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Japan External Trade Organization

WTO and Regional Trade Agreements Monthly Report

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environmental laws has proven more challenging. We analyze below the GAO's assessment of the four FTAs.

Multilateral

WTO Panel Reaches Decision in US-China Dispute Over Publications and Audiovisual Products (DS363)

Decision: A World Trade Organization (WTO) Panel has ruled against a number of restrictions imposed by China on the importation and distribution of publications, audiovisual products, sound recordings and films. In response to a complaint by the United States, the Panel ruled that such measures violated China's commitments under its Protocol of Accession, as well as under the General Agreement on Trade in Services (GATS) and the General Agreement on Tariffs and Trade (GATT).

WTO Appellate Body Issues Decision in US-Japan "Zeroing" Dispute

Decision: The World Trade Organization (WTO) Appellate Body has ruled that the United States failed to implement the 2007 rulings of the Dispute Settlement Body (DSB) on "zeroing."

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Reports in Detail

United States

AEI Holds Forum on Obama Trade Policy and its Future Direction

Summary

On August 12, 2009, the American Enterprise Institute (AEI) held a forum and discussion on "The Obama Trade Policy: An Assessment at Six Months." The purpose of the forum was to review the events that have shaped President Obama's trade policy during his first six months of office, as well as discuss what steps the Administration should take with regards to US trade policy. We review below the forum and discussion.

Analysis

On August 12, 2009, AEI held a forum in which trade policy experts discussed President Obama's trade policy. Participants discussed the events which shaped the President's first six months in office and his trade policy, as well as relevant items to be addressed in the future. Many of the speakers echoed at the forum that "trade is hard," but the lecturers believe there are many important steps that President Obama can take to "solidify a trade policy which has become de-prioritized in light of the current economic situation both domestically and abroad."

I. "Inherited Issues" and US Trade Policy

According to the participants, one of the key factors which has contributed to the lack of major trade policy in the first six months of the Obama Administration has been the onset of the current economic downturn (*i.e.*, the "economic downturn" that President Obama inherited upon beginning his term of office). The speakers noted that the current economic climate has diverted the President's attention away from trade toward "bigger, more pressing issues" such as the American Recovery and Reinvestment Act of 2009 ("Recovery Act") and its stimulus measures for the US economy. **Edward Gresser of the New Democratic Leadership Council** pointed out that the downturn of the US economy itself has resulted in a contraction of trade world-wide.

In addition to the inherited economic issues surrounding the current economic downturn, **AEI Resident Scholar Claude Barfield** noted that the composition of the 111th Congress has also contributed to President Obama's trade policy decisions over the first six months of his term in office. According to

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Barfield, although it would seem "highly lucrative" for the President to begin his Administration with a Congress whose majority reflects the same party, this may actually have adverse effects for President Obama because the current Congress pre-dates him by two years. According to Barfield, the current House of Representatives and Senate spent their first two years "not answering" to the President as a result of former-President Bush's affiliation with the Republican Party; consequently, the current Congress is unaccustomed to following the President's lead on many major issues which has thus resulted in Congress "taking the lead" on many issues, including trade.

AEI Resident Scholar Philip Levy echoed Barfield's thoughts and stated that President Obama has had "trade policy thrust upon him." According to Levy, the Recovery Act serves as a prime example of how much control the current Congress has over the President in that it contains "Buy American" language supported by many legislators. Levy referred to President Obama's expression of "concern of protectionism" when this language was first introduced prior to the bill's passage; however, once Congress passed the Recovery Act, the President signed the bill into law with the Buy American language intact. According to Levy, this serves as proof that the 111th Congress is not only used to taking the lead on issues such as trade, but that it intends to continue to do so in the future.

II. The Future of US Trade Policy

Speakers at the forum also discussed important issues that the President will likely face in the coming months. **John Murphy from the US Chamber of Commerce** stressed the importance for President Obama to address the reduction of foreign barriers for US exporters, noting that the United States "offers free access to [its] markets but does not seek to lower barriers of access to other markets." **Bruce Stokes of the National Journal** discussed US disputes with China and urged President Obama to have an "adult conversation" with China about being able to "walk and chew gum," stating that when the United States and China have a trade dispute, "the Chinese tend to stop talking rather than address the issue diplomatically." Stokes opined that this type of behavior by China "forces the United States to say [it does not] want to fight" which consequently enables the perpetuation of these Chinese policies and behaviors. Stokes opined that if President Obama can discuss the need for resolving issues with China rather than walking away from them, the United States will be in a much better position with regard to its trading relationship with China.

Speakers also discussed potential trade-related disputes that the United States may face in the future. Murphy stated that there is a "growing threat of retaliation" from Canada in response to the Buy American provisions found in the Recovery Act and he opined that because the funds for this Act "will be rolled out slowly over time, the dispute [over the Buy American provisions] is not over yet," despite President Obama's signing of the law in early 2009. Murphy estimated that over time, the United States is likely to

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hear more complaints from Canada and Europe on the Buy American provisions. Stokes, however, noted that "we are all sinners in this game" and that Canada has implemented regulations which are very similar to the US Buy American provisions in the Recovery Act.

Levy opined that President Obama needs to be less "ambiguous" with regard to his policies, and he opined that because "taking a clear stance could offend certain constituencies he needs, President Obama tends to be ambiguous with his policies and rhetoric." The majority of the speakers appeared to agree that the President will soon have to confront his "ambiguous" approach to trade as certain clear stances become necessary for him to establish. Stokes noted that the President "needs a trade policy that convinces industries and the public that it is good for them," adding that it could take years for President Obama and his Administration to persuade the public that trade has positive benefits. Levy noted that if the President expects "to rally the United States behind him" with a pro-trade policy, President Obama will need to take strong and clear stances on trade and many other issues.

Outlook

The speakers at the AEI forum all addressed the major concern that US businesses and trade observers have voiced over the past several months, namely that the Obama Administration has not been "proactive" on trade and has not outlined a firm US trade policy direction. Instead, as some of the speakers pointed out, the Administration has chosen to be "reactive" and has responded to trade policy issues as they come from Congress, in place of advocating its own pro-trade agenda. The Buy American provisions that formed a part of the stimulus package President Obama signed earlier this year exemplifies the Administration's "reactive" approach to trade, demonstrating that President Obama only addressed the Buy American language once Congress had included it in the bill, and that he only lobbied for additional language promising US compliance with its multilateral obligations when it was clear that legislators were unwilling to budge on the Buy American issue.

President Obama's "ambiguous" stance on trade will certainly change in the coming months, especially when he has to decide whether to impose trade remedies on imports of Chinese tires as part of the Section 421 investigation of imports of certain passenger vehicle and light truck tires from China. The US International Trade Commission has already voted that tires from China are being imported into the United States in such increased quantities or under such conditions as to cause or threaten to cause market disruption to the domestic producers of like or directly competitive products, and has submitted a remedy proposal to President Obama. In September, President Obama, under law, will have to make the final decision regarding whether to provide relief to the US tire industry, and the type and duration of any relief granted. This Section 421 decision thus represents the first real "litmus test" for President Obama

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on trade, and he cannot "punt" on this issue or avoid it altogether. His decision will certainly have direct consequences for the US-China trade relationship and US trade policy in general, and could provide further insight as to the direction that US trade will take under his Administration. Even after President Obama makes such a decision, however, it may still be difficult to tell where US trade policy will go, as some speakers, such as Gresser, opined that the Administration is unlikely to implement any new major trade policies until 2011.

United States Highlights

Congress Adds More Funds to "Cash for Clunkers" Program

On August 7, 2009, President Obama signed into law a bill that provides an additional USD 2 billion for the "cash for clunkers" auto trade-in program that Congress had passed in June. The House of Representatives had approved the cash injection for the program on July 31, 2009 by a vote of 316 to 109 after the Obama Administration announced to legislators that the "cash for clunkers" program's initial allotment of USD 1 billion had been exhausted after one week due to high consumer demand. The Senate approved the measure on August 6, 2009 by a vote of 60 to 37.

Congressional sources expect the USD 2 billion injection to fund the "cash for clunkers" program through mid- to late September. The additional funds will be transferred to the "cash for clunkers" program from unused stimulus funds intended for Title 17 renewable energy loan guarantees from the economic stimulus law (P.L. 111-5) passed earlier this year. Congressional observers note that depending on the popularity of the program, Congress may have to consider another injection to the program in the Fall once the USD 2 billion in funds are exhausted.

On June 16, 2009, the House of Representatives passed a supplemental military funding bill that contained the "cash for clunkers" provision. House and Senate conferees charged with negotiating a supplemental appropriations bill for foreign military operations (H.R. 2346) added the provision authorizing the "Consumer Assistance to Recycle and Save (CARS)" program, a plan that provides consumers with vouchers of up to USD 4,500 that can be used towards the purchase of a more fuel-efficient vehicle. The Senate passed H.R. 2346 on June 18, 2009. The "cash for clunkers" program as included in H.R. 2346 offers cash rebates in the form of a voucher to help consumers who trade in cars or SUVs with a combined fuel economy of 18 miles per gallon or less to buy more fuel-efficient vehicles. Eligible vehicles include passenger cars, light-duty trucks and SUVs, and Category 2 trucks. Large vans, large pickups and work trucks are also are eligible for the program. H.R. 2346 authorized USD 1 billion for the proposed program and under the bill, the period of eligibility for use of a voucher is between July 1, 2009 and November 1, 2009.

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The implementation of the auto trade-in program has stirred contentious debate. Supporters of the program argue that the "cash for clunkers" program is a "green program" and supports emission-reducing environmental policies by encouraging consumers to purchase more environmentally-friendly automobiles. Critics of the "cash for clunkers" program, meanwhile, argue that the fuel-efficiency standards included under the program will create only minimal changes in emissions levels. They also argue that the program is meant more as a stimulus for the US auto industry rather than an environmental measure. US trading partners have yet to publicly question whether such a program violates any US bilateral and multilateral trade obligations, but they are likely keeping a close eye on the United States' administration of the program in order to ensure that it complies with US obligations.

Senators Urge Inclusion of Border Adjustment Mechanism in Climate Change Legislation

In an August 6, 2009 letter to President Obama, several Democratic Senators expressed their "strong support" for the inclusion of a border adjustment mechanism in any climate change policy crafted by Congress. The signatories to the letter are Sherrod Brown (D-OH), Debbie Stabenow (D-MI), Russ Feingold (D-WI), Carl Levin (D-MI), John Rockefeller (D-WV), Robert Casey (D-PA), Arlen Specter (D-PA), Robert Byrd (D-WV), Evan Bayh (D-IN), and Al Franken (D-MN).

According to the Senators, any climate change bill passed by Congress must include provisions in order to "maintain a level playing field for American manufacturing." The Senators stated that any climate change legislation must prevent the export of jobs and related greenhouse gas emissions to countries that "fail to take actions to combat the threat of global warming comparable to those taken by the United States." The Senators recommend the imposition of several measures meant to ensure that US manufacturers "do not bear the brunt of our climate change" such as:

- short-term transition assistance in the form of rebates provided to energy-intensive and trade-exposed industries;
- negotiating objectives requiring any international agreement to address manufacturing competiveness;
- effective means to measure, monitor, verify, and hold countries accountable for emissions reductions; and
- policies that promote investments in energy efficient and clean technology manufacturing.

The Senators also recommend the imposition of a longer-term border adjustment mechanism meant to prevent the relocation of carbon emissions and industries if other major carbon emitting countries fail to

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commit to an international agreement requiring commensurate action on climate change. Although the letter does not explicitly define the border adjustment mechanism, Congressional observers opine that such an adjustment could take the form of "carbon tariffs" on imports of carbon- and energy-intensive goods from US trading partners. The Senators note that in the absence of an adequate international agreement, "a border measure could help to prevent countries from responding to climate change less rigorously than the United States and undercutting the effectiveness of our climate policy by shifting, rather than reducing, greenhouse gas emissions." The Senators also believe that a border adjustment mechanism could assist efforts to reach a global climate change agreement at the upcoming United Nations Framework Convention on Climate Change (UNFCCC) summit by "eliminating the competitive benefit of not acting to address [climate change] [and] spurring countries to reach a comprehensive accord." The Senators note that a recent World Trade Organization (WTO) and United Nations Environment Program (UNEP) report confirmed "that WTO rules do not override environmental measures."

In closing, the Senators noted that they would "find it extremely difficult to support a final [climate change] measure that does not effectively deal with these important issues" or that does not include a border adjustment mechanism.

The legislators sent their letter to the President in preparation for the climate change work that the Senate will undertake at the conclusion of the August recess. Congressional sources note that climate change will likely be a top agenda item for the Senate in the Fall, although they question whether Senators will have enough time to craft, vet and pass their own version of climate change policy and reconcile it with the House of Representatives' version of a climate change bill before the December 2009 UNFCCC summit. President Obama has urged legislators to pass climate change legislation before the December summit, and the House of Representatives passed its American Clean Energy and Security Act of 2009 (ACES; H.R. 2454) on June 26, 2009. Among other things, the ACES proposes cuts in greenhouse gas emissions that would be accomplished through the creation of a cap-and-trade program under which covered industries must hold allowances for each ton of greenhouse gases they emit. The bill also proposes an emission allowance rebate per unit of production for eligible industrial sectors.

The Senators' stance on a border adjustment mechanism demonstrates US Senate support - albeit limited - for border adjustment measures similar to those already approved by the House of Representatives. Consequently, the inclusion of carbon tariffs in a final climate change bill will likely fuel a long debate when the Senate begins drafting its climate change legislation. The Democratic Senators' refusal to support a climate change bill without carbon tariffs is also important because it conflicts with President Obama's tepid opposition to measures in any final Senate legislation. President Obama has

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stated that "at a time when the economy worldwide is still deep in recession and we've seen a significant drop in global trade, I think we have to be very careful about sending any protectionist signals out there" in reference to border adjustment measures as included under the ACES. In an April 14, 2009 letters to legislators, United States Trade Representative (USTR) Ron Kirk echoed the President's views on climate change, stating that "the Administration . . . does not support any specific measures [to prevent the movement of jobs and production offshore in the event the United States imposes a cap-and-trade system], including border measures, at this time."

Thus, the ten Democratic Senators' refusal to support climate change legislation without the inclusion of a border adjustment mechanism puts the President in a difficult position and will force him to choose between his opposition to border measures (thus possibly delaying a final climate change bill before the UNFCCC summit) or the potential passage of one of his most important legislative priorities before the December summit (thus drawing ire from trading partners that might see such measures as "protectionist"). Moreover, President Obama's willingness to cede to the Senators' demands would further reinforce the growing view in Washington that Congress, and not the President, really controls US trade policy.

Business Groups Urge President Obama to Revitalize US Trade Policy

In an August 5, 2009 letter to President Obama, several prominent US business groups urged the Administration "to make the case that international economic engagement and strong efforts to eliminate market barriers overseas and at home are more important than ever to the revitalization of America's economy and new opportunities for American workers and industries." The groups that signed the letter included the Business Roundtable, the Emergency Committee for American Trade (ECAT), the National Association of Manufacturers (NAM), the National Foreign Trade Council (NFTC), the United States Council for International Business (USCIB), and the US Chamber of Commerce.

The groups signing the letter acknowledge that President Obama's "leadership is essential to start a new dialogue with the American people on how a revitalized bipartisan trade policy, along with domestic-competitiveness initiatives, can promote America's success" and they argue that the President must emphasize that US trade policy will continue to provide assistance to workers, industries and communities dislocated because of trade. The groups also state that the President must make clear that trade and trade agreements are not the major cause of job loss in the United States and highlight that trade agreements can open new markets, generate exports, and economic growth. The groups argue that "a re-affirmation of America's longstanding commitment to open markets" will help the United States forge closer ties with US trading partners.

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The groups recommend that the Administration revitalize US export and international trade leadership by pursuing trade agreements with Asia-Pacific trading partners and by passing the three pending US Free Trade Agreements (FTAs) with Colombia, Panama and South Korea. According to the groups, failure to move forward on such bilateral and multilateral initiatives "will be costly to the United States" and could serve to make US manufacturers, farmers and service providers disadvantaged as they face barriers in foreign markets and competing agreements among other US trading partners that could prevent them from having access to new market-opening opportunities. The groups recommend that the "key members" of the President's international economic team meet with the groups' representatives so as to discuss the United States' international economic priorities.

For a diverse and influential group of business leaders to send a public letter to the President indicates that they, like many others, are confused and pessimistic about the current state of US trade policy under the Obama Administration. Already eight months into his first year in the White House, President Obama still has not provided US businesses with a clear indication as to what US trade policy will look like under his Administration. President Obama and Administration officials have repeatedly praised free trade but have yet to support that rhetoric with concrete action. Moreover, Administration promises that United States Trade Representative (USTR) Ron Kirk will soon introduce new US trade policy have thus far rung hollow: to date, there has been no indication as to when such a policy announcement will occur, and USTR Kirk's recent statements that the Administration is "80 percent done" with its current review of US trade policy indicates that the new policy will not debut until the Fall, at the earliest.

In the meantime, pending trade issues – such as the three completed FTAs with Colombia, Panama and Korea, the stalled World Trade Organization (WTO) Doha Round, and the Administration's response to alleged "protectionist measures" (such as the "Buy American" provisions of the American Recovery and Reinvestment Act, the termination of the US-Mexican trucking program, and the continued US ban on Chinese poultry imports) – remain unsettled while the Obama Administration tends to prioritize issues like global warming and health care. Nonetheless, US businesses are growing increasingly concerned about an Administration that refuses to address US trade policy, and their patience has obviously grown thin. Administration statements and Beltway scuttlebutt indicate that the White House will produce a "revamped" US trade policy that focuses on monitoring and enforcement of current US trade agreements, rather than a strong commitment to forge new ones. But *when* these changes will actually occur remains a mystery. Until the Administration unveils its new trade policy, trade stagnation will continue, and the Administration will "cede its leadership [on trade issues] to Congress," much to the growing consternation of US businesses, consumers and free trade advocates.

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Senate Passes Fiscal Bill Possibly Allowing Resumption of Chinese Poultry Imports; Bill Differs from House Version That Continues Ban

On August 4, 2009, the Senate approved a fiscal 2010 Department of Agriculture (USDA), Food and Drug Administration (FDA), and rural development bill (H.R. 2997) that contains a provision authorizing the United States to reopen the US market to Chinese imports of poultry under certain new requirements. The Senate bill is different from the version of the funding bill passed by the House of Representatives on July 9, 2009 that included a provision continuing the ban on US imports of Chinese poultry. Conferees from the Senate and the House of Representatives will next meet in September (after the August recess) in an attempt to reconcile the two versions of the bill.

The Senate version of the funding bill contains several new requirements before funds can be made available to the USDA to implement a rule allowing for Chinese poultry to be imported to the United States. Before establishing a rule that would certify Chinese facilities as eligible to ship fully cooked poultry products from China, the USDA's Food Safety and Inspection Service (FSIS) is required to formally commit in advance to:

- on-site reviews of poultry slaughter and processing facilities, laboratories, and other control operations;
- conduct audits of inspection systems;
- repeat reviews at least once every year;
- increase port of entry inspections; and
- conduct information sharing with other countries importing poultry products from China that have conducted audits and plant inspections.

The ban on poultry imports from China has proven contentious and has elicited a trade war between the United States and China. On July 31, 2009, the World Trade Organization (WTO) Dispute Settlement Body (DSB) established a Dispute Settlement Panel to examine US measures affecting poultry imports from China (DS392). According to Chinese officials, on March 11, 2009, President Obama signed into law a USD 410 billion dollar omnibus spending bill (H.R. 1105). China contends that Section 727 of the omnibus spending bill continues the US ban on Chinese poultry and states that none of the funds made available in the legislation may be used to establish or implement a rule allowing poultry products to be imported into the United States from China. According to Chinese officials, “this resulted in a complete ban on the import of poultry products from China into the United States . . . thus violating various WTO rules.” China argues that the poultry ban violates Articles I:1 and XI:1 of the WTO General Agreement on

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Tariffs and Trade (GATT) and Article 4.2 of the WTO's Agriculture Agreement. Chinese officials also contended that the United States "had entirely closed the door to China's poultry products" since 2007 through a number of annual omnibus appropriation acts and a series of related measures.

The Senate's version of the bill could help resolve the US-China poultry dispute, provided that House Members agree to the Senate's language on Chinese poultry in conference. With Congress out of office for the August recess, however, it is difficult to tell what House Members' reaction to the Senate language is, and it remains unclear if House Members would support the removal of the poultry ban when the House version of the funding bill contains language continuing the ban. The Obama Administration has already indicated that it would like the final version of the funding bill to remove the poultry ban under certain requirements so as to avoid a continued trade fight with China. Once Senate and House conferees meet in September to hammer out the final funding bill, it should be more clear to see if the bill will continue the poultry ban or lift it altogether, thus possibly resolving a US-China WTO dispute.

ITC Releases "Year in Trade 2008" Report on US Trade Agreements Programs

On July 30, 2009, the US International Trade Commission (ITC) released its "Year in Trade 2008: Operation of the Trade Agreements Program" report. The report is the 60th in a series of annual reports submitted to the US Congress under section 163(c) of the Trade Act of 1974 (19 U.S.C. 2213(c)) and its predecessor legislation, and is one of the principal means by which the ITC provides Congress with factual information on trade policy and its administration for calendar year 2008.

The report notes that the expansion of the US economy that began in November 2001 "slowed notably" in 2008 as financial market instability deepened, credit tightened, and asset values declined at an accelerating pace. The ITC found that slower growth in both the United States and world economies contributed to the decline in both US exports and imports in the fourth quarter of 2008. Nonetheless, the US trade deficit for goods and services decreased for a second consecutive year as the surplus in services grew more than the deficit in goods, and there was a small increase in the merchandise trade deficit from 2007 to 2008 (from USD 819.4 billion in 2007 to USD 820.8 billion in 2008) as the increase in US imports exceeded the increase in US exports. Increases in US exports of oil and other mineral fuels, lubricants, and related materials; chemicals and related products; food and live animals; machinery and transport equipment; and crude materials (except fuels) represented about 80 percent of the total increase in exports in 2008. Increases in US imports of oil and other mineral fuels, lubricants, and related materials, and chemicals and related products represented most of the increase in imports for the same year.

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The ITC's report also highlighted several other developments, including developments in:

- **Free Trade Agreements (FTAs).** The report notes that the United States was a party to nine FTAs as of December 31, 2008. In December 2008, the President issued proclamations implementing the Dominican Republic Central American Free Trade Agreement (DR-CAFTA) for Costa Rica and the US-Oman FTA effective January 1, 2009. In September 2008, the United States also announced the launch of negotiations to join the Trans-Pacific Strategic Economic Partnership Agreement (TPA FTA). According to the report, US merchandise exports to FTA partners increased eight percent to USD 444.2 billion or 38 percent of total US exports in 2008. US imports of goods from FTA partners increased 4.7 percent to USD 625.8 billion or 30 percent of total US imports in 2008.
- **Generalized System of Preferences (GSP) Program.** According to the report, duty-free US imports entered under the GSP program totaled USD 31.7 billion in 2008, with the leading beneficiaries being Angola, India, Thailand, Equatorial Guinea, Brazil, and Indonesia.
- **Andean Trade Preference Act (ATPA) Program.** US imports under ATPA totaled USD 17.2 billion in 2008, and US imports under ATPA increased from all of the beneficiary countries except Bolivia in 2008, driven primarily by increases in the value of petroleum-related imports. Effective December 15, 2008, President Bush suspended Bolivia from eligibility for failing to meet ATPA's counternarcotics cooperation criteria.
- **Doha Round.** According to the report, the World Trade Organization (WTO) Doha Development Agenda of multilateral trade negotiations resumed in February 2008 after the negotiating texts for the Agriculture Negotiating Group and the Non-Agricultural Market Access (NAMA) Group were revised. The negotiations reached an impasse on July 29, 2008.
- **WTO Dispute Settlement Activity.** The report states that in 2008, WTO Members filed 19 new requests for WTO dispute settlement consultations, compared to 13 in 2007, 22 in 2006, and 12 in 2005. The United States filed three of the 19 requests, with two directed against China and one against the EU.
- **Special 301 Report.** The United States Trade Representative's (USTR) 2008 Special 301 report on intellectual property rights (IPR) identified nine countries on the priority watch list and highlighted weak IPR protection and enforcement in China, Russia, Argentina, Chile, India, Israel, Thailand, Venezuela, and Pakistan. Thirty-six countries were placed on the watch list.
- **Antidumping and Countervailing Duty Investigations.** The ITC instituted 13 new antidumping investigations and completed 32 during 2008. The Department of Commerce (DOC) issued antidumping duty orders in 2008 in 23 of those completed investigations. The ITC instituted six new

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countervailing duty investigations and completed seven investigations during 2008. DOC issued countervailing duty orders in all seven completed investigations.

- **Section 337 Investigations.** During 2008, there were 89 active section 337 investigations and ancillary proceedings, 47 of which were instituted in 2008. Of these 47, there were 41 new section 337 investigations and six new ancillary proceedings relating to previously concluded investigations. At the close of 2008, 52 section 337 investigations and related proceedings were pending.

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Summary

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Analysis

I. Background and Methodology

In July 2009, the GAO released its FTA report ("Four Free Trade Agreements GAO Reviewed Have Resulted in Commercial Benefits, but Challenges on Labor and Environment Remain," GAO-09-439) to the Senate Finance Committee. In its report, the GAO analyzed four US FTAs with Jordan, Chile, Singapore, and Morocco and assessed progress through these FTAs in: (i) advancing US economic and commercial interests; (ii) strengthening labor laws and enforcement in partner nations; and (iii) strengthening partners' capacity to improve and enforce their environmental laws. GAO selected the US FTAs with Jordan, Chile, Singapore, and Morocco "because of their economic, social, and geographic diversity and [because they are] relatively older FTAs." In analyzing the FTAs, GAO reviewed relevant trade laws and trends, met with US agencies and foreign government officials, conducted fieldwork in the four countries, and solicited input from the private sector.

II. FTA "Results"

A. Merchandise Trade

According to the GAO, US merchandise (goods) trade with the four FTA partners "increased substantially following the FTAs' entry into force," and total two-way trade, US exports, and partner country exports for the four selected FTAs all rose. Growth in two-way trade since implementation of the four FTAs has

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ranged from 42 percent for the Singapore FTA (from 2003 to 2008) to 259 percent for the Jordan FTA (from 2001 to 2008), and increases in US exports ranged from 72 percent for Singapore to 365 percent for Chile. According to the GAO, US import increases ranged from 10 percent for Singapore to 397 percent for Jordan.

Of the US industrial sectors that experienced the most growth post-FTA implementation, the report states that US agricultural exports, such as wheat, corn, rice, edible fruits and nuts, and dairy products, grew substantially post-FTA in several partner countries. The report also notes that several US manufacturing sectors, including construction equipment, automobiles, and machinery, gas turbines, and optical/medical equipment, also showed significant gains in US exports to FTA partners and increases in US market share.

1. US-Jordan FTA

According to the GAO, of the four FTAs, US imports from Jordan have experienced the largest increase (from USD 229 million in 2001 to USD 1.139 billion in 2008). The report notes that US exports also increased from (USD 339 million prior to the FTA to USD 904 million in 2008). The report states that between 2002 and 2008, an average of 87 percent of US imports from Jordan were textiles and apparel. The GAO concludes, however, that the EU remains the dominant overall foreign supplier in Jordan's market, and that US market share has "decreased somewhat" since the FTA.

2. US-Morocco FTA

The report notes that bilateral trade increased after the US-Morocco FTA entered into force. According to the report, from 2005 through 2008, US exports to Morocco grew from USD 519 million to over USD 1.5 billion. Imports from Morocco grew from USD 470 million to about USD 880 million during the same period. The GAO reports that the EU still has the largest overall share in Morocco but US market share has increased marginally since before the FTA went into force (from three percent in 2005 to five percent in 2008).

3. US-Chile FTA

The GAO report states that US-Chile trade has increased considerably under the FTA. Since the FTA entered into force, US exports to Chile have increased by 365 percent from USD 2.4 billion to USD 11.4 billion, whereas US imports from Chile have increased by 106 percent from USD 4 billion to USD 8.2 billion. US-Chile trade has thus increased from USD 6.4 billion in 2003 to USD 19.5 billion in 2008, increasing by 204 percent since the FTA's implementation. In 2008, Chile's share in the US market reached the pre-FTA levels it had in 2001. During 2007-2008, Chilean exports to the United States

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dropped due to increased Chilean exports of copper and raw materials to China after the entry into force of the Chile-China FTA.

4. US-Singapore FTA

According to the GAO, since implementation of the US-Singapore FTA, US exports to Singapore have grown from USD 14.9 billion in 2003 to USD 25.7 billion in 2008. US imports from Singapore have also grown, from USD 14.3 billion to USD 15.7 billion during the same period. The GAO reports that total US market share in Singapore has declined slightly (from 13 to 12 percent from 2003 to 2008) but notes that the United States "has remained a major competitor despite several other trade agreements by Singapore with key trading partners, such as China, Malaysia, and Japan." The report states that the "top valued, higher growth US exports to Singapore in 2008" include electrical machinery and industrial machinery. In addition, the report states that "while total US imports from Singapore have grown overall since 2003, they have faced intensified competition from Asian suppliers such as China and India."

B. Trade in Services

According to the report, the United States experienced substantial services trade growth in both Singapore and Chile post-FTA implementation. In addition, "strong growth was apparent in service sector categories that are associated with provisions of the FTAs."

1. US-Jordan FTA and US-Morocco FTA

The GAO study grouped the US-Jordan and US-Morocco FTAs together in its discussion of trade in services, and states that United Nations' data show that both of these countries have experienced substantial growth in their worldwide services trade, with Jordan experiencing growth of 96 percent in its service exports since 2001 and Morocco experiencing growth over 230 percent since 2001. According to the report, Jordan's imports of services have grown 78 percent since 2001 and Morocco's service imports grew 181 percent since 2001.

2. US-Chile FTA

The GAO report notes that US-Chile services trade has shown substantial growth since the entry into force of the FTA. In 2007, US services exports to Chile totaled USD 1.76 billion, whereas Chilean exports totaled USD 868 million. US services exports to Chile grew 47 percent as compared with the pre-FTA period, whereas Chilean exports only increased 19 percent. The GAO report also states that exports in the "other private services" category increased 100 percent, and "business, professional and technical services" increased 168 percent.

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3. US-Singapore FTA

According to the report, "[of the FTAs included in the GAO study] Singapore has the highest level of bilateral services trade, with the United States exporting over USD 7 billion, and importing almost USD 4 billion, for a services trade surplus of over USD 3 billion in 2007." The GAO concludes that US service exports to Singapore grew 24 percent from the average level of the pre-FTA three-year period 2001–2003 to 2007, whereas US service imports from Singapore grew by 90 percent. The most substantial gains have taken place in the broad category "other private services," such as "business, professional and technical services" (of which US exports to Singapore grew over 800 percent, and imports to the United States grew over 1,200 percent post-FTA implementation).

C. Foreign Direct Investment

The GAO analysis shows that foreign direct investment (FDI – both inward and outward) has been affected by the implementation of the FTAs, with the US-Chile and US-Singapore FTAs experiencing more growth in FDI than the US-Jordan and US-Morocco FTAs following their respective implementations.

1. US-Jordan FTA and US-Morocco FTA

Similar to the "Trade in Services" discussion, the GAO grouped the US-Jordan and US-Morocco FTAs together in discussing FDI. The report states that following FTA implementation in both these countries, US FDI in Jordan and Morocco grew but by less than FDI from other nations. US FDI in Jordan totaled USD 119 million in 2007 (an increase from USD 39 million in 2006), and US FDI in Morocco totaled USD 238 million in 2007 (an increase from USD 130 million in 2006). These 2007 levels, however, are still lower than the stock of US FDI in the period 2001-2003. Based on these figures, the GAO concludes that "the United States has yet to play a significant role in FDI in these countries."

2. US-Chile FTA

The report notes that the stock of foreign direct investment and sales of foreign affiliates of US-based companies in Chile also increased after the FTA's implementation. Prior to the entry into force of the FTA, the United States was already one of the largest investors in Chile. In 2007, the US stock of FDI in Chile totaled USD 12.6 billion, less than one percent of total US FDI. The main target sectors of US FDI include financial and banking, manufacturing and chemicals.

3. US-Singapore FTA

According to the GAO, "the post-FTA period has seen bilateral growth with Singapore and greater economic integration between the partners." In 2007, the US stock of FDI in Singapore reached over USD 82 billion, and the level of FDI in the United States by Singapore firms grew over 370 percent

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compared with 2003, the year prior to FTA implementation. Singaporean FDI in the United States is concentrated in financial services and manufacturing.

III. US Private Sector Views

The report notes that many US private sector representatives opine that the four FTAs included in the study have provided direct and indirect commercial benefits to US businesses across a range of sectors. Agricultural interests have reported improved market access in a variety of product areas, including processed food, dairy, grains, almonds, tree fruits, and, to a certain extent, meat. Manufacturing industries such as construction equipment, industrial equipment, and electrical machinery reported FTA-related gains whereas US textiles and apparel, and the chemicals industry, reported mixed to no impact. Many services trade and intellectual property-related industries – including express delivery, financial services, pharmaceuticals, business software, and information services – also reported gains due to FTA market-opening provisions in services, improved investor protections, strengthened intellectual property rights (IPR), procurement liberalization, and regulatory transparency.

Nonetheless, US industrial sectors do have some outstanding concerns on the four FTA, including concerns on:

- Increased costs due to varying rules of origin and cumbersome paperwork;
- IPR-related issues that have not been adequately addressed (such as "Chile's delay in the implementation of its FTA IPR obligations").
- Lack of requirements to "use US-made goods for imports from these countries that enjoy FTA benefits," such as a lack of requirements for imports from Jordan and other suppliers to use US fabric; and
- Opaque or cumbersome regulatory practices, such as certain regulations in Singapore "that are undermining US firms' access to Singapore's telecommunications and domestic pharmaceutical procurement markets."

IV. Labor and Environmental Concerns

A. Labor

According to the GAO, Jordan, Chile, Singapore, and Morocco "have all made efforts to meet their commitment in the FTAs to strive to ensure that their domestic labor laws provide for agreed labor standards consistent with the internationally recognized labor rights and strive to make improvements." The GAO has found, however, that Jordan, Chile, and Morocco all have documented difficulties ensuring

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respect for core labor rights and face enforcement challenges. The GAO also notes that US agencies have provided "little sustained engagement or assistance" to these countries with regards to labor standards and enforcement.

1. US-Jordan FTA

According to the GAO, Jordan has made some improvements to its labor laws and enforcement but US officials have noted that ongoing weaknesses in Jordan's labor protections have contributed to abuses of workers that occurred in factories in the US-designated Qualifying Industrial Zones (QIZs). Nonetheless, although some labor problems persist in the QIZs, the US government recently decided to widen Jordan's duty-free access to the US apparel market.

2. US-Morocco FTA

The report notes that Morocco has strengthened its labor laws in connection with the FTA, but its enforcement is often poor, and child labor and suppression of strikes remain problematic. According to Moroccan government officials, the number of labor disputes has decreased since the FTA's implementation, and Moroccan trade union officials opine that the environment for labor dialogue has improved as a result of the new labor code. Nonetheless, US officials feel that labor protections should be further expanded to cover workers in Morocco's large informal economy.

3. US-Chile FTA

The GAO report states that Chile has strengthened its labor regime since the entry into force of the FTA but problems persist with regards to the enforcement of labor laws by Chilean employers and with the labor enforcement regime. Chile has increased the number of labor inspectors and improved the procedures to deal with labor disputes in a timely manner. Most experts agree, however, that the US-Chile FTA has not been a powerful catalyst for change or improvement of Chile's labor regime.

4. US-Singapore FTA

The report states that Singapore generally had strong protections for workers going into the FTA and has since improved them. The International Trade Union Confederation (ITUC) reports that there are some restrictions on unions in Singapore's labor laws, but many of the restrictions are not applied in practice. The Department of State's 2008 human rights report indicates that Singapore's Ministry of Manpower effectively enforces its laws and regulations on working conditions, safety and health standards, and child labor.

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B. Environment

The GAO report states that "some of the partners have demonstrated significant progress in improving the environment since the FTAs were signed." However, three of the four FTA partners reported ongoing challenges to enforcing environmental laws.

1. US-Jordan FTA

According to the GAO, "Jordan still faces enforcement challenges," and US officials note that among the challenges Jordan faces in implementing environmental laws is that it has only 25 environmental inspectors in the country, who are responsible for agricultural, construction, and industrial sectors throughout a large area of the national territory. Another challenge for Jordan is the limited experience and training of judges in adjudicating environmental cases.

2. US-Morocco FTA

The report notes that Morocco passed environmental laws in anticipation of the FTA, and has implemented additional reforms post-FTA implementation, including a general framework law on environmental protection, a law requiring environmental impact assessments, and an air pollution law. Nonetheless, US officials note that enforcement of environmental law in Morocco is inconsistent, mostly because enforcement of laws is left to the local and regional governments and that, at the national level, jurisdiction for environmental laws lies across several agencies or law enforcement entities.

3. US-Chile FTA

The GAO report notes that Chile has made some improvements in its environmental regime. In March 2007, Chile created the position of the Minister of the Environment, elevating the role of the National Environmental Commission (CONAMA) to ministry status with new enforcement authorities. Environmental issues of concern in Chile, however, relate to CONAMA's lack of enforcement power to implement or issue environmental laws thus preventing Chile from making tangible progress in this area.

4. US-Singapore FTA

The report states that Singapore continues to strengthen its environmental laws, and has passed new regulations that, among other things, control import and export of endangered species in Singapore, and introduce more severe penalties for violations of environmental laws and regulations. Environmental issues of concern in Singapore relate to Singapore's role as a significant transit center for environmentally sensitive trade: wildlife and wildlife products, including endangered species; ozone depleting substances; timber and wood products; and live fish for consumption and aquarium.

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V. GAO Recommendations

In closing the report, the GAO recommends that US government agencies involved in FTA implementation and monitoring update their plans for implementing and overseeing FTAs to make the FTAs more effective in producing results. Specifically, the GAO recommends that USTR, in cooperation with other agencies, prepare updated plans to implement, enforce, monitor, and report on compliance with and progress under the FTAs' labor and environmental provisions.

Outlook

Based on the GAO's analysis, it appears that the "success in achieving US goals" among the four FTAs has been mixed. Commercial results tend to be positive and have resulted in an expansion of trade in goods and services since the agreements' implementations. Total two-way trade, US exports, and partner country exports for the FTAs examined grew post-FTA implementation. In addition, in some cases (*i.e.*, Singapore and Chile), trade in services and FDI increased. Effective enforcement of labor and environmental laws and regulations (certainly a "US goal" for the Obama Administration), however, has lagged behind the commercial successes of the agreements. Although in some countries (*i.e.*, Singapore and Chile), enforcement of labor and environmental laws has grown stronger in recent years, US government agencies still point to a lack of consistency and effective monitoring of labor and environmental laws and regulations in other FTA partners. The GAO reflected this view in its report, although it noted that the "weakness" in effective enforcement of labor and environmental laws can be largely attributed to both the US trading partners' weak enforcement mechanisms **and** US government agencies' "missed opportunity" to work with these trading partners and cooperate on strengthening labor and environmental enforcement.

The GAO's recommendation that US government agencies involved in FTA implementation and monitoring update their plans for implementing and overseeing FTAs falls squarely in line with Obama Administration's promises to increase enforcement and monitoring of implemented US FTAs. Although the Administration has yet to announce its "new" US trade policy, some elements of its new trade direction will likely reflect the recommendations of the GAO report, in particular with regards to increased enforcement and monitoring of US FTA partners' commitments on labor and environment. How the Administration will "increase monitoring and enforcement" is unclear at this stage, although given the numerous labor and environmental concerns highlighted in the GAO report, any new plans for USTR and other government agencies on FTA implementation and enforcement are likely to focus on these two key areas.

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Multilateral

WTO Panel Reaches Decision in US-China Dispute Over Publications and Audiovisual Products (DS363)

Summary

Decision: A World Trade Organization (WTO) Panel has ruled against a number of restrictions imposed by China on the importation and distribution of publications, audiovisual products, sound recordings and films. In response to a complaint by the United States, the Panel ruled that such measures violated China's commitments under its Protocol of Accession, as well as under the General Agreement on Trade in Services (GATS) and the General Agreement on Tariffs and Trade (GATT).

Significance of Decision / Commentary: This is one of two simultaneous challenges launched by the Bush Administration with respect to China's treatment of US copyrighted cultural products, such as books and films. In the first case, the United States argued that China's intellectual property rights laws were inconsistent with China's obligations under the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs). The Panel in that case rendered its decision earlier this year, and the outcome fell far short of US expectations [see our report of February 18, 2009; available on request].

The current case dealt with market access, particularly "trading rights", *i.e.*, the right to import and export. The United States argued that China "denies US companies the right to import books, journals, movies, music, and videos, and instead requires all imports to be channelled through specially authorized state-approved or state-run companies." The United States also complained about similar restrictions on the distribution of these products. From the US perspective, the outcome of the present case was significantly more successful than its TRIPS challenge, as it established violations relating to both trading rights as well as national treatment for goods and services.

This is the **first WTO Panel to rule on trading rights**. These disciplines on the right to import and export are not included in the Uruguay Round Agreements, and apply only to countries that acceded to the WTO after it was founded in 1995. Trading rights are now routinely included in the "Working Party Reports" (WPRs) of acceding countries, principally to seek to ensure that tariff concessions are not undermined by restrictions on the right to import. These are "WTO Plus" obligations that do not apply to the original Members of the WTO. (The Panel described this more delicately, noting that it was "mindful of the possibility that the Accession Protocol may impose obligations on China that are not imposed on other Members under the WTO Agreement, or are stricter than those that are applicable to other Members.") The Panel read the trading rights provisions of the Protocol broadly, stressing that "China was under an

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obligation to ensure that 'all enterprises in China', including foreign-invested enterprises registered in China (wholly foreign-owned enterprises, Chinese-foreign equity joint ventures and Chinese-foreign contractual joint ventures), have the right to import all goods into China."

At the same time, the Protocol of Accession states that China's trading rights obligations are "[w]ithout prejudice to China's right to regulate trade in a manner consistent with the WTO Agreement." This qualifier is a potentially significant carve-out. The Panel ruled that "China's right to regulate trade in a WTO-consistent manner takes precedence over China's obligation to ensure that all enterprises in China have the right to trade." However, it is unclear when the "right to regulate trade" can or should "take precedence" over trading rights. The Panel considered – and rejected – one potential instance of precedence, as China argued that its right to regulate trade included its right to invoke the "public morals" provision of the GATT, as discussed below.

This is the **first WTO Panel to rule on the GATT "public morals" defence**. This provision – one of the exceptions set out in the GATT – states that "nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures…necessary to protect public morals[.]" The exception for "public morals" has been part of the multilateral trading system since its inclusion in the original GATT in 1947. However, the fact that it had not previously been invoked likely reflects the reluctance of many countries to override objective trade rules with something as subjective as public morals.

The United States was the first country to invoke the public morals defence, as it cited the parallel provision in the GATS in the 2005 *US – Gambling* dispute. The Panel *US – Gambling* found that "the term 'public morals' denotes standards of right and wrong conduct maintained by or on behalf of a community or nation" and that "the content of these concepts for Members can vary in time and space, depending upon a range of factors, including prevailing social, cultural, ethical and religious values." The *US – Gambling* Panel also stressed that WTO Members "should be given some scope to define and apply for themselves the concepts of 'public morals'... in their respective territories, according to their own systems and scales of values." The Panel in the present case saw "no reason to depart" from this interpretation.

However, the current Panel held China to a **strict standard to justify the invocation of the public morals defence as "necessary**." It ruled that China failed to satisfy the "necessity" standard, in part because the United States identified other, less trade-restrictive means for China to achieve its objectives.

This Panel ruling confirms that "public morals" will be defined on a national basis, which will vary from country to country – there is no international or WTO standard of "public morals." Thus, WTO Members

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can expect a certain degree of deference by WTO Panels when they "define and apply for themselves" the concept of public morals, based on the "social, cultural, ethical and religious values" of the invoking country. However, no such deference will be accorded on the issue of whether the policy is "necessary" to protect the defined public morals. In determining the viability of the public morals defence in future cases, the necessity test will continue to be determinative.

Finally, the Panel chose not to rule on the **threshold issue of whether the public morals defence is available for non-GATT violations**. The exceptions set out in GATT Article XX can be used to defend breaches of "this Agreement", *i.e*., the GATT. It could be argued that such a defence cannot be invoked to defend violations of non-GATT commitments, such as those set out in China's Protocol of Accession. On the other hand, China's Protocol of Accession, by its own terms, is "an integral part of the WTO Agreement", and the WTO Agreement includes the GATT. The Panel chose not to address these interpretive issues, and instead assumed – without deciding - that GATT Article XX could be invoked for non-GATT Agreements, pending a ruling on whether China met the terms of Article XX(a). This question is important not just for the public morals defence, but for all of the GATT Article XX provisions that could be invoked for non-GATT violations. The resolution of this interpretive issue will need to await a future dispute.

China has announced to the press that it is likely to appeal this Panel's decision.

Analysis

Trading Rights: "all enterprises in China" have the right to import

China made a range of commitments in its accession WPR, which were incorporated by reference into its Protocol of Accession. China's WPR provided in part that following a transition period, "all enterprises in China would be granted the right to trade." The WPR similarly provided that "China would permit all enterprises in China and foreign enterprises and individuals…to export and import all goods…throughout the customs territory of China." In addition, the Protocol of Accession stated that "[w]ithout prejudice to China's right to regulate trade in a manner consistent with the WTO Agreement, China shall progressively liberalize the availability and scope of the right to trade, so that, within three years after accession, all enterprises in China shall have the right to trade in all goods throughout the customs territory of China…."

The Panel interpreted the clause "all enterprises in China" to encompass "both Chinese enterprises registered in China and foreign enterprises invested and registered in China." As noted above, the Panel found that "China was under an obligation to ensure that 'all enterprises in China', including foreign-invested enterprises registered in China...have the right to import all goods into China."

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The Panel then turned to the "without prejudice" language in the Protocol of Accession. The Panel stated that "we consider that the phrase 'without prejudice to' is intended to indicate that China's obligation to ensure that all enterprises in China have the right to trade must not, and does not, detrimentally affect China's right to regulate trade in a WTO-consistent manner." Therefore, in the Panel's view, "if China regulates trade in a WTO-consistent manner, and this results, contrary to the obligation[,]…in 'enterprises in China' not 'hav[ing] the right to trade in all goods', China's right to regulate trade in a WTO-consistent manner takes precedence over China's obligation to ensure that all enterprises in China have the right to trade."

The Panel interpreted the phrase "right to regulate trade" to mean the "right to regulate imports and exports." It added that "we consider that China's 'right to regulate trade' in a WTO-consistent manner includes, by implication, a consequent right to regulate importers or exporters of the relevant good(s) in a WTO-consistent manner."

The Panel stated that it was "mindful of the possibility that the Accession Protocol may impose obligations on China that are not imposed on other Members under the WTO Agreement, or are stricter than those that are applicable to other Members." However, in the Panel's view, "this element does not logically lead to the conclusion that the obligation to grant trading…was intended to prejudice China's ability to regulate imports and exports and, incidentally, importers or exporters of the regulated goods. As explained above, other elements and considerations lead us to a different conclusion."

The Panel noted that the Protocol of Accession also provided that "all foreign individuals and enterprises, including those not invested or registered in China" must be accorded treatment no less favourable than that accorded to enterprises in China with respect to the right to trade. The Panel found that the phrase "all foreign …enterprises, including those not invested or registered in China" applied "both to foreign-registered enterprises which wish to engage in importing or exporting, but have no commercial presence in China, and foreign-registered enterprises maintaining a commercial presence in China and wishing to engage in importing or exporting through the entity present in China."

Having enunciated these principles, the Panel then examined the numerous "trading rights" measures challenged by the United States. One of the successful claims advanced by the United States related to foreign-invested enterprises. The Panel found that as foreign-invested enterprises in China did not have the right to import the relevant products, this was inconsistent with China's obligations under the WPR and the Protocol of Accession.

Although the Panel found for the United States on some of its trading rights claims, the Panel also rejected a number of such claims and the ground that the United States had not established violations.

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China's "public morals" defence fails the "necessity" test

China pointed to the language in the Protocol of Accession that its trading rights commitments were "[w]ithout prejudice to China's right to regulate trade in a manner consistent with the WTO Agreement", which China argued included the "public morals" defence in GATT Article XX(a). China asserted that "imported cultural goods, because they are vectors of different cultural values, may collide with standards of right and wrong conduct which are specific to China."

The Panel raised - but did not rule on – the issue of whether GATT Article XX was available as a defence for violations of non-GATT provisions, such as a Protocol of Accession. Following the approach taken by the Appellate Body in the 2008 case of *US – Customs Bond Directive*, the Panel proceeded on the provisional assumption that Article XX was potentially available to China as a defence to violations under the Protocol. Turning to the scope of the "public morals" defence, the Panel followed the interpretive approach adopted by the GATS Panel in *US – Gambling*, as noted above.

However, the Panel in the present case found that the Chinese measures at issue failed the "necessity" test, in part because "it is not apparent to us that the requirements in question make a contribution to protecting public morals." Moreover, the Panel found that the measures could not be considered as "necessary" in light of a less trade-restrictive alternative proposed by the United States, *i.e.*, that the Chinese Government could make final content review decisions before the products were cleared through customs. The Panel considered that "the US proposal would allow China to achieve its desired high level of protection of public morals" and would "have no restrictive impact on those wishing to engage in importing the relevant products."

Given the conclusion that "China has in any event not established that the measures at issue satisfy the requirements of Article XX(a)" the Panel decided that "we need not, and hence do not, revert to the issue whether Article XX(a) is in fact applicable as a direct defence to breaches of China's trading rights commitments. We thus take no position on this issue."

National treatment obligations: "adversely modifying the conditions of competition"

GATS Article XVII imposes a national treatment obligation with respect to services trade. It provides in part that "each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers." The Panel found a number of Chinese measures to be inconsistent with this obligation, including a law that had the "effect of prohibiting foreign service suppliers from wholesaling imported reading materials, while like Chinese suppliers are permitted to do so." In the view of the Panel, such a measure "clearly modifies the conditions of competition to the detriment of the

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foreign service supplier and thus constitutes 'less favourable treatment' in terms of Article XVII." (In addition to the multiple violations of GATS Article XVII, the Panel also found that a limitation on the participation of foreign capital in contractual joint ventures engaged in the distribution of audiovisual products was inconsistent with China's market access commitments under GATS Article XVI.)

The United States made a number of claims under GATT Article III:4, a national treatment obligation applicable to goods. GATT Article III:4 requires importing WTO Members to accord to imported products "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 accepted two US claims under this provision.

Under one measure, imported reading material – but not domestically-produced reading material – must be distributed through a subscription-based regime. The Panel stated that "a distributor of domestic newspapers and periodicals can distribute individual issues to consumers via newsstands, bookstores, and other shops, as well as via subscription, while a distributor of imported newspapers and periodicals may only distribute its products through a subscription to every issue of that publication." This meant that "the restrictions on the distribution channels…may reasonably be expected to adversely modify the conditions of competition in the marketplace between imported and domestic like products", inconsistently with GATT Article III:4.

Another measure limited the "type of sub-distributors available to imported books, newspapers, and periodicals by excluding foreign-invested enterprises from the potential pool of sub-distributors." The Panel stated that "domestic publications have a wider range of possible sub-distributors than their imported counterparts." It concluded that this measure "may reasonably be expected to adversely modify the conditions of competition in the marketplace between imported and like domestic products", in violation of GATT Article III:4. The other US claims under this provision were rejected.

The United States brought a large number of claims and sub-claims against China in this case, which in the interests of brevity have not been summarized in their entirety here. The description above should thus be considered as illustrative rather than exhaustive. The Panel also ruled that a number of the US claims were outside its terms of reference on procedural grounds.

The decision of the Panel in *China - Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products* (DS363) was released on August 12, 2009.

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WTO Appellate Body Issues Decision in US-Japan "Zeroing" Dispute

Summary

Decision: The World Trade Organization (WTO) Appellate Body has ruled that the United States failed to implement the 2007 rulings of the Dispute Settlement Body (DSB) on "zeroing."

Significance of Decision / Commentary: This decision deals with important issues related to the implementation of WTO rulings in the context of the US "retrospective" system for anti-dumping duties.

Virtually every country in the world other than the United States maintains a prospective system for collecting anti-dumping duties, *i.e.*, the duties are assessed at the time of entry of the goods. By contrast, under the US retrospective duty assessment system, definitive anti-dumping duties are not assessed upon the entry of the goods. Instead, a cash deposit is required, and the definitive duties are determined during the annual administrative reviews of the order conducted by the US Department of Commerce (USDOC). In some cases, the final anti-dumping duty rate can be significantly higher than the cash deposit.

The US retrospective duty system gives rise to unique "temporal" issues when the United States implements rulings of the DSB. In the present case, certain imports entered the United States before the expiration of the compliance period, but liquidation (*i.e.*, actual collection of the duties) occurred after the "reasonable period of time" for compliance. The United States took the position that it had no legal obligation with respect to such imports. It argued that the operative date was the date of importation, when it was not yet under an obligation to comply.

The Appellate Body rejected this position, reasoning that "[i]rrespective of the date on which the imports entered the territory of the implementing Member, the WTO-inconsistencies must cease by the end of the reasonable period of time", even if the WTO-inconsistent conduct is "related to imports that entered the implementing Member's territory before the reasonable period of time expired."

The Appellate Body also found that delays in implementation due to domestic judicial proceedings "cannot exonerate a Member from its compliance obligations" since "[t]he judiciary is a state organ and even if an act or omission derives from a WTO Member's judiciary, it is nevertheless still attributable to that WTO Member." The United States had argued, among other things, that "the USDOC loses jurisdiction over a periodic review while it is under review by the United States courts." However, the Appellate Body stated that "whatever restrictions there are on the United States' executive branch taking actions during the pendency of domestic judicial proceedings would derive solely from United States law"

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and "would not provide a basis for delaying compliance with the DSB's recommendations and rulings beyond the end of the reasonable period of time."

The Appellate Body has thus set down a clear marker: all WTO-inconsistent "actions or omissions subsequent to the reasonable period of time" are impermissible, regardless of the date of entry of the goods. The United States cannot engage in any WTO-inconsistent conduct – not just "actions" but also "omissions" - following the expiration of the compliance period. The US government must ensure that no effects of zeroing remain in force once the compliance period has ended.

(*For a further explanation of the mechanics of zeroing, please see our report of August 17, 2006 on the Appellate Body decision in* ***US – Softwood Lumber V (Article 21.5 - Canada****; available upon request*)

Analysis

Duty collection after expiration of the compliance period: "the DSU requires cessation of all WTO-inconsistent conduct"

Japan challenged the WTO-consistency of assessment rates with respect to imports that entered prior to the end of the compliance period, but for which the liquidation occurred after the expiry of the compliance period. The United States argued that it was "not required to implement in respect of the importer-specific assessment rates because they relate to import entries occurring before the expiry" of the reasonable period of time.

The Appellate Body dismissed this US argument. It ruled that "[w]here the periodic reviews cover imports that entered the implementing Member's territory prior to the expiration of the reasonable period of time, the WTO-inconsistencies may not persist after the reasonable period of time has expired." It stated that "importer-specific assessment rates that were found to be WTO-inconsistent may not remain in effect after the expiration of the reasonable period of time." In other words, according to the Appellate Body, "the WTO-inconsistent conduct must cease completely, even if it is related to imports that entered the implementing Member's territory before the reasonable period of time expired."

The Appellate Body concluded that the WTO Dispute Settlement Understanding (DSU) "requires cessation of all WTO-inconsistent conduct immediately upon the adoption of the DSB's recommendations and rulings or no later than upon expiration of the reasonable period of time." Thus, in the case of periodic reviews of anti-dumping duty orders, the Appellate Body stressed that "the obligation to comply covers actions or omissions subsequent to the reasonable period of time, even if they relate to imports that entered the territory of a WTO Member at an earlier date."

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The Appellate Body then considered whether "actions or omissions that occur after the expiration of the reasonable period of time due to domestic judicial proceedings are excluded from the implementing Member's compliance obligations." The United States argued that delay in liquidation until after the compliance period as a result of judicial review "should not serve as a basis to find that a Member has failed to comply with the recommendations and rulings of the DSB…." The Appellate Body rejected this position. It found that delays in implementation due to domestic judicial proceedings "cannot exonerate a Member from its compliance obligations and are not consistent with the overall objectives of 'prompt' and 'immediate' compliance…."

The Appellate Body similarly dismissed the US argument that the timing of liquidation was controlled by the independent judiciary rather than the administering authority. The Appellate Body stressed that "[t]he judiciary is a state organ and even if an act or omission derives from a WTO Member's judiciary, it is nevertheless still attributable to that WTO Member." Therefore, according to the Appellate Body, "the United States cannot seek to avoid the obligation to comply with the DSB's recommendations and rulings within the reasonable period of time, by relying on the timing of liquidation being 'controlled by the independent judiciary.'"

Breach of tariff bindings: no "safe harbour"

Japan argued that the United States had collected anti-dumping duties on the affected products in excess of the bound rate in the US tariff schedule, in violation of US obligations under GATT Article II.

GATT Article II does not permit the application of tariffs above the scheduled rate. However, Article II also includes what the Panel called a "safe harbour": a WTO Member can impose "any anti-dumping…applied consistently with the provisions of [GATT] Article VI[.]" The Panel found that such a safe harbour was unavailable to the United States in the present case, since the US liquidation actions "had been found to be WTO-inconsistent in the original proceeding." It therefore concluded that the USDOC liquidation instructions were inconsistent with GATT Article II. This finding was upheld by the Appellate Body, largely without discussion.

Procedural issue: Panel's terms of reference

The United States challenged the inclusion in the Panel's terms of reference of a review that did not exist at the time of the original dispute. The United States argued that this was a "future measure" that could not be considered by a compliance Panel established under Article 21.5 of the DSU.

The Appellate Body disagreed. It ruled that a measure that was "initiated before there has been recourse to an Article 21.5 panel, and which is completed during those Article 21.5 panel proceedings, may have a bearing on whether there is compliance with the DSB's recommendations and rulings." The Appellate

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Body found that "an *a priori* exclusion of measures completed during Article 21.5 proceedings could frustrate the function of compliance proceedings."

The decision of the Appellate Body in *United States – Measures Relating to Zeroing and Sunset Reviews: Recourse to Article 21.5 of the DSU by Japan* (DS322) was released on August 18, 2009.

Multilateral Highlights

WTO Arbitration Panel Sides with Brazil in Cotton Dispute But Awards Retaliation Amount Lower than Brazilian Request

On August 31, 2009, the World Trade Organization (WTO) issued arbitration reports in the US-Brazil cotton dispute (DS267). The WTO arbitration Panel ruled that the United States has failed to comply with an earlier WTO Panel decision that found that US cotton subsidies and support did not comply with US multilateral obligations. The arbitration Panel authorized Brazil to initially impose retaliatory measures worth USD 294.7 million on a range of US imports. The arbitration Panel's decision on the retaliation amount is less than the USD 2.68 billion initial retaliation amount that Brazil had requested. The United States, meanwhile, had argued that Brazil's retaliatory measures should not exceed USD 30 million.

In addition to determining the amount of retaliation Brazil is allowed to impose on US imports, the arbitration Panel examined Brazil's request to cross-retaliate by withdrawing concessions in respect of services under the General Agreement on Trade in Services (GATS) or suspending certain of its obligations in respect of intellectual property right protection for US goods and services suppliers. Although the arbitration Panel considered that Brazil had not followed the proper procedures to determine that such cross-retaliation was justified, the arbitration Panel indicated that it would be permissible for Brazil to retaliate under the GATS or the Trade-Related Aspects of Intellectual Property Rights (TRIPs) Agreement with respect to any amount of permissible countermeasures applied in excess of the threshold of USD 409.7 million. According to the arbitration Panel, if Brazilian retaliation is below USD 409.7 million, retaliation can occur in trade in goods "without significantly harming the Brazilian economy because Brazil can substitute the US imports with imports from other countries." Brazil had initially contended that it should have the ability to cross-retaliate without restrictions "because 96 percent of imports from the United States are crucial agricultural and industrial imports, and retaliation on these goods could be counterproductive for the Brazilian economy."

In a ruling against Brazil, the arbitration Panel found that Brazil is **not** entitled to a one-time USD 350 million retaliation for the US "Step-2" cotton program. The United States eliminated the Step-2 cotton program in 2006 following an adverse WTO ruling in respect of the Step-2 program, but only well after the

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reasonable time for implementation of that ruling had ended. However, the arbitration Panel found that retaliation is intended to induce compliance. Since the Step 2 program has been terminated and the United States has thus brought itself into compliance, the arbitration Panel considered that it would not be appropriate to allow Brazil to impose retaliation at this point in time. The arbitration Panel considered that retaliation is not intended to compensate for past failures to comply with a WTO ruling.

The arbitration Panel's decision is the fifth major decision in DS267 since Brazil initiated dispute settlement proceedings with the United States in 2002. In September 2004, a WTO Panel sided with Brazil and found that US subsidies and support to cotton producers under the Step-2 program and other measures, such as export credits, unfairly allowed US cotton producers to undersell foreign competitors and depress world market prices for cotton. Three subsequent WTO decisions reached similar conclusions (a March 2005 Appellate Body decision, a December 2007 Article 21.5 Panel decision, and a June 2008 Article 21.5 Appellate Body decision).

Reaction from the Office of the United States Trade Representative (USTR) was mixed. Although US officials expressed satisfaction with the final retaliation amount that the arbitration Panel awarded Brazil. They lauded the arbitration Panel's rejection of Brazil's request for unlimited retaliatory sanctions on US intellectual property rights (IPR) and its request for the one-time USD 350 million award for the Step-2 program. Nevertheless, the United States "still remains disappointed with the overall outcome of the dispute." The National Cotton Council of America (NCC) also issued a press release that echoed USTR's statements, noting that "[it is] pleased that the arbitration award is far less than requested by Brazil, that the Panel provided no award with respect to the Step 2 cotton program, and that Brazil is not authorized to cross-retaliate at this time."

USTR Announces China's Decision to Eliminate Additional Duties on Imported Auto Parts

On August 28, 2009, the Office of the USTR announced that China will eliminate the additional duties it places on imported automobile parts effective September 1, 2009. China's decision to eliminate the duties comes after a WTO Panel ruled in July 2008 that a charge imposed by China on imported auto parts violates China's WTO obligations (DS339/340/342). The Panel upheld the claims by the United States, the European Union and Canada that the charge on imported auto parts was an internal measure that was inconsistent with China's national treatment obligations under Article III of the General Agreement on Tariffs and Trade (GATT). The WTO Appellate Body backed the Panel's decision in December 2008.

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According to USTR, "the necessary amendments to China's laws [to eliminate the auto parts charge] are expected to be published shortly." USTR Ron Kirk noted that the United States is "pleased that China has informed us that it is eliminating the additional charges on imported auto parts in response to the WTO ruling [and] we look forward to carefully reviewing the changes announced by China." USTR Kirk opined that "ending these charges will help ensure a level playing field for the high quality auto parts made in America and is an important example of the importance of enforcing our international trade agreement rights."

Brazil Challenges United States at WTO Over "Zeroing" Used in Orange Juice Review

On August 19, 2009, the Brazilian Ministry of Foreign Affairs submitted a panel request to the World Trade Organization (WTO) Dispute Settlement Body (DSB), challenging the United States' antidumping measures on imports of Brazilian orange juice. On November 25, 2008, Brazil had sent a notification to the WTO requesting consultations with the United States over the US Department of Commerce's (DOC) use of its "zeroing" methodology in a dumping investigation involving imports of Brazilian orange juice. In its consultation request, Brazil alleged that the DOC used zeroing in an administrative review of the dumping order on Brazilian orange juice issued on August 11, 2008 (with a period of review covering August 24, 2005 to February 28, 2007). DOC found a 4.81 percent margin of dumping through the review. Brazil argues that the margin is inflated because of DOC's use of zeroing. According to several reports, Brazilian officials decided to request a panel after two rounds of unsuccessful consultations with the United States, which took place on January 16 and June 18, 2009. Brazil's decision reflects a growing perception among US trading partners that zeroing is non-compliant with WTO regulations.

Zeroing refers to the practice whereby an investigating authority discounts the so-called "negative dumping margins" to zero. Where the export price of a product is lower than the price in the exporting country, the difference between the two is a positive dumping margin. However, when the export price of the product is higher than the price in the exporting country and zeroing is used, investigating authorities do not give any credit for negative dumping margins. The investigating authority does not average positive and negative dumping margins together – instead, it considers all negative dumping margins to be zero. This has the effect of inflating the overall average dumping margin, and can lead to the imposition or maintenance of antidumping duties which may not otherwise apply.

The DSB will analyze Brazil's panel request at its next meeting, scheduled for August 31, 2009. Should the United States block Brazil's first panel request, the DSB will automatically establish the panel if Brazil makes a second panel request at its meeting, in September 2009.

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Brazil's decision to request a panel on the "zeroing" issue adds another dispute to the United States' long list of disputes with trading partners over its zeroing methodology. To date, there have been more than a dozen disputes regarding the DOC's zeroing methodology. Experts note that the WTO Appellate Body has repeatedly found that DOC's zeroing in original investigations, periodic reviews, sunset reviews and new shipper reviews does not comply with US WTO obligations, and has previously ruled against DOC zeroing methods in disputes such as *United States - Measures Relating to Zeroing and Sunset Reviews* (DS322), *United States - Laws, Regulations and Methodology for Calculating Dumping Margins* (DS294) and *United States - Final Dumping Determination on Softwood Lumber from Canada* (DS264), among others. In face of these adverse decisions, however, US officials continue to defend the zeroing methodology. US officials will likely continue to present arguments against the WTO's adverse views on zeroing during this latest dispute with Brazil.

According to data provided by the Brazilian Ministry of Development, Industry and Foreign Trade, in 2008, the United States imported USD 182 million in frozen orange juice from Brazil – a 47 percent decrease as compared to the amount imported in the previous year. Brazil is the top orange juice world exporter. According to the Brazilian Association of Citrus Exporters (Abecitrus), in 2008, Brazil exported 1.2 million tons of frozen orange juice, accounting for USD 1.7 billion, from which 20 percent was destined to the US market, 60 percent to the European Union and 10 percent to Japan.

The orange juice dispute is not the only dispute between the United States and Brazil. In November 2007, the Brazilian Government requested the establishment of a dispute settlement panel on US trade-distorting agricultural subsidies (DS365). Brazil argued that the United States had provided trade-distorting agricultural subsidies in excess of its WTO commitments in 1999, 2000, 2001, 2002, 2004 and 2005. Panelists have not yet completed their work on that dispute. US agricultural support – specifically for cotton – was also issue at stake in a long-running dispute between the United States and Brazil, and in June 2008, the WTO Appellate Body affirmed that US cotton subsidies continue to violate the obligations of the United States under the Agreement on Subsidies and Countervailing Measures ("SCM Agreement") and the Agreement on Agriculture. Recently, the Appellate Body upheld the rulings of a WTO "compliance" Panel that the United States had failed to implement the original (2005) WTO rulings on cotton. The Brazilian government is also considering requesting the establishment of a WTO dispute settlement panel on US import tariffs on Brazilian ethanol. The Brazilian government is expected to make a decision on this matter shortly, after holding consultations with sugar producers and government lawyers.

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