WHITE & CASE

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General Trade Report - JETRO

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UNITED STATES

UNITED STATES GENERAL TRADE POLICY

House Ways and Means Committee Holds Hearings on China's Currency Practices

Summary

On September 15 and 16, 2010, the House Ways and Means Committee held hearings to determine whether China has made any material progress in allowing its currency (RMB) to appreciate against the dollar and to determine what actions the Obama Administration and Congress should take to address China's currency practices and their effect on the US economy and job creation. Possible actions discussed at the hearing include redoubling bilateral negotiations, enacting legislation to address China's currency practices and initiating formal dispute settlement consultations with China before the World Trade Organization (WTO). At this stage, it is unclear whether the House or Senate will pass China currency legislation before the mid-term election recess.

Analysis

I. HOUSE WAYS AND MEANS COMMITTEE DISCUSSES PAST PROGRESS IN AND FUTURE POLICY OPTIONS FOR ADDRESSING CHINA'S CURRENCY PRACTICES

Members of the private sector and Congress gave testimony before the House Ways and Means Committee on September 15, 2010 while the September 16, 2010 hearing was reserved for testimony given by Secretary of the Treasury Timothy Geithner. Testimony given addressed whether China has allowed the RMB to move freely against the US dollar (and the basket of currencies of China's trading partners) and to determine what policy options are available to the Obama Administration and Congress to engage China on its currency practices.

<u>September 15, 2010 Hearing</u>

- In his opening remarks, House Ways and Means Committee Chairman Sander Levin (D-MI) stated that China's exchange rate policies "distort trade and investment flows" and "undoubtedly contribute to [the US'] staggering trade deficit with China." Rep. Levin laid out three courses of action the United States can take to engage China on this issue:

  I. **Intensify US-China bilateral dialogue and negotiation**. Rep. Levin expressed a preference for this course of action stating that it is the one which is "most likely to yield the broadest results."

  II. **File a WTO case**. Rep. Levin stated that many lawmakers believe that China's currency practices are not WTO-compliant but stated that Congress cannot file WTO petitions on behalf of the United States.

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III. **Enact legislation which clears the way for trade remedy measures to be applied on goods imported from countries with an undervalued currency.** Rep. Levin stated that he believed such legislation to be consistent with the United States; WTO obligations.

Four members of the House and six private sector representatives gave testimony. Testimony given by the lawmakers was evenly split between those in favor of legislation addressing the currency issue and those against such legislation. Of the six private sector representatives who gave testimony, however, two warned the committee that passing such legislation would hurt the US-China bilateral relationship. We highlight some of the testimony given:

- **Rep. Tim Ryan (D-OH)** stated that HR 2378 "addresses […] currency manipulation by using internationally agreed-upon WTO rules." Countering Rep. Levin's opinion that the United States has three options, Rep. Ryan posited that that enacting legislation to address China's currency issues "is the only viable option [the United States has] at this point to bring strong pressure on China and other countries with persistently undervalued currencies."

- **Rep. John Boccieri (D-OH)** stated that HR 2378 "is designed to be consistent with [the US'] obligatons under the WTO and that it "is a perfect example of the kind of action [the US needs] to force China to play by the same rules as US businesses."

- **Rep. Adrian Smith (R-NE)** urged the Committee to "ensure that [the US'] current export markets are not threatened because Congress has taken questionable legislative action which invites retaliation."

- **Rep. Lynn Jenkins (R-KS)** urged the Committee members to "proceed with great caution" in addressing China's currency practices and noted that growing US agricultural exports to China could be put in jeopardy if China currency legislation were to pass.

- **United Steelworkers Union President Leo Gerard** urged lawmakers in his September 15, 2010 testimony to pass HR 2378 stating that China's "currency manipulation" contributed significantly to US job losses and wage stagnation.

- **United States-China Business Council President John Frisbie** warned that enacting legislation to address China's currency practices would be counterproductive to rebalancing the US-China trade deficit. He stated that such legislation is doubtfully WTO-compliant and that the USCBC does not believe that losing a WTO case would strengthen the US' position on the currency issue. He also called into question the validity of the argument that the United States trade deficit with China will be reduced by persuading China to revalue its currency citing the period between 2005 and 2008 during which the RMB appreciated by 20 percent while the US trade deficit with China also grew.

- **President and CEO of Nucor Corporation Dan Dimicco** urged lawmakers to pass HR 2378 and posited that ending China's alleged currency manipulation will "reinvigorate [the US'] manufacturing sector and [the US] economy."

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- **Director of the Peterson Institute for International Economics C. Fred Bergsten** posited that "expanding the scope for countervailing duty actions (such as HR 2378) could lead to protectionist abuse of [the] safeguard device [and] […] trigger temporary instability in financial markets."

- **Partner of Greenberg Traurig, LLP Ira Shapiro** noted that "lashing out against China (by passing currency legislation) would threaten the US economy." He also highlighted that the United States needs the support of China in order to apply pressure on Iran and North Korea and and to address climate change such that the US approach to dealing with contentious issues with China will require "patience, persistence and diplomacy."

- **President of TradeWins, LLC John Magnus** stated that "China's present currency regime meets the technical, legal definition (in current US and WTO law) of an export-contingent subsidy" and that "the case for congressional action (against China) is strong."

September 16, 2010 Hearing

- **Secretary of the Treasury Timothy Geithner** posited in his testimony that the appreciation of the RMB "will not erase [the US'] global trade deficit nor [the US'] deficit with China." Secretary Geithner did not make any specific reference to pending legislation in either the Senate or the House to address China's currency practices but he did emphasize the Obama Administration's continued efforts and commitment to engaging China on the currency issue through bilateral and multilateral dialogue and negotiation such as the Strategic and Economic Dialogue (S&ED), the G-20 and the WTO. Secretary Geithner gave identical testimony to the Senate Committee on Banking, Housing and Urban Affairs on the same day.

II. RECENT IRRITANTS

There have been several events during the past year that have served as motivation for lawmakers to pursue legislation addressing China's currency practices:

- China announced on June 19, 2010, ahead of the G-20 talks in Canada, that it would allow a greater flexibility of its currency. Observers note, however, that the RMB has appreciated by less than 1 percent since this announcement. Labor unions, as well as some US lawmakers and manufacturers, have cited economic analyses showing a 25-40 percent undervaluation of the RMB. Consequently, the less than 1 percent appreciation of the Chinese currency since June is unlikely to stop many US lawmakers' calls for the Obama Administration to undertake a more aggresive position toward China's currency practices and for Congress to consider legislation such as HR 2378 and S. 3134 (discussed below).

- In its semi-annual report on International Economic and Exchange Rate Policies released on July 8, 2010 (delayed from April 15, 2010), the Department of the Treasury, at the behest of the Obama Administration, declined to label China a currency manipulator for the purpose of preventing effective balance of payments adjustment or gaining unfair competitive advantage in international trade during the period July 1, 2009 to December 31, 2009. Treasury maintains the view that China's currency remains undervalued despite its decision not to label China a currency manipulator. In support of this view, the treasury report cited: (i) sustained purchases by China of large amounts of foreign currency reserves; (ii) the narrow band within which the renminbi is allowed to move against the US dollar (0.5 percent per day); (iii) the limited appreciation

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of the renmimbi despite rapid productivity growth in China; and (iv) continued Chinese current account surpluses despite the fact that many of China's trading partners remain in recession. Had Treasury's report labeled China a currency manipulator, it would have initiated a process requiring the United States to discuss with China its currency policy. The next Treasury report is due on October 15, 2010.

- The Department of Commerce (DOC) declined on August 31, 2010 to investigate the alleged undervaluation of the RMB as a countervailable subsidy in cases involving coated paper and aluminum extrusions imported from China. DOC determined that petitioners failed to establish that China's undervaluation of the RMB could meet the statutory requirements of a countervailable subsidy because the evidence provided did not demonstrate that China's currency policies targeted Chinese exports or were specific to certain Chinese companies or industries. Less than a week before DOC's currency determination, it released a proposal for 14 new policies as part of the Administration's Trade Law Enforcement Package, which aims support the Obama Administratons National Export Initiative (NEI) by addressing a range of US trade remedy (AD and CVD) issues.

Ninety-three US lawmakers have signed a letter drafted by Rep. Tim Ryan (D-OH) urging House Democratic leadership to bring HR 2378 to a vote. The letter also gives an explanation as to why HR 2378 would not violate WTO rules. Sources say that House Speaker Nancy Pelosi has yet to decide whether to bring HR 2378 to the House floor for a vote. HR 2378 would allow companies or organization(s) representing an industry to petition the DOC to apply CVD duties on imported goods equal to the determined undervaluation of the exporting country's currency.

Sen. Schumer has repeatedly stated that he will push for a vote on the Currency Exchange Rate Oversight Reform Act of 2010 (S. 3134), a bill that, similar to HR 2378, would allow the United States to deem China's currency undervaluation a countervailable subsidy and subject all Chinese exports to potential remedial tariffs. Sen. Schumer, as well as S. 3134 co-sponsor Sen. Lindsey Graham (R-SC), has insisted that there is enough support in the Senate to pass S. 3134.

A bi-partisan group of eight former Secretaries of Commerce and US Trade Representatives sent a letter on September 20, 2010 to House Speaker of the House Nancy Pelosi (D-CA), House Majority Leader Steny Hoyer (D-MD), House Minority Leader John Boehner (R-OH), Senate Majority Leader Harry Reid (D-NV) and Senate Minority Leader Mitch McConnell (R-KY) urging them to carefully consider the consequences of passing legislation to address China's currency practices. In the letter, Michael Kantor (Secretary of Commerce 1996-1997 and USTR 1993-1996), William Daley (Secretary of Commerce 1997-2000), Charlene Barshefsky (USTR 1997-2001), Norman Mineta (Secretary of Commerce 200-2001 and USTR 2001-2006), Carla Hills (USTR 1989-1993), Barbara Hackman Franklin (Secretary of Commerce 1992-1993), Carlos Gutiérrez (Secretary of Commerce 2005-2009) and Susan Schwab (USTR 2005-2009) state that China's possible response to such legislation could be "some form of copycat response or other threats and retaliation against US exports and companies." Moreover, the letter states that Congress and the Obama Administration should, instead, be focusing their attention on other contentious issues in the US-China trade relationship such as market access, intellectual property rights and China's indigenous innovation policies.

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The United Steelworkers Union (USW) filed a petition on September 9, 2010 under Section 301 of the Trade Act of 1974 with the United States Trade Representative (USTR) against China regarding its support of its clean energy sector. The petition asks the Obama Administration to initiate dispute settlement proceedings at the WTO and in order to pressure the Chinese government to desist from providing this "unfair" support. The USW claims that this support has unfairly contributed to Chinese companies expanding their market share for clean energy equipment to the detriment of American workers in those sectors.

Outlook

Due to a struggling US job market, a difficult US near-term economic outlook, news of China's trade surpluses, the November mid-term elections in the United States, and the impression among some US manufacturers and lawmakers that China has not fulfilled its promise to allow greater RMB flexibility, the impetus for Congress to pass legislation addressing China's currency practices has reached its highest point since 2006. In that year, the House passed legislation imposing tariffs on Chinese imports unless China appreciated the RMB, and China subsequently allowed its currency to appreciate almost 20 percent against the dollar over the next two years. Thus, most analysts opine that there is a good possibility that a bill addressing China's currency practices will be passed by at least one of the chambers of Congress before the November elections.

It appears unlikely, however, that President Obama would sign any China currency legislation into law, and his team may be working behind the scenes to ensure that the legislation does not pass both the House and Senate in order to avoid taking a public position on the matter before the November elections. The appearance of Secretary Geithner before the House and Senate came one day after the the Obama Administration filed two WTO cases against China – a move that most experts believe was intended to diffuse congressional calls for trade action against China and to demonstrate that the White House is, indeed, taking a firm stance toward China. Past Obama Administration action and statements suggest that it believes legislation such as S. 3134 or H.R. 2378 will harm an already-tense US-China relationship and could not only close the US' fastest growing export market, but also hinder US-China diplomatic cooperation on issues such as the containment of North Korea and Iran.

The legislation also faces a very real practical hurdle in the Senate, as there are only thirteen voting days left in that chamber before it adjourns on October 8, 2010 for the mid-term elections. Given these facts, it appears unlikely that any currency legislation will become law in 2010. However, with congressional Democrats facing a troubling US economy and the prospect of significant electoral losses in November, the currency legislation's chances, while slim, cannot be ruled out.

United States General Trade Policy Highlights

US Export Promotion Cabinet Releases Five-Year Plan for Doubling Exports

On September 16, 2010, the US Export Promotion Cabinet – comprised of the heads of the US Departments of Commerce, State, Treasury, Agriculture, Labor, and other agencies – released a report to the President outlining a specific five-year plan for increasing exports under the President's National Export Initiative ("NEI").

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Formulated through Executive Order 13534 in March 2010, the NEI is a response to President Obama's January 2010 State of the Union Address in which he called for a doubling of US exports over a five-year period. The NEI's key policy components include: (i) improving advocacy and trade promotion efforts for US exporters; (ii) increasing access to export financing; (iii) removing barriers to trade; (iv) enhancing the enforcement of US trade laws; and (v) promoting balanced growth around the world. The report outlines specific recommendations for addressing each of these objectives.

In the report, the US Export Promotion Cabinet called on the US government to: (i) help small- and medium-sized enterprises expand exports through training, better financing, and increased exposure to potential customers; (ii) bring more overseas business delegations to US trade shows and push US companies to participate in trade shows overseas, including participation in green technology-related programs; (iii) expand the number of US trade missions overseas while better coordinating these efforts with foreign governments and overseas trade associations; (iv) improve US exporters' access to credit; (v) push key trading partners to reduce their trade surpluses with the US; (vi) reduce trade barriers through negotiations with trading partners, including completing the Trans-Pacific Partnership Agreement and the US-Korea Free Trade Agreement; (vii) tighten the enforcement of US trade remedy laws; and (viii) promote the export of US services, including a focus on Brazil, China and India as key emerging markets for US services.

Although the NEI report to the President does outline specific recommendations for achieving significant export growth during the next five years, it is not yet clear if the report will stand only as a set of general guidelines for specific agency-level initiatives that are already underway, or if trade-related agencies within the US government will invoke new personnel and financial resources to pursue the objectives outlined in the report. As reported previously, the US Department of Commerce in late August 2010 announced specific NEI-related proposals for the stricter enforcement of US antidumping and countervailing duty laws, especially with respect to China. These practical proposals from the US Department of Commerce indicate that at least some US government agencies will use the NEI as political cover to justify controversial initiatives, especially with respect to the more stringent enforcement of US trade laws and trade agreements.

House Passes Bill Targeting Chinese Currency Practices; Senate Fate Uncertain

On September 29, 2010, the House of Representatives voted 348-79 to approve HR 2378, a bill authorizing the Department of Commerce (DOC) to apply US countervailing duties (CVD) on goods imported from countries deemed to have fundamentally misaligned currencies. The House Ways and Means Committee sent the Currency Reform for Fair Trade Act (HR 2378) to the House floor for a vote after Representatives Sander Levin (D-MI) and Dave Camp (R-MI) reached a compromise agreement last week to adjust language so that it was, in supporters' view, consistent with the United States' obligations under the World Trade Organization (WTO) agreements. The current bill, or a similar version, must be approved by the Senate, and signed by the President, before becoming law. The Senate is unlikely to vote on any currency legislation until after the November elections, and even then a Senate vote remains uncertain.

Introduced by Representative Tim Ryan (D-OH), the original version of HR 2378 amended the Trade Act of 1974 whereby currency undervaluation (*i.e.*, currency misalignment) must be found by DOC to be a countervailable

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subsidy. Under current CVD law, a "subsidy" exists in cases in which (i) a government confers a financial contribution; and (ii) a benefit is perceived by the recipient of the financial contribution. A subsidy is countervailable where it is "specific," *i.e.*, it is (a) contingent upon export performance; (b) contingent upon the use of domestic over imported goods; or (c) limited, in law or fact, to an enterprise or industry. In two recent CVD determinations involving imports of coated paper and aluminum extrusions from China, DOC chose not to investigate alleged currency-related subsidy investigations after concluding that the petitioners had failed to demonstrate specificity through either export-contingency or enterprise/industry limitation, and thus did not meet the legal threshold for the imposition of countervailing duties on the subject merchandise.

Before being approved in the House Ways and Means Committee, HR 2378's language was amended in an effort to minimize WTO-inconsistent. The amended version of HR 2378 no longer directs DOC to regard a currency undervaluation as a countervailable export subsidy. Instead, the legislation mandates that DOC may not dismiss a petition to impose CVDs on goods from countries with undervalued currencies for failing to meet the "export contingency" specificity criterion solely on the grounds that the alleged currency "subsidy" is available to non-exporters.

Opponents of HR 2378 and the proposed changes to the CVD laws argue that an increase in the number of CVD petitions filed, and potentially higher CVD rates imposed on Chinese imports, could lead to higher prices for imported goods, cost American jobs, and create "trade diversion," *i.e.*, a shift in sourcing from China to other countries, including Vietnam, Mexico and other US trading partners. Experts also point out that if HR 2378, or a similar bill, becomes law, the Chinese government would likely retaliate against US exports through increased trade remedy actions or by imposing other non-tariff barriers on US exports.

However, assuming the bill becomes law as written, a large spike in CVD petitions against China is unlikely in the near term. Instead, only a small number of "test case" petitions will likely be filed initially in order to determine how the Department of Commerce intends to exercise its initiation authority under the revised legal standard. As noted above, the amended version of HR 2378 does not force DOC to initiate a CVD investigation based on alleged currency undervaluation. Instead, it narrows DOC's discretion to refuse to initiate an investigation based on an allegation of export contingency and describes how the Department would calculate the subsidy benefit.

Should DOC decide to initiate CVD investigations in those test cases and then go on to find significant levels of subsidization, several more petitions would likely follow. However, even if DOC signals a broad and aggressive desire to pursue CVD investigations under the new law, the number of new petitions will still be limited by (a) practical considerations surrounding the time and expense of filing a CVD petition; (b) the requirement of proving "material injury" at the International Trade Commission before the imposition of remedial tariffs; and (c) the requirement that the petition be supported by a significant proportion of a domestic industry that manufactures a like product. On the other hand, the new law would likely encourage industries with existing CVD orders on Chinese goods to request administrative reviews and submit new subsidy allegations to increase countervailing duties under those orders.

Senator Charles Schumer (D-NY) has recently stated his intention to resuscitate the Currency Exchange Rate Oversight Reform Act (S. 3134) that has been stalled in the Senate Finance Committee since March 2010. Given that it is unlikely that the Senate will consider voting on S. 3134 until Congress reconvenes for a lame-duck

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session in November 2010 and in light of widespread concerns among US lawmakers, US business community and the Obama Administration that China could launch immediate and severe retaliatory actions if and when the US Congress passes legislation to unilaterally address China's alleged currency undervaluation, it remains unclear what the prospects are for S. 3134 to be passed in the Senate.

India and United States Hold 7th Trade Policy Forum

On September 22, 2010, Indian Commerce Minister Anand Sharma and USTR Ambassador Ron Kirk co-chaired the 7th Indo-US Trade Policy Forum (TPF) meeting in Washington D.C. During the meeting, the two sides examined a range of bilateral trade and investment issues. They also agreed to intensify their efforts to resolve key bilateral trade and economic differences. Minister Sharma expressed concern on the trade restrictive and protectionist stance adopted recently by the United States, including possible restrictions on outsourcing of government contracts taken by the US state of Ohio. He also expressed the need for an agreement between India and the United States to support growth in the services sector. The two sides aim to address some of these concerns prior to the visit of US President Barack Obama to New Delhi in early November 2010.

The United States-India TPF was established in July 2005 and constitutes the principal bilateral forum for the two governments to discuss trade and investment issues. Such issues are discussed in detail through the TPF's five Focus Groups, which include (i) agriculture; (ii) innovation and creativity (intellectual property rights); (iii) investment; (iv) services; and (v) tariff and non-tariff barriers. During the latest TPF meeting, Minister Sharma and Ambassador Kirk received reports from the five Focus Groups on key trade and investment concerns. The two sides held comprehensive discussions on a wide range of issues, identifying areas for future constructive engagement between the two trading partners.

Ambassador Kirk and Minister Sharma also welcomed the inaugural meeting of the US-India Small and Medium Enterprise (SME) Forum, which advanced the mandate provided in the *Framework for Cooperation on Trade and Investment* signed in March 2010. Under the framework, the TPF has agreed to collaborate in areas such as infrastructure development, information and communications technology (ICT), energy and environmental services, health care, and education services. The TPF also agreed to do more to help SMEs to enhance mutual market access and create tie-ups.

The Private Sector Advisory Group (PSAG) submitted a report to Ambassador Kirk and Minister Sharma outlining its proposals for furthering the US-India trade and investment relationship. The PSAG was formed in April 2007 as an adjunct to the TPF to provide the TPF with views and advice from non-government trade and investment experts.

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FREE TRADE AGREEMENTS

TPP Partners Hold Intercessional Meeting in Peru to Discuss Market Access Issues

Summary

From August 20-21, 2010, countries participating in negotiations for the Trans-Pacific Partnership (TPP) Free Trade Agreement (FTA) held an intercessional meeting in Lima, Peru. All TPP negotiating partner countries, including Australia, Brunei, Chile, New Zealand, Peru, Singapore, the United States, and Vietnam (as an "associate member"), were present at the meeting. Officials from Malaysia and Canada were also in attendance in order to conduct bilateral meetings with TPP partners regarding their interest in joining the negotiations. During the meeting, negotiating partners discussed ways to determine the market access structure for the goods and services schedules under the agreement, although negotiators were unable to reach a consensus on what kind of scheduling approach the final TPP FTA should reflect, including whether the TPP agreement will maintain market access (tariff) and services schedules in existing bilateral FTAs, or whether the TPP agreement will subsume and/or reopen the existing bilateral agreements for additional negotiations. All parties expect to reconvene to deliberate on the coexistence of a TPP agreement with other existing bilateral agreements in the next round of negotiations scheduled to take place from October 4-6, 2010 in Brunei.

Analysis

In the lead up to the intercessional meeting, Assistant Office of the United States Trade Representative (USTR) Barbara Weisel held a conference call with private-sector participants on August 18, 2010 where she announced that the United States plans to establish uniformity in regulations across TPP partners. The aim is to prevent US companies from facing differing regulatory regimes when exporting their products to different TPP partner countries. She hinted that US negotiators will likely only secure coherence in a limited number of areas, but that the United States aims to prioritize key regulatory barriers facing US companies in the areas of labor and environmental protection.

According to AUSTR Weisel, US TPP FTA negotiators are pursuing "multiple tracks" in order to attain regulatory coherence among participating countries. In this effort to attain regulatory coherence, the first track USTR has pursued is to prioritize issues such as regulation of emerging technologies in the areas of food safety, biotechnology and green technology. AUSTR Weisel expressed that several TPP participants do not yet have regulations in place in these areas and that ensuring that parties to the agreement develop similar regulatory systems in these areas within the framework of the TPP FTA will be beneficial for trade among TPP partners. The second track USTR is pursuing is to increase the transparency of regulatory requirements across TPP countries. This may include a central repository or online database where all TPP members could access information readily. The third and fourth tracks relate to labor and environmental regulations, respectively. USTR explained that the Obama Administration is aiming to expand labor and environmental protections contained in the TPP FTA beyond what has been agreed to in past FTAs. With regard to labor, AUSTR Weisel conceded that attaining regulatory coherence in this matter could be difficult due to the varying levels of development and

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differing industrial relations in each TPP participant country. With regard to environment, US TPP FTA negotiators are aiming to eliminate trade barriers in TPP counties to US "green" exports, such as wind turbines and photovoltaic cells.

During the Lima intercessional meeting, the United States and other TPP partners explored whether countries will negotiate a single, unified TPP FTA tariff schedule applicable to all members, or whether TPP countries will negotiate bilateral tariff schedules with one another in the instances where they do not already have a bilateral trade agreement in place. The United States, which currently has FTAs with Australia, Chile, Peru, and Singapore, expressed a preference for retaining the tariff schedules in its existing bilateral FTAs, and negotiating tariff schedules with Brunei, New Zealand and Vietnam. Reportedly, US officials noted that negotiations on other aspects of the TPP agreement could occur on a bilateral basis between each of the TPP members. TPP members, such as Singapore, expressed a willingness to consider deepening its bilateral agreement with the United States.

In contrast, Australia (and New Zealand to some extent) sought a "more ambitious agreement," and argued in favor of reopening current FTA schedules, includes both tariff and services schedules, to new concessions not contained in the existing agreements and argued in particular against adopting similar concessions contained in the AUSFTA. In a TPP public consultation process held on October 3, 2008, a resounding theme among Australia's economic sectors was that none of the parties supported the concessions made in the AUSFTA, and opposed the inclusion of similar concessions in any future FTAs, including the TPP agreement. Stakeholders in the media and audiovisual sectors, for example, requested that the TPP agreement's treatment of the audio visual industry does not adopt an approach along the lines of the AUSFTA. As for New Zealand, stakeholders in a consultation, which took place from October-December 2008, expressed concern about the potential vulnerability of New Zealand's companies to intellectual property litigation challenges from the United States. Peru additionally expects to renegotiate sectors, such as intellectual property, that could restrict market access to generic medicines. In response to these issues, TPP negotiating partner countries deliberated on ways to maintain "the best" elements of each existing bilateral agreement, but were unable to find an appropriate solution and reach a consensus on whether to adopt one tariff schedule and one services schedule for all TPP members, or pursue bilateral negotiations to develop individual tariff and services schedules with each TPP member. TPP partners agreed to review these issues at the next formal round of TPP negotiations, taking place in Brunei.

Regarding Canada and Malaysia's participation in the TPP FTA negotiations, neither Canada nor Malaysia participated in the formal discussions on market access during the intercessional meeting. Canada, however, did meet with a number of TPP members in Peru, but did not meet with the United States or Vietnam. The United States announced that it plans to schedule a separate and comprehensive meeting with Canada to discuss Canada's ability to meet the standards and objectives of the TPP; this meeting is scheduled to take place on September 6, 2010. According to media sources, the United States and New Zealand have both expressed some concern regarding Canada's participation in the TPP. New Zealand is concerned that Canada would likely not offer enough concessions in terms of dairy market access. Remaining TPP partners have not yet made a final decision regarding Canada's participation in the TPP agreement. On Malaysia, reportedly all the negotiating partner countries have agreed to allow Malaysia to join the TPP negotiations, and initial reports note that Malaysia could join the next formal round of negotiations.

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Outlook

Ahead of the third negotiating round in Brunei, TPP negotiating partners will likely conduct internal consultations to review existing tariff schedules to facilitate the discussions on trade in goods at the next round. The US TPP business coalition, for example, is currently preparing revised papers for submission to the USTR outlining refined industry suggestions for what the United States should propose in key areas of the negotiations. US businesses are seeking to expand cooperation in labor and environmental protection as well as new and emerging areas where there are no existing regulations in place.

Analysts predict that the modalities and negotiating approach regarding the tariff and services schedules will continue to be contentious among the TPP parties. Moreover, TPP negotiating partners have not yet formally decided how to incorporate other negotiating partners into the TPP agreement. There will have to be a consensus from all TPP partners on the entrance of a new negotiating partner, and the integration process could prove time consuming and possibly controversial. That said, Malaysia may be a good first choice. Malaysia already has agreements in place or under various stages of negotiation with seven of the eight TPP parties. Malaysia is part of the ASEAN Free Trade Area along with Brunei, Singapore and Vietnam, concluded FTA negotiations with Chile in early May 2010, implemented an FTA with New Zealand on August 1, 2010, will hold the next round of FTA negotiations with Australia in October 2010, and already has several years of experience negotiating with the United States.

Free Trade Agreements Highlights

US and Philippine Officials Discuss Expanding Bilateral Trade and Investment Relations, Including Possible Participation in TPP Negotiations

As a follow-up to President Aquino's recent official visit to the United States, the Undersecretary for the Department of Trade and Industry (DTI) International Trade Group, Adrian Cristobal, met with his counterpart Assistant United States Trade Representative (AUSTR) Barbara Weisel on September 28, 2010 in Manila. During the meeting, both sides discussed US concerns regarding Philippine intellectual property rights (IPR), labor standards, customs facilitation, and excise taxes on wines and spirits. They further discussed expanding bilateral trade and investment relations under the US-Philippines Trade and Investment Framework Agreement (TIFA), which was signed on November 9, 1989 and designed primarily to boost bilateral trade and economic ties. However, Barbara Weisel pointed out that the United States is no longer interested in pursuing a bilateral free trade agreement (FTA) with the Philippines, but is instead focusing on expanding its trade and investment commitments with the Philippines, potentially under the Trans-Pacific Partnership (TPP) Agreement. She added that the United States is ready to move forward with expanding trade under the Aquino administration, with initial talks centering on the Philippine government's interest in joining the TPP negotiations. AUSTR Weisel indicated that the TPP would be more beneficial than a bilateral FTA since a number of countries with which the Philippines has limited trade ties (*e.g.*, Chile and Peru), and other potential countries are either current TPP members or expected to join the negotiations. Adrian Cristobal in turn, highlighted the Philippines' interest in taking part in the TPP as a means to expand trade with the United States, but did not indicate a specific date for doing so. To

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formally engage in the TPP negotiations, Adrian Cristobal stated that the Philippines intends to conduct a series of studies on the feasibility of the Agreement and to engage in extensive consultations with the government, Congress, the private sector, and members of the civil society.

CUSTOMS

Customs Highlights

US Customs Withdraws Proposal to Eliminate First Sale Rule

On September 29, 2010, US Customs and Border Protection (CBP) announced its decision to withdraw notice of its proposal to eliminate the "First Sale Rule." CBP published notice of its proposal in the Federal Register on January 24, 2008, specifically proposing to reinterpret the expression "sold for exportation to the United States" for the purposes of applying transaction value as the basis of appraisement in a series of sales importation scenarios.

Under CBP Customs valuation regulations, transaction value is the preferred method of valuation, and is defined as the price actually paid or payable for the merchandise "when sold for exportation to the United States." To date, the phrase "sold for exportation to the United States" has been interpreted to include sales prior to the transaction between the final foreign exporter and the US importer, if it could be documented that the sale was intended for export to the United States. Under the proposed interpretation, "sold for exportation to the United States" would have been interpreted to mean that the price of goods in a transaction that involved a series of sales was the price paid for the goods in the last sale occurring immediately prior to importation of the goods into the United States. Consequently, the transaction value usually would have been determined based on the price the buyer in the United States paid for the goods.

CBP's decision to withdraw its 2008 proposed interpretation maintains the status quo, the First Sale Rule, with regard to determining transaction value in a series of sales situation. Thus, CBP will continue to base transaction value on the price paid by the buyer in the first or earlier sale, provided the importer can present sufficient evidence to show that the sale was an arm's length sale and that the goods were clearly destined for exportation to the United States.

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MULTILATERAL

WTO Panel Releases Decision in European Communities and its Member States - Tariff Treatment of Certain Information Technology Products (DS375, DS376, DS377)

Summary

Decision: A WTO Panel has ruled that the European Communities violated their WTO obligations by imposing customs duties on information technology products that should have been granted duty-free treatment under the 1996 Information Technology Agreement (ITA). The Panel upheld the complaint of the United States, Japan and Chinese Taipei that the imposition of duties on these goods breached the EC's tariff bindings under GATT Article II.

Significance of Decision / Commentary: This dispute arose from the technical evolution of products for which duty-free treatment was agreed in 1996.

The ITA – more formally the "Ministerial Declaration on Trade in Information Technology Products" – was adopted at the 1996 WTO Ministerial Conference in Singapore. The parties agreed to "bind and eliminate customs duties" on certain IT products by January 1, 2000. They implemented their ITA obligations by amending their tariff commitments under GATT Article II. The IT products identified for tariff-free treatment continued to be developed after the adoption of the ITA, which gave rise to a dispute over whether more technically-advanced products should be considered to remain covered by the 1996 Agreement. For example, the ITA parties agreed that automatic data-processing machine (ADP) monitors would fall under the ITA, but television sets would not. Yet in 2010, as the EC argued, "monitors…can be used both as ADP monitors and as…TVs." The EC acknowledged that "a genuine ADP monitor is entitled to zero duties treatment", but pointed to "radical changes in monitor technology over the past decade or so" which made it "extremely difficult to distinguish between computer monitors and video monitors including television sets." This led the EC to reclassify some IT products away from the duty-free headings on the grounds that "the inclusion of a new product must be negotiated; it cannot be assumed to be covered by the concessions just because it happens to also perform similar functions as a product that is covered by the concessions."

The Panel rejected the EC's position, reasoning that there was "no express limitation on technical characteristics" and "no requirement for exclusivity." Moreover, the Panel stressed that the ITA listed the covered goods not just by specific headings under the Harmonized System (HS), but also through a narrative list of products that were "covered by this agreement wherever they are classified in the HS."

The decision of the Panel in this case is consistent with prior WTO rulings that have imposed strict disciplines on the use of tariff reclassification, such as the 2005 Report of the Appellate Body in *EC – Chicken Cuts*. In that case, the EC reclassified frozen boneless chicken to move it from the category of "salted meat" to that of "frozen chicken." Although the product remained unchanged, the reclassification increased the applicable tariff dramatically, from 15 percent to a tariff equivalent of nearly 60 percent. Thus, the simple reclassification of the

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product quadrupled the applicable customs duties. The Appellate Body ruled that the EC breached its tariff commitments when it reclassified chicken imports to move them into a higher tariff category.

The present case was more complicated, in that the EC argued that technological innovation had essentially transformed certain goods into entirely new products. Nonetheless, the Panel was right to insist that goods subject to ITA commitments had to remain duty-free, even if some covered products have since become capable of performing additional functions. A ruling to the contrary could have vitiated the value of the ITA. Moreover, continuing product evolution is not limited to IT goods. If the EC position had been upheld, the predictability of non-ITA tariff commitments could similarly have been jeopardized by the unilateral customs reclassification decisions of importing countries.

Analysis

I. BACKGROUND: THE INFORMATION TECHNOLOGY AGREEMENT – THE "DUAL APPROACH"

The original parties to the 1996 ITA were the EC and its (then) 15 member states, the United States, Japan, Korea, Canada, Australia, Norway, Switzerland, Singapore, Hong Kong, Chinese Taipei, Turkey, Switzerland, Indonesia and Iceland. Membership has since expanded to 70 participants.

In order to promote "the expansion of world trade in information technology products", the ITA participants agreed to remove customs duties on certain IT products. More specifically, they agreed to the phased elimination of duties on two sets of products:

- IT Products listed by HS headings, down to the six digit level, as set out in Attachment A to the ITA Agreement; and

- IT Products identified through a narrative description, without any reference to the HS system, as set out in Attachment B to the Agreement. Under the ITA, this was considered as a "[p]ositive list of specific products to be covered by this agreement wherever they are classified in the HS."

Attachment A was described under the ITA as a "list of HS headings", while Attachment B was a "list of products." The Panel explained the reason for this dichotomy as follows:

> …[T]he drafters of the ITA considered that the traditional approach of listing HS codes was inadequate to address the full scope of the product coverage that was intended by participants to the ITA, in particular given the then prevailing divergences in the classification of products in and for Attachment B. Consequently, ITA participants agreed to implement their commitments though a "dual" approach that included binding and eliminating duties for both: (i) products classified or classifiable in HS codes listed in Attachment A, and (ii) products specified in Attachment B. While the approach under Attachment A is straightforward and "traditional" in WTO terms, ITA participants were directed under Attachment B to eliminate duties on all products "specified" in that Attachment. This approach was taken because ITA participants could not agree on precise headings for the products identified through the narrative descriptions in Attachment B. Since the narrative

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> descriptions must determine the scope of coverage of those products, duty-free treatment must be extended to products specified in Attachment B "wherever they are classified". Otherwise, ITA participants would have ended up with diverging product coverage, which runs contrary to the intent to provided [*sic*] duty-free coverage for specified "products" in Attachment B, and not headings of tariff lines under which products are classified.

All ITA participants were required to amend their tariff schedules to implement their ITA obligations. As noted above, the elimination of customs duties had to be completed by January 1, 2000.

II. POSITIONS OF THE PARTIES ON "TECHNICAL EVOLUTION"

The complainants argued that the EC had breached its obligations under the ITA by applying duties on three classes of products: (i) flat-panel displays; (ii) "set top boxes which have a communication function"; and (iii) multifunctional digital machines. The United States argued that "[w]hile the particular measures the EC has adopted to eliminate duty-free treatment for the products in question differ, all share a common theme: the use of arbitrarily chosen technical characteristics to reclassify products and thereby exclude an increasingly significant share of products from duty-free treatment."

The EC argued that the three categories of products were multifunctional, and that "[a]s a result, they may be *prima facie* classifiable within more than one of the different concessions included in the EC's Schedule." The EC argued that "[t]he complainants' position…is guided by the notion that any multifunctional product which happens to have among its functions one covered by an ITA concession must always be classified according to that function, irrespective of that function's relative importance when compared to other functions not covered by the ITA." The EC stated that "[i]n essence, the complainants' view is that an ITA concession always trumps a non-ITA concession."

III. THE EC HEADNOTE

A headnote in the EC tariff schedule provided that "[w]ith respect to any product described in or for Attachment B" of the ITA, "to the extent not specifically provided for in this Schedule, the customs duties on such product, as well as any other duties and charges of any kind…shall be bound and eliminated" in accordance with the ITA "wherever the product is classified."

The Panel interpreted this provision to mean that "the EC headnote requires the European Communities to extend duty-free treatment to products described in the Annex to the EC Schedule, irrespective of where they are classified in the EC Schedule."

IV. EC CLASSIFICATION OF IT PRODUCTS WTO-INCONSISTENT

The Panel, after a lengthy and detailed review of the technical evidence related to the products at issue, concluded that the EC measures directed national customs authorities to classify these products "under dutiable headings", in breach of the EC's tariff bindings under GATT Article II.

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The Panel also found that the EC had failed to "publish promptly" certain amendments to the classification regulations and Explanatory Notes (CNENs) for one of the product groups, in violation of GATT Article X:1.

The lengthy Panel decision in this case turned largely on the specific factual evidence related to the products. The summary above is not intended to be exhaustive.

The decision of the Panel in *European Communities and its Member States – Tariff Treatment of Certain Information Technology Products* (DS375, DS376, DS377) was released on August 16, 2010.

Multilateral Highlights

Japan Files WTO Complaint Against Canada Over Alleged Solar Power Subsidies

On September 13, 2010, Japan filed a complaint with the World Trade Organization (WTO) against Canada over requirements set by the provincial government of Ontario that allegedly favor local firms under a subsidy program, the Feed-in Tariff Program (FIT), designed to boost use of solar and wind power generation. According to Japan's request for consultations, the FIT Program was established to provide "guaranteed, long-term pricing for the output of the renewable energy generation facility that contains a defined percentage of domestic content." Japan maintains that these requirements are inconsistent with Canada's obligations under the General Agreement on Tariffs and Trade (GATT), the WTO Agreement on Trade Related Investment Measures (TRIMs Agreement), and the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement).

Ontario established the FIT in May 2009. Among other provisions, it requires electricity providers to use solar power equipment that is at least 50 percent made in Ontario in order to participate in the program; those levels increase to 60 percent for projects scheduled to begin operation in 2011. In a news release, the Japanese Ministry of Economy, Trade and Industry (METI) noted that "Solar panels or other equipment exported by Japanese companies to Ontario are less favorably treated than those locally produced." METI's view is that the FIT measures are inconsistent with Article III of the GATT, which stipulates national treatment obligations, and Article II of the TRIMs Agreement. METI also takes the view that the FIT measures fall under the definition of a prohibited "import substitution subsidy," *i.e.*, subsidies contingent on the use of domestic over imported goods, as specified in the SCM Agreement.

Japan has therefore requested formal WTO dispute settlement consultations to resolve this issue. Requesting consultations is the first step in a WTO dispute. Under WTO rules, if the parties do not reach a resolution within the 60-day consultation period, Japan can refer the matter to a WTO dispute-settlement panel.

The Japan-Canada case is the latest in a growing number of international disputes related to trade in "green" energy products such as solar panels, windmill turbines and biofuels. On September 9, 2010, the United Steelworkers (USW) filed a petition under Section 301 of the Trade Act of 1974 with the United States Trade Representative (USTR) against China with regard to its support of the Chinese clean energy sector. Any investigation stemming from the 301 petition will result in WTO dispute settlement proceedings as the investigation would involve an alleged violation of a multilateral trade agreement (WTO rules) to which the United

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States and China are party. Exports of US biofuels are currently subject to countervailing duties in the EU and are under similar investigation in Australia. Given than many governments have provided financial support to their alternative energy industries and have promoted exports of the products benefiting from this support, other "green trade" disputes could be on the horizon.

US Files Two WTO Cases Against China on Electric Steel and E-Payment Services

On September 15, 2010, The United States filed two complaints at the WTO asking for consultations with China regarding allegedly unfair treatment of US steel and electronic payment providers in China. US Trade Representative Ron Kirk has stated that China applies "unfair" duties on US grain oriented flat-rolled electrical steel and has employed discriminatory practices against US electronic payments firms.

According to USTR, the People's Bank of China has imposed several restrictive measures since 2001 that allow the Chinese firm UnionPay to monopolize RMB-denominated electronic payments. USTR further alleges that this monopolization is tantamount to discrimination against US electronic payment service providers and, consequently, it violates China's commitment before the World Trade Organization to liberalize its financial services industry.

Regarding the grain oriented flat-rolled electrical steel complaint, USTR claims that China has unfairly imposed antidumping (AD) and countervailing (CVD) duties on imports from the United States. The USTR contends that China's imposition of AD/CVD duties on grain oriented flat-rolled electrical steel violate several requirements under WTO rules such as not providing sufficient evidence or explanation in its trade remedy proceedings. According to USTR Kirk, although the WTO allows countries to impose duties on imports that hurt domestic producers, China has used "AD and CVD-duty proceedings to harass US exports."

China has 10 days from the filing of the complaints to respond to the US request for consultations on the two complaints. Under WTO rules, if the United States and China do not resolve the matters through consultations within 60 days, the United States can request that a WTO dispute settlement panel be established.

USTR filed the two WTO complaints the same day the House Committee on Ways and Means commenced hearings on China's allegedly unfair currency practices and possible US legislative action to address the same. Treasury Secretary Timothy Geithner gave testimony at the September 16, 2010 continuation of these hearings in which he emphasized the Obama Administration's commitment to engaging China on the currency issue through bilateral and multilateral dialogue and negotiation. Due to the common perception among US lawmakers that the Obama Administration has not taken a sufficiently firm stance toward China's allegedly unfair trade policies, experts opine that the filing of two WTO complaints a day before Secretary Geithner gave his testimony was a calculated political maneuver employed by the Obama Administration to demonstrate that it is exerting force on China on the issue. Congressional insiders have stated that legislation addressing China's currency practices is likely to pass in at least one chamber of Congress and that, if it is passed in both chambers and President Obama does not sign the bill into law, the Obama Administration will likely point to actions such as the filing of the two WTO complaints in order to demonstrate that it has been proactive in seeking China's compliance with WTO rules as is reflected in the Administration's National Export Initiative (NEI).

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