brazil has threatened to impose retaliatory duties against the U.S. for its failure to remove illegal subsidies to cotton growers by the deadline of 1 July imposed by the WTO. Brazil had earlier said that it would seek authority for retaliation amounting to $ 3 billion annually.

Third, the EU's proposed measures to bring its banana import regime into compliance with a WTO arbitrator's findings have been attacked by the Latin American countries which were parties to the original dispute. They claim the proposal – to replace all quota ceilings with a tariff of 187 Euros per tonne – would reduce their current access levels. The ACP beneficiaries of the regime, for their part, are also displeased.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

OUTLOOK

As it was in the beginning, agriculture is still the crux of this Round. It has reached the stage of political decision: there is little that negotiators in Geneva can do at the technical level, since the issues are well understood. It is true that without agreement between the EU and US there can be no progress. The "Blair House" agreement between them on agriculture in November 1992 unblocked the Uruguay Round. But it is remembered that the joint proposal they developed before the Cancun Ministerial Conference in 2003 was badly received, provoking a sharp disagreement with the Group of 20 developing countries which contributed to the failure of that Conference. Although they still have important differences between themselves, the EU and the U.S. are taking care to engage other key players. Together with Brazil and India they constitute the "New Quad", which has so far focused mainly on agriculture.

The outcome of the Hong Kong Conference will depend to a great extent on the quality of the draft submitted to it. Ministers cannot reconcile in four days a great number of conflicting positions and inconsistent drafts. By far the most important input to Hong Kong will be the draft modalities on agriculture: if it is not possible at Hong Kong to agree dates and figures for the elimination of export subsidies, and for the reduction of domestic support and tariffs, very few will continue to believe in the possibility of concluding this Round in 2006, or before the expiry of US negotiating authority in mid-2007. Governments are in a sense trapped by the negotiating structure they agreed in Doha. It was possible to agree there to negotiate agriculture and industrial tariffs by deferring agreement on the detailed objectives, or "modalities" of the negotiations. It is now clear that the essence of the agriculture and NAMA negotiations is the modalities, which will determine the results: but governments find it extremely difficult to strike essential deals before the last minute of the eleventh hour, and in this case that will doom negotiations in services and perhaps other areas to failure. If they cannot treat Hong Kong as a defining moment the Round will probably fail.

****

For further information, please contact David Hartridge (dhartridge@whitecase.com) or Tashi Kaul (tkaul@whitecase.com).

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

Multilateral Highlights

Senator Chambliss Provides Insight on U.S. Domestic Farm Support, Doha Round

On October 5, 2005, Senate Agriculture Committee Chairman Saxby Chambliss (R-GA) suggested that the United States "hold back on offering reductions in domestic farm supports" until the EU makes its own Doha Round commitments on agricultural market access. Senator Chambliss stated that EU officials have not indicated whether the EU is ready to open its markets to agricultural imports. Chambliss, presenting at a seminar in Washington D.C., did opine, however, that he was "cautiously optimistic" that a farm negotiating agreement could result from December's WTO ministerial meeting in Hong Kong.

Senator Chambliss stated that his legislation to end the United States' "Step 2" cotton subsidy program reflected his serious commitment to agricultural reforms. The proposal, expected to pass today, would cut payments received by cotton and dairy producers by 2.5 percent as part of the budget reconciliation plan to reduce U.S. agricultural spending by $3 billion over five years.

Senator Chambliss' remarks further indicate that many congressional members are turning their attention increasingly toward December's WTO talks and seek to influence the negotiations from Washington. In recent weeks, Senators Dorgan and Grassley have offered amendments related to U.S. negotiations on trade remedies, and 25 Senators introduced a Senate resolution against "weakening" U.S. trade laws in the Doha round. As Hong Kong grows closer, congressional activity related to the negotiations should continue.

United States Submits Formal Proposal on WTO Agriculture Negotiations

On October 9, 2005, United States Trade Representative (USTR) Rob Portman offered significant cuts in U.S. agriculture subsidies to revive the WTO's Doha Round of multilateral trade negotiations. Portman will discuss the proposals with trade ministers in Zurich this week. In a Financial Times editorial piece, Portman offered a "practical, two-stage reform - by initially making deep cuts and over time eliminating all trade-distorting measures." He outlined a 60 percent cut in U.S. domestic farm subsidies ("amber box" support), "halving the ceiling" on farm subsidies regarded as less trade distortionary ("blue box" support), and the elimination of farm export subsidies by 2010. The proposal would be consistent with the tariff-reduction formula created by the Group of 20 developing countries, including Brazil and India.

Portman stated "the United States is committed to breaking the deadlock in multilateral talks on agriculture, and unleashing the full potential of the Doha Round," and that "the U.S. offer is conditional on other countries reciprocating with meaningful market access commitments and subsidy cuts of their own." He also noted that the proposal calls for greater cuts from the EU and Japan consistent with the harmonization commitment. Portman identified the specific measures that the United States proposes WTO Members undertake in each of the three pillars of agricultural negotiations:

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

- **Market Access:** The proposal calls for an aggressive tariff reduction, following both the "tiered formula" agreed to in the July 2004 WTO framework and the formula created by the Group of 20 (G-20) developing countries, including India and Brazil. According to the proposal, by 2010, developed countries will: (i) cut their tariffs by 55-90 percent (lowest tariffs cut by 55 percent and highest cut by 90 percent); (ii) establish a "tariff cap" ensuring that no tariff is higher than 75%; (iii) limit tariff-lines subject to "sensitive product" treatment to 1% of total dutiable tariff lines; and (iv) offer lesser cuts and longer phase-in periods for developing countries.

- **Export Competition:** The proposal calls for the rapid elimination of export subsidies as well as the establishment of the following disciplines on other forms of export support by 2010: (i) eliminating all agriculture export subsidies; (ii) establishing disciplines on export credit programs; (iii) installing new disciplines on export State Trading Enterprises that end monopoly export privileges, prohibit export subsidies and expand transparency; (iv) ending discriminatory tax provisions that encourage processed food exports; and (v) establishing disciplines on food aid shipments that guard against commercial displacement.

- **Domestic Support:** The proposal also calls for significant reduction in trade-distorting domestic support with countries that provide larger subsidies making deeper cuts. The proposal calls for U.S. enactment of the following measures within five years: (i) a 60 percent cut in "Amber box" trade distortionary domestic support; (ii) a cap at 2.5 percent of agricultural production value for "Blue box" support; (iii) a 53 percent reduction in overall trade-distorting domestic support; (iv) reduce "*de minimis*" allowances for trade-distorting support by 50% and (iv) the establishment of a "peace clause" to protect farm-programs should a country keep trade-distorting support below agreed levels.

The U.S. proposal comes after repeated demands for subsidy reduction from EU Trade Commissioner Peter Mandelson and is a significant and positive step in the Doha negotiations. It indicates U.S. willingness to end politically sensitive domestic supports but only if negotiating partners make similar sacrifices. The EU's initial response has been positive, and Mandelson has promised that the EU proposal will go "even further" than that of the United States. However, French agricultural minister Dominique Bussereau has acquired 13 EU Member signatures on a memorandum insisting that EU trade negotiators consult with Member States prior to offering any multilateral farming concessions. The memorandum could stall EU negotiators and decrease the momentum that the U.S. proposal has created.

Senators Demand Reciprocal Response to U.S. Agricultural Proposal

On October 10, 2005, the United States submitted its multilateral agricultural proposal, which called for the immediate reduction and eventual elimination of agricultural tariffs and

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

farm subsidies. United States Trade Representative (USTR) Rob Portman described the proposal as a "kick start" to World Trade Organization (WTO) negotiation and will present it at a meeting with WTO trade ministers in Zurich. The U.S. proposal provoked immediate responses from congressional leaders:

- **Senator Charles Grassley (R-IA).** In a October 10, 2005 press release, Senate Finance Committee Chairman Sen. Charles Grassley stated that the U.S. "offer on domestic support is absolutely contingent upon equally ambitious market access, from both developed and developing countries." Grassley urged the EU and Japan "to be just as bold and ambitious in committing to reform their agricultural programs" and stated that Congress must meet its timeline under the 2002 Trade Promotion Authority (TPA) Act but can only do so if there is "significant progress by the December meeting in Hong Kong to substantially complete the Doha round by early January 2007." The TPA Act is set to expire in 2007.

- **Senator Max Baucus (D-MT)**. Ranking Senate Finance Committee Member Sen. Max Baucus released a similar statement the same day, indicating that the U.S. offer was conditional on reciprocal concessions from other WTO Members. Baucus stated that U.S. farmers "cannot be asked to reduce support payments unless the EU, Japan, India, and others in the developed and developing world make deep cuts to agriculture tariffs and, where applicable, domestic supports." He also urged Congress and the Administration to consult closely in developing WTO proposals that affect U.S. farm programs and noted that "it is the Congress in Washington - not the world's trade negotiators in Geneva - that will write the Farm Bill in 2007."

- **Senator Saxby Chambliss (R-GA).** Chairman of the Senate Committee on Agriculture, Nutrition and Forestry Sen. Saxby Chambliss stated that "if other countries do not harmonize their levels of domestic support and provide meaningful and tangible market access, then the Senate and House will find it very difficult to support the final [WTO] agreement." He also stated that the Doha Round is a comprehensive agreement that requires cooperation from all parties involved.

- **Representative Bob Goodlatte (R-VA).** Congressman Goodlatte, Chairman of the House Committee on Agriculture, stated that the United States "will need to see action on the part of other countries such as the EU before [it] can agree to any reduction or elimination of tariffs or domestic supports." Goodlatte also encouraged the U.S. trade negotiators to focus on the issues listed in an October 6 joint letter that he and Senator Chambliss sent to USTR. The letter identifies four principles that the Congressmen believe would guide support for the final agreement: (i) improvements in real market access; (ii) greater harmonization in trade-distorting domestic

support; (iii) elimination of export subsidies; and (iv) greater certainty and predictability regarding WTO litigation.

Although USTR Portman met with congressional leaders, including Sen. Chambliss and Rep. Goodlatte, before issuing the U.S. agricultural proposal, these leaders' immediate responses indicate that Congress will closely monitor and attempt to influence ongoing WTO agricultural negotiations before and after the December WTO ministerial meeting in Hong Kong. With the WTO discussions' intensity increasing significantly in anticipation of Hong Kong, further congressional activity regarding the negotiations is likely.

Portman and Johanns Comment on WTO Negotiations in Zurich

On October 11, 2005, United States Trade Representative (USTR) Rob Portman and Secretary of Agriculture Mike Johanns held a press conference in Geneva to discuss reactions to the U.S. agricultural proposal and to elaborate upon current multilateral trade negotiations in Zurich. The U.S. proposal, presented on October 10, calls for immediate tariff reduction followed by a general phase-out of domestic support programs. Over the next several weeks, Portman will continue agriculture negotiations with WTO Members' trade ministers in the hopes of securing a formal negotiating framework on agriculture before the December World Trade Organization (WTO) ministerial in Hong Kong.

- **International and Domestic Response to the U.S. Proposal**. Portman stated that the proposal generated "good and constructive" discussion and a "new energy and optimism" about reaching goals for the ministerial. He noted that reaction in the United States to the proposal was mixed, with most of the concern focused on the elimination of domestic supports without guarantees on increased market access abroad. According to Portman, "market access is the key to having true development benefits result from this round." He assuaged to U.S. congressional concerns by affirming that the United States would seek reciprocity from other WTO Members. On this point, Portman noted that "without other countries becoming more forthcoming, it will be difficult to put the Doha compromise together." Johanns echoed Portman's statements and added that the U.S. proposal "now enables the domestic support pillar to be developed very quickly" allowing more time for trade negotiators to work on a market access deal.

- **U.S. Flexibility**. Portman added that "the United States is willing to look at any proposal [and] consider any alternatives" and that they are "entirely open-minded to get the Doha Round moving," indicating that the U.S. will be flexible when considering counterproposals.

- **Harmonizing Domestic Supports is Key**. When asked what the United States expected from the EU proposal in terms of quantitative cuts in domestic support, Portman responded that there had always "been an agreement in the WTO that there be major harmonization," and that he

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

hoped to see the EU propose to cut the ratio of EU-to-U.S. domestic support levels from four-to-one to two-to-one. Portman also clarified that the United States would be cutting close to 54 percent overall from its agriculture budget with a 60 percent cut in "Amber box" support and a 2.5 percent cap on "Blue box" support.

- **Developing Nations Will Benefit Greatly from Doha.** When asked if the completion of the Doha round would benefit developing nations, Portman responded that "the world economy will benefit from Doha," especially developing nations, because "they would not be asked to make any contribution, either on the subsidy side or the tariff reduction side." Portman added that he agreed with WTO Director General (and former EU Trade Commissioner) Pascal Lamy's view that the EU must now make a more aggressive market access proposal.

- **NAMA.** Speaking briefly of non-agricultural market access (NAMA), Portman stated that he supported the "Swiss formula," which calls for larger cuts to higher tariffs, and that Members must make real progress in the coming months. Portman concluded by stating that the negotiating teams would "need to see real cuts in market access, across the board, for everyone." Johanns agreed, stating that "the rest of the world has to step up in terms of market access."

Portman's statements make clear that the United States will now focus on the aggressive pursuit of market access openings in upcoming multilateral trade negotiations. This focus reflects congressional and domestic agricultural concerns. The United States believes that it has made a dramatic proposal, and Portman and Johanns have made clear that they expect reciprocal concessions - especially from the EU and Japan - to conclude the current negotiations. The U.S. proposal seems to have given the Doha negotiations much needed momentum, but several issues remain that Portman and his counterparts must address this week in Zurich, chief among them the revised EU proposal on domestic support cuts and its initial proposals on market access.

European Union Submits Conditional Proposals during Zurich Multilateral Trade Negotiations

On October 10, 2005, EU Trade Commissioner Peter Mandelson released the EU's conditional negotiating proposals for the WTO's Doha Development Round. The proposals were circulated to Ministers at the WTO Doha Round Informal Ministerial in Zurich. Mandelson stated that the proposals are entirely contingent on reciprocity from other WTO Members, and that there must be "real offers providing forward movement." The EU's proposals focused on: (i) domestic support in agriculture; (ii) market access in agriculture; (iii) a maximum agricultural tariff; and (iv) minimum recourse to sensitive agricultural products. The proposals also included non-agriculture market access (NAMA), services, and development issues, but Mandelson noted that "agriculture is the engine for an ambitious and balanced result at [the December WTO ministerial in] Hong Kong."

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

- **Domestic Agricultural Support:** The EU proposed to provide a 70 percent cut in its Aggregated Measurement of Support (AMS), also known as "Amber box" support, with an additional 65 percent reduction in '*de minimus*' support. It also proposed possible reductions in maximum agreed levels of "Blue box" payments. On this issue, Mandelson indicated that the EU's "negotiating flexibility on that ceiling is limited, but [that] there is some room."

- **Market Access:** Mandelson stated that the EU has accepted the Group of 20's (G20) proposal of 'non-linear bands with linear cuts' with four bands for developed countries in which the top band would contain all tariffs higher than 90 percent.

- **Maximum Agricultural Tariff:** Mandelson also noted that the EU is prepared to accept a 100 percent cap for all agricultural tariffs for developed countries (with a 150 percent cap for developing countries).

- **Sensitive Products:** Regarding sensitive products, Mandelson stated that "the greater the flexibility given in linear tariff cuts in each band, the fewer total number of sensitive products it would seek." Mandelson noted that it would be important to negotiate whether sensitive products would be treated through tariff reductions and Tariff Rate Quotas (TRQs) "which would secure market access in these areas."

- **Export subsidies:** Mandelson stated that the EU is committed to ending all export subsidies and is ready to negotiate a phase-out schedule. He did note, however, that "the elimination of [the EU's] export subsidies must be matched by the removal of other trade-distorting practices in export competition" especially by Canada, Australia, New Zealand and the United States.

- **NAMA:** Mandelson stated that the EU "seeks to achieve an understanding on full modalities for market opening in Hong Kong" on NAMA issues. The EU proposed that industrial tariffs be capped at 10 percent using a Swiss Formula. Mandelson noted that the EU is ready to extend the principle of less than full reciprocity to other developing countries with an understanding that this would open more market access.

- **Services:** Mandelson noted that services negotiations had been ineffective and were languishing. The EU proposed to establish certain minimum numbers of sectors to be covered and to produce schedules as aspirational benchmarks.

- **Antidumping:** Mandelson stated that "the objective of the DDA negotiations in this area must be to ensure that reductions in tariffs are not

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

frustrated by inappropriate recourse to antidumping, and to ensure that antidumping duties do not remain in force longer than is justified." The EU is proposing that the negotiators should agree on the most important problems for the December ministerial and on broad guidelines in treating them.

- **Development:** The EU proposed implementation of its "Everything But Arms" program, which would extend tariff- and quota-free access to all imports, except weapons, from LDCs. Mandelson also reiterated the EU's support for a "Round for Free" for LDCs, in which developed countries would make asymmetrical tariffs cuts without a reciprocal cuts from LDCs.

G-20 Offers Market Access, Domestic Support Proposal while Portman 'Disappointed' by Other Trade Offers

On October 12, 2005, United States Trade Representative (USTR) Rob Portman announced that he was 'disappointed' that the U.S. proposal to cut its "amber box" trade distorting domestic support by 60 percent was not met by other offers to reduce tariffs and increase market access. Portman stated that the United States was asked to present an ambitious proposal at the WTO's informal ministerial and "told that the market access proposals would be equally ambitious." He noted that the EU's counteroffer on subsidy and tariff cuts did not come close to meeting expectations but promised to return to Geneva next week to continue negotiations. Portman stated that he "can't be too impatient" but added that the time frame between the Zurich meeting and the December ministerial in Hong Kong is "absolutely critical."

That same day, the Group of 20 (G-20) developing country alliance on agriculture offered new proposals on market access and domestic support during World Trade Organization (WTO) farm trade talks in Zurich:

- **Market Access.** The proposal on market access includes different levels of tariff cuts and different tariff bands, with developed countries cutting their tariffs between 45-75 percent with a maximum tariff of 100 percent, and developing countries cutting their tariffs between 25-40 percent with a maximum tariff of 150 percent. The G-20 stated that its proposal would "result in an average cut of at least 54 percent on developed country tariffs and a 36 percent cut on developing country tariffs." The G-20 also proposed tariff cuts for developed and developing countries. For developed countries: (i) tariffs between 0-20 percent would receive a 45 percent cut; (ii) tariffs between 20-50 percent would receive a 55 percent cut; (iii) tariffs between 50-75 percent would receive a 65 percent cut; and (iv) tariffs above 75 percent would receive a 75 percent cut. For developing countries: (i) tariffs between 0-30 percent would be cut by 25 percent; (ii) tariffs between 30-80 percent would receive a 30 percent cut; (iii) tariffs between 80-130 percent would be cut by 35 percent; and (iv) tariffs above 130 percent would be cut by 40 percent.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

- **Domestic Support.** The G-20 proposed that WTO Members with amber box support totaling above $25 billion a year (including the EU and Japan) cut that support by 80 percent while Members with support between $15 billion-$25 billion (including the United States) cut that support by 70 percent. For other countries with amber box support of $15 billion or less, the proposed cut is 70 percent. On overall domestic support (including amber box, blue box, and de minimis), the G-20 proposed an 80 percent cut for Members spending more than $60 billion annually (EU and Japan) and a 75 percent cut for Member spending between $10 billion- $60 billion annually. For other countries spending below $10 billion annually, the G-20 proposed a 70 percent cut.

As Portman has consistently stated during the Zurich negotiations, the United States considers reciprocal concessions by the EU on market access to be the lynchpin to any future multilateral agreement. Until the EU - and to a lesser extent Japan - steps forward with an ambitious and specific proposal on tariff reductions, the United States will not provide support for an agreement. With time running out before Hong Kong, the longer that the EU delays making a "satisfactory" market access proposal, the closer the Hong Kong talks come to failure.

Mandelson Reiterates General Council Backing of EU Negotiators

On October 18, 2005, in a statement to the European Union (EU) General Affairs Council, EU Trade Commissioner Peter Mandelson reviewed the state of Doha Round negotiations and how the EU should proceed with the talks within the limits of its negotiating mandate. Mandelson noted that negotiations had seen a "welcome sign of progress" during talks in Zurich this past week but that proposals tabled by other countries were "unsatisfactory in some respects, notably on disciplines within the so called blue box category of support payments." Mandelson outlined elements brought up in negotiations:

- **Agricultural Market Access**: Mandelson stated that discussions on agricultural market access were "still at a level of process rather than numbers" and that the EU expects balance within agricultural negotiations. He also affirmed the single undertaking principle under which "nothing is agreed until everything is agreed."

- **Non-Agricultural Goods**: Mandelson noted that a large WTO majority supports entering negotiations on industrial goods on the basis of the Swiss formula [a formula that would impose deeper reductions on higher tariffs]. The EU favors the adoption of a Swiss formula that would use different coefficients for developed and developing countries.

- **Services**: The EU is proposing a negotiating method that would request WTO Members to commit to a given number of service sectors through "quantitative and qualitative benchmarks" with flexibilities for developing countries and least developed countries (LDCs).

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]

Mandelson stated that the EU would be asking Member countries to respond to its proposal noting that the EU "shall be entirely justified in calling a halt" if countries do not respond. Mandelson told the Council that "it is absolutely and unequivocally not the intention of the Commission to use the Doha Development Agenda (DDA) to precipitate a new phase of Common Agricultural Policy (CAP) reform." He stressed that EU negotiators must be given latitude to set their tactics under the EU mandate, adding "[i]f the Council were to restrict our ability to explore further movement following initial proposals, this would be tantamount, in my view, to a significant tightening of the mandate."

Mandelson faces opposition from some EU member states, led by France, to deeper cuts in tariffs. Last week French Agricultural Minister Dominique Bussereau gained 13 Member States' signatures on a letter urging Mandelson to consult with the Member States before making any concessions on agriculture. Through his cooperation with the General Affairs Council and the Council's support of EU negotiators, Mandelson has managed to sidestep this opposition and in the process, opened the door for quicker and more effective negotiations without the need to report to Member States before making negotiating proposals.

United States Calls for New EU Offer on Market Access; EU Will Move Only If Others Reciprocate

On October 18, 2005, the United States called on the European Union (EU) to present a "meaningful tariff-reduction proposal" in World Trade Organization (WTO) agriculture negotiations. A senior U.S. trade official stated that the United States was awaiting an EU proposal on market access improvements for farm products, with a small number of "sensitive" products excluded. The official also stated that United States hopes that the EU is allowing sufficient maneuvering room for the trade-negotiating European Commission to respond effectively to the U.S. agricultural proposal. On October 9th, in Geneva, United States Trade Representative (USTR) Rob Portman unveiled the U.S. proposal, which would cut U.S. domestic support by 60 percent in exchange for a 83 percent cut in domestic support by the EU; the EU had already proposed a 70 percent cut in their farm subsidies. Another U.S. trade official commented that the EU plans to accept the 83 percent cut that the United States requested, stating that this reform is "well within the bounds" of the EU's common agricultural policy (CAP).

That same day, European Commission President Jose Manuel Barroso welcomed the U.S. agriculture proposal but stated that the EU will progress on agricultural issues when other WTO Member countries reciprocate to ensure a "balanced" outcome. During a visit with President Bush at the White House, Barroso also stated that agriculture was not the only issue at the December WTO ministerial in Hong Kong, and that he does not accept "reducing these negotiations to an agricultural negotiation".

On October 19, Director-General Pascal Lamy briefed the EC General Council on WTO trade negotiations, stating that the U.S. proposal injected momentum into the negotiations, but new market access proposals tabled by the G10, EU, United States, G33 and G20 "were still too far apart." Lamy added that "Members will need to approximate their positions on the level of

ambition needed in this pillar before negotiations on numbers can commence." Lamy also stated that the EU must define its objectives during the December ministerial meeting because it will need to move from general formulae to specific commitments in 2006, leaving little room for further negotiations. Lamy's target is to circulate a comprehensive draft text in mid-November placing trade negotiators "under severe pressure of time."

Although Barroso stated that agriculture would not be the sole issue at Hong Kong, the United States' call for a new EU package, the EU's comments on reciprocation, and Lamy's insistence on the near-term resolution of market access concerns certainly make agriculture the current focus of multilateral negotiations. Because two of the three pillars - export subsidies and domestic supports - are nearing (basic) agreement, it appears that market access is the lynchpin of not only the agriculture negotiations, but also the Doha round itself. Contentious issues persist in other areas of the talks, particularly services, but until agriculture is resolved, these negotiations will likely progress slowly, if at all.

G-20 Proposal on Sensitive Farm Products Parallels U.S. Proposal

On October 19, 2005, the Group of 20 (G-20) developing countries presented a new proposal on "sensitive products" as part of the World Trade Organization's (WTO) agriculture negotiations. The G-20 submitted the proposal, which supplements the G-20's agricultural market access plan, in advance of the trade ministers meeting in Geneva.

- **Sensitive Products**. Under the proposal, developed countries can designate up to 1 percent of their tariff lines as sensitive products, while developing countries have a 1.5 percent limit. The 1 percent limit for developed countries parallels the U.S. proposal but is significantly lower than the Group of 10 (G-10) developed countries and the EU's plans. The EU proposed that 8 percent of its tariff lines be treated as sensitive while the G-10 proposal included a 10-15 percent allowance for sensitive products on all tariff lines. The G-20 also proposed that sensitive products will be subject to tariff capping with no tariff rate quota (TRQ) creation.

- **Tariff Deviation**. The G-20 proposal calls for a correlation between the size of the deviation from the tariff determined by the tariff reduction formula and the size of the TRQ expansion in the same tariff line. Under the proposal, countries would be allowed a maximum deviation from the tariff reduction formula of 30 percent of the cut determined therein.

United States Trade Representative (USTR) Rob Portman lauded the G-20 proposal, stating that it "echoed the U.S. proposal" and took the opportunity to call on the EU to "step forward with bolder proposals." The G-20 also unveiled a supplement to its proposal on domestic support, calling for the establishment of product-specific caps in total Aggregate Measure of Support (AMS) of amber box subsidies subject to WTO reduction commitments. The G-20 indicated that these product-specific caps might also apply to blue box payments. With the two-day meeting of trade ministers in Geneva on October 19-20, the G-20 proposal's

timing and congruence with the U.S. market access proposal should help push negotiations forward. However, the significant divide between the aggressive U.S./G-20 proposals and the limited EU/G-10 proposals on sensitive products provides further indication that much is left to be done in the crucial market access sector of multilateral agricultural negotiations. Because the agriculture negotiations - and specifically market access - are integral to the progress of the entire Doha round, WTO negotiators must bridge the remaining gaps on issues like sensitive products before the Doha talks can move forward. With the December Hong Kong ministerial rapidly approaching, negotiators have precious little time to do so.

Russia Sets New Target Date for WTO Accession

On October 19, 2005, Russia's chief World Trade Organization (WTO) negotiator Maxim Medvedkov stated that Russia would not complete its accession to the WTO by the end of 2005 and was targeting Spring 2006 as the new date for accession. After the latest WTO working party on Russia's accession, Medvedkov stated that it would be "impossible" for Russia to achieve accession in time for the WTO's December ministerial in Hong Kong.

Under WTO rules, Russia must complete bilateral trade agreements on market access for goods and services with WTO Members requesting negotiations prior to its accession. To date, Russia has completed agreements with 50 of the 58 WTO Members requesting negotiations. It continues to negotiate with the United States, Canada, Australia, Switzerland, the Philippines, Colombia, Malaysia, and Uruguay. Medvedkov said that Russian negotiators were able to reach a preliminary agreement with the United States and Canada to finish the negotiation processes before the end of 2005. U.S. Ambassador to Russia William Burns recently confirmed this development, as it regards the United States. Contentious outstanding issues include market access barriers to financial services and agricultural trade, adequate protection of intellectual property rights (IPR), and Russian subsidies in the energy and aircraft sectors.

Negotiating Group Reviews in Detail Proposals on Trade Facilitation Measures; Discusses Report for Hong Kong Ministerial

The Negotiating Group on Trade Facilitation (NGTF) met in informal session on October 5-6 and on October 24-25. Members reviewed the Secretariat's compilation (TN/TF/W/43.Rev.3) of the different proposals Members have made so far. Members discussed proposed measures in further detail. An informal document prepared by the Secretariat (JOB (O5)/222) containing questions and answers about the proposals that Members had submitted, was used to assist Members in this discussion. This discussion should serve to inform the text-based negotiations that will likely take place after the Hong Kong Ministerial. Members also continued the discussion on the possible technical assistance mechanisms that should be part of the final agreement.

10/28/2005 10:20 AM (2K)
WASHINGTON 818450 v1 [818450_1.DOC]