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Japan External Trade Organization  
**WTO AND REGIONAL TRADE AGREEMENTS**  
**MONTHLY REPORT**

*March 2005*



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

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## SUMMARY OF REPORTS

### Special Report

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#### **Trade Relations With Asia Likely to Top US Trade Priorities in 2005 and Beyond**

Trade relations with Asia is likely to be among the top U.S. trade priority in 2005, according to a panel of government officials and private sector representatives. The panel, hosted on February 15, 2005, by the American Bar Association, noted the importance of bilateral trade relations with China, as well as the need for the US to broaden its trade presence in India, Malaysia, and South Korea.

The panel reflected on policy tools available to manage trade irritants with the region. The panel agreed that business, Congress, and the Bush administration are likely to emphasize economic relations with Asia in the coming years.

#### **AEI Panel Offers Views on Direction of U.S. Trade Policy in the Second Bush Term**

On January 26, 2005, the American Enterprise Institute (AEI) held a panel discussion on the prospects for trade policy in President Bush's second term. The event featured prominent analysts from DC-area think tanks. Panelists agreed that Republican control of White House and Congress presents the President a good opportunity to advance an ambitious trade agenda. However, some panelists expressed concern about the prospects and direction of U.S. trade policy. Among these issues, panelists commented on the 'competitive liberalization' strategy, growing East Asian regionalism and China's role in the region, and the prospects for the Doha Round.

#### **Former USTRs Urge Administration to Focus On Doha Round In 2005; Believe Vote On CAFTA Might Be Postponed Until 2006**

On February 9, 2005, the Center for Strategic and International Studies (CSIS) and The Economist magazine held their fifth annual seminar featuring several former United States Trade Representatives (USTRs). In particular, the following USTRs who served under various Presidential Administrations from 1981-2000 provided their perspectives on a wide range of issues relating to US trade policy in 2005:

- Ambassador Carla Hills (USTR 1989-1993);
- Ambassador Charlene Barshefsky (USTR 1996-2001);
- Ambassador Clayton Yeutter (USTR 1985-1989);
- Ambassador Mickey Kantor, (USTR 1993-1996); and
- Ambassador William Brock, (USTR 1981-1985).

The former USTRs agreed that the Administration's priority in 2005 should be to make further progress in the World Trade Organization's (WTO) Doha Development Agenda (DDA) negotiations, particularly regarding market access for agriculture. Some thought, however, that it would not be possible to conclude the negotiations by the December 2005 Hong Kong Ministerial. Regarding the US-Dominican Republic-Central America Free Trade Agreement (DR-CAFTA), some speakers thought that Congress might postpone its vote on the controversial legislation until 2006. Some speakers also doubted that the agreement in its current form would obtain Congressional passage.

## **United States**

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### **USTR Annual Review of China's WTO Compliance Offers Praise and Criticism**

The U.S. Trade Representation (USTR) has published the annual review of China's compliance with its obligations under the World Trade Organization (WTO) as mandated by the U.S.-China Relations Act of 2000. The third annual report delivered to Congress, praises efforts by China in 2004 to meet its WTO obligations, but also raises ongoing and new areas of concerns. For example, the report cites as a major accomplishment the results of the April 2004 meeting of the Joint Committee on Commerce and Trade (JCCT). USTR's report raises as a chief area of concern the lack of enforcement of intellectual property rights (IPR). The report also highlights the importance that China meet key obligations in services sectors due as of December 11, 2004.

### **Administration and Business Community Struggle Over U.S. Visa Policies and Their Impact on Trade**

Representatives of the U.S. Administration and the business community debated the United States' post-9/11 visa policy and its implications on trade at a recent discussion hosted by the Global Business Dialogue (GBD). While representatives of the State Department and the Department of Homeland Security highlighted recent successes in facilitating visa procedures, the speaker from the private sector emphasized the lack of progress in areas most crucial to the trade community. A former Congress trade staffer added her views on the cooperation needed between USTR and Congress to encourage Congressional approval of international trade agreements containing visa provisions. In her view, U.S. visa policy will soon come under greater scrutiny in the WTO Doha Round negotiations on services.

## **United States Highlights**

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

- Congress Introduces Legislation Targeting China's Currency and Trade Practices.
- President Bush Submits FY2006 Budget Proposal to Congress.
- Gutierrez Sworn In As Commerce Secretary.
- Agreement Granting PNTR To Laos enters Into Force.
- ITC Institutes Investigation On 2004 GSP Review; Announces Hearing.

- Senate Confirms Zoellick as Deputy Secretary of State; Rumors Over New USTR Continue to Swirl.

## **Free Trade Agreements**

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### **DR-CAFTA Signatories Discuss Benefits of FTA; USTR Announces CAFTA Briefing Book**

On February 9, 2005, the Heritage Foundation hosted a lecture on how DR-CAFTA benefits all its signatories. The Ambassadors of the Dominican Republic and Central American signatories discussed the benefits of the FTA for the region, including the positive effects on the economies, foreign policy, labor standards, and environment, textile, manufactures and the agricultural sectors.

The U.S. business sector, represented by the Vice President, Western Hemisphere Affairs, of the U.S. Chamber of Commerce stated that the U.S. business community is working hard for the implementation of DR-CAFTA, the largest trade agreement the US has negotiated in the last 10 years.

USTR, in preparation for congressional consideration of DR-CAFTA, announced the availability of the online CAFTA briefing book, which contains background information and fact sheets on the agreement.

### **FTA Highlights**

We also want to alert you to the following FTA development:

- House Democrats Issue Letter Criticizing Ecuador's Labor Laws

## **US – European Union**

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### **Mandelson Discusses Transatlantic Relationship And WTO Doha Round During First Official US Visit**

From February 9-11, 2005, European Union Trade Commissioner Peter Mandelson traveled to the United States for his first official visit since he took office in November 2004. Mandelson met with various US officials, including outgoing United States Trade Representative (USTR) Robert Zoellick and Secretary of the Treasury John Snow, to discuss ways to:

- strengthen the transatlantic relationship between the EU and the US; and
- complete the negotiations under the World Trade Organization's (WTO) "Doha Round".

Mandelson concluded the visit by attending a luncheon of the US Chamber of Commerce, where he commented on the current status and future priorities of the transatlantic relationship.

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## **US – Latin America**

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### **Deputy USTR Allgeier Emphasizes Parallel Nature of Doha and FTAA Negotiations**

On February 7, 2005, the U.S. section of the Brazil-US Business Council hosted a luncheon with Deputy US Trade Representative Ambassador **Peter Allgeier**. Allgeier, who is responsible for Western Hemisphere issues within USTR, emphasized the link between progress on the Doha agenda and the Free Trade Area of the Americas (FTAA). Allgeier highlighted agriculture as the central issue to regional and global trade negotiations, noting the importance of a balanced approach to subsidy elimination and market access.

Brazil and the US plan to meet at the end of February to try and establish the broad parameters for the resumption of FTAA negotiations.

### **U.S.-Mexico Trade Disputes Continue in 2005; Mexican Senate Expected to Approve Rules of Origin Modifications**

We would like to alert you to the following NAFTA developments:

- U.S.-Mexico Trade Disputes Likely to Continue in 2005.
- Mexican Senate Expected to Approve Rules of Origin Modifications During Spring Term.
- US and Mexico Open Additional FAST Lanes at U.S.-Mexico Border.

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## **MULTILATERAL**

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### **WTO Panel Rules Against U.S. Imposition of Countervailing Duties on Korean Computer Chips (DRAMs)**

A WTO Panel has ruled that the U.S. imposition of countervailing duties on computer chips from Korea violated the obligations of the United States under the WTO *Agreement on Subsidies and Countervailing Measures* (SCM Agreement). The Panel found that the United States Department of Commerce (DOC) did not have a sufficient evidentiary basis to conclude that the Korean government had "entrusted or directed" private creditors to provide financial contributions to the Korean computer chips exporter, Hynix Semiconductors Inc.

## REPORTS IN DETAIL

### SPECIAL REPORT

#### Trade Relations With Asia Likely to Top US Trade Priorities in 2005 and Beyond

##### *SUMMARY*

Trade relations with Asia is likely to be among the top U.S. trade priority in 2005, according to a panel of government officials and private sector representatives. The panel, hosted on February 15, 2005, by the American Bar Association, noted the importance of bilateral trade relations with China, as well as the need for the US to broaden its trade presence in India, Malaysia, and South Korea.

The panel reflected on policy tools available to manage trade irritants with the region. The panel agreed that business, Congress, and the Bush administration are likely to emphasize economic relations with Asia in the coming years.

##### *ANALYSIS*

The ABA Asia trade policy panel featured current and former government officials, and a representative from the private sector. We review here the key points raised by the panelists:

**Wendy Cutler**, Assistant US Trade Representative (USTR) for Japan, Korean and APEC Affairs discussed the various policy tools employed by USTR in its relations with Asia. She noted that, unlike the 1980s and early 1990s, blunter tools like the threat of sanctions or high-level state visits were no longer the major policy tools used. Instead, USTR employs a variety of “soft-power” tactics including:

- **Building domestic constituencies** – when attempting to deal with a trade issue, USTR looks to companies and trade groups both in the US and in the country(ies) in question to pressure foreign governments to act;
- **“Multilateralize”** – USTR seeks to develop support from other countries affected by a trade irritant. In the case of China’s VAT policies on semi-conductors, the US worked with the European Union and Japan to pressure China;
- **FDI Competition** – USTR works with US investors and foreign countries to ensure the implementation of policy that would be favorable to the flow of foreign direct investment (FDI); and
- **Carrot Approach** – the offer of a free trade agreement, or trade and investment framework agreement is used to obtain favorable policies from interested partners.

**Frank Vargo**, Vice President of the National Association of Manufactures (NAM) began by providing an overview of NAM's trade priorities in 2005. Vargo noted that China is such an important trade actor that NAM had developed a separate trade policy for China.<sup>1</sup> NAM continues to believe that China's fixed currency regime poses a serious problem for US competitiveness. NAM will continue to pressure the Bush administration to seek an end to the peg. With respect to Asia, Vargo noted the following NAM trade priorities:

- **Market Access** – tariffs on industrial goods in several Asian countries remain high and effectively deny access to U.S. manufacturing. Tariff reduction should be made a priority in both the Doha round and bilateral FTAs;
- **Government Intervention** – whether through currency manipulation or subsidies, NAM believes that USTR should work to encourage Asian countries to curtail market-distorting economic policies; and
- **Enforcement of Global Trading Rules** – NAM believes that global trading rules, particularly with respect to intellectual property rights must be better enforced. If necessary, this should include using the WTO dispute settlement mechanism.

With respect to negotiating priorities, Vargo expressed his view that the Doha round represents the best vehicle for achieving greater market access and subsidy reduction. However, NAM is conscious of the difficulties in advancing the Doha round, and has suggested pursuing bilateral trade arrangements with Egypt, India, South Korea, Malaysia and New Zealand.

**Tim Punke**, former Chief Senate Democratic Trade Counsel, warned of the mounting pressure in Congress to find solutions to a wide range of perceived trade problems. Punke mentioned concerns over currency manipulation, the trade deficit, textiles, and intellectual property rights as Congress' primary areas of interest. While unlikely to come to a full vote in the Senate, Punke suggested that a majority of senators might support a bill introduced by Senator Charles Schumer (D-New York) and Lindsey Graham (R-S. Carolina) to impose 27.5% tariffs on Chinese goods in retaliation for China's fixed exchange rate. (S. 295)

Countervailing duties against China could also become a major legislative issue during 2005. Senator Susan Collins (R-Maine) has vowed to re-introduce a bill that would allow U.S. companies to bring countervailing duty claims against China, despite its non-market economy status. Much like the Schumer bill, the desire to appear "tough with China" might compel Members to vote in favor of it.

## **OUTLOOK**

Congressional concern over U.S. trade policy vis-à-vis China is likely to continue mounting during 2005. Larger U.S. trade deficits could exacerbate Congressional concern over China and prompt greater calls for legislative solutions. Congress has already introduced a bill to revoke China's permanent normal trade relations (PNTR) with the US. A recent hearing of the U.S.-China Economic and Security Commission witnessed the largest

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<sup>1</sup> NAM's "Trade Policy Agenda 2005" and "Trade Agenda for China 2005" can be found at [http://www.nam.org/s\\_nam/sec.asp?CID=46&DID=44](http://www.nam.org/s_nam/sec.asp?CID=46&DID=44).



ever turnout of Members of Congress to testify about China's exploitation of trade rules to the detriment of the United States.

Further compounding Congress' concern over China is the positions taken by several trade associations. Many U.S. companies have witnessed significant growth in exports to China and success in the Chinese market. However, groups like NAM and the U.S. Chamber of Commerce have raised serious concerns about doing business in China on behalf of their members. These trade frictions have contributed to tension in U.S.-Asia relations and further stoked Congress' concerns over China.

## AEI Panel Offers Views on Direction of U.S. Trade Policy in the Second Bush Term

### SUMMARY

On January 26, 2005, the American Enterprise Institute (AEI) held a panel discussion on the prospects for trade policy in President Bush's second term. The event featured prominent analysts from DC-area think tanks. Panelists agreed that Republican control of White House and Congress presents the President a good opportunity to advance an ambitious trade agenda. However, some panelists expressed concern about the prospects and direction of U.S. trade policy. Among these issues, panelists commented on the 'competitive liberalization' strategy, growing East Asian regionalism and China's role in the region, and the prospects for the Doha Round.

### ANALYSIS

The AEI trade policy panel featured several noted analysts for DC-based think tanks. We review here the key points raised by panelists.

**Gary Hufbauer**, Reginald Jones Senior Fellow, Institute for International Economics commented on the following:

- **CAFTA:** Noted that CAFTA trade is important for both the US and regional economies; this point needs to be conveyed to the White House. Time is not on the side of the US, especially if the US tries to fold the agreement into the Andean FTA. Hufbauer expressed confidence that Congress will approve Central American FTA (CAFTA).
- **WTO/Doha Round:** Expressed concern over U.S. farm subsidies, how they should be converted to cash to reduce the budget deficit and enable Doha talks to proceed. He also emphasized that China, India and Brazil need to reduce barriers in the areas of service, agriculture and manufacturing.

**Lael Brainard**, Director of the Poverty and Global Economy Initiative and New Century Chair, Brookings Institution, made the following observations:

- **China and East Asian regionalism:** Emphasized that East Asia is focused on expanding trade as demonstrated by the recent ASEAN+3 summit that did not include the US. The summit brings the ASEAN-China FTA closer to reality; the FTA is another example of China using trade for geo-strategic clout. Brainard remarked the US has been reactive, not proactive, in managing trade with China.
- **Bilateral and multilateral trade negotiations:** Noted concern over the Western Hemisphere moving forward with regional agreements while the US is primarily going ahead with bilateral agreements. CAFTA negotiations may be difficult because the US might have to remove items from the table such as sugar, as it did with the Australia FTA. Brainard also asserted that the administration of trade adjustment assistance has been disappointing under Bush.

- ***Budget and trade deficits:*** Warned that the ‘twin’ budget and trade deficits are being financed with Asian Central Bank capital purchases of U.S. securities, not foreign direct investment (FDI). However, FDI continues to flow inward and unabated, and helps to expand GDP. Brainard remarked, however, that neither a hard or soft landing would alleviate the growing trade deficit.

**Brink Lindsey**, Vice President for Research, CATO Institute, stated he does not expect much from the current White House as politics has trumped trade policy during the previous four years. On pending trade issues Lindsey stated:

- ***Doha Round:*** Commented that the round will conclude, albeit with modest gains. He argued that the current Doha proposals are not ambitious enough, and that WTO members are too focused on defensive interests. Lindsey remarked, for example, that the US is unlikely to concede much on anti-dumping and trade remedy laws.
- ***‘Competitive liberalization’ policy:*** Expressed doubts about the continuing viability of Bush’s competitive liberalization strategy. While FTAs with Egypt and ASEAN may be possible, Lindsey wondered whether there would be many significant FTAs that could be pursued.

**Ed Gresser**, Director of the Trade and Global Markets Project, The Progressive Policy Institute, open his remarks by citing a Pew Research Center survey showing low public interest in trade policy. He also made the following observations:

- ***East Asian regionalism:*** Noted that trade and investment ties in the Asia-Pacific region are growing rapidly. China became the number one trading partner for Japan in 2004; the last time this occurred was in 1873. Moreover, approximately 80 percent of all foreign direct investment flowing into China originates from Asian countries.
- ***Trade trends in Muslim nations:*** Cautioned that Middle East nations continue to rely on oil and commodities trade for economic growth while losing over two-thirds of their global trade share since 1980. This trend is all the more concerning as the population of Muslim nations has doubled to over 1 billion people during this timeframe. Moreover, the expiration of the WTO textile agreement may make it even more difficult for these nations to keep pace in the global marketplace.

**Claude Barfield**, Director of Trade, Science, and Technology Policy, American Enterprise Institute, made the following remarks:

- ***East Asian regionalism:*** Warned that the White House is behind the curve in managing trade policy with East Asian nations. China, however, has become increasingly sophisticated in managing national security and political issues. China’s growing ties with ASEAN are one example. Barfield also suggested that China is reaping the benefits of bilateral agreements it enters because it will gain better market-access than provided by WTO commitments. Moreover, China does not have to

concede much in the bilateral agreements due to its significant WTO accession commitments.

### ***OUTLOOK***

Overall, the panelists expressed hope that the second term of the Bush administration will advance the trade agenda on the bilateral and multilateral fronts. For example, most were confident that CAFTA legislation will be approved before the end of 2005 and that that Trade Promotion Authority will be extended through 2007.

Nevertheless, panelists remained skeptical about the direction of U.S. trade policy, including U.S. engagement in the Asia-Pacific region and the chances for major progress in the Doha Round. The panelists also called attention to China's increasingly prominent role in Asia and abroad and the declining trade share of Muslim countries. Some panelist also were concerned that trade policy would be politicized in the second term (as in the case of Bush's decision to impose steel tariffs in the first term).

## Former USTRs Urge Administration to Focus On Doha Round In 2005; Believe Vote On CAFTA Might Be Postponed Until 2006

### SUMMARY

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- Ambassador William Brock, (USTR 1981-1985).

The former USTRs agreed that the Administration's priority in 2005 should be to make further progress in the World Trade Organization's (WTO) Doha Development Agenda (DDA) negotiations, particularly regarding market access for agriculture. Some thought, however, that it would not be possible to conclude the negotiations by the December 2005 Hong Kong Ministerial. Regarding the US-Dominican Republic-Central America Free Trade Agreement (DR-CAFTA), some speakers thought that Congress might postpone its vote on the controversial legislation until 2006. Some speakers also doubted that the agreement in its current form would obtain Congressional passage.

### ANALYSIS

#### I. Hills Indicates WTO Members and USTR Face Numerous Challenges to Conclude Doha Round in 2005

Ambassador Carla Hills, who served as USTR under the administration of George H.W. Bush from 1989 to 1993, commented on the challenges for a successful conclusion of the WTO "Doha Round" in 2005. To reach this goal, she stated that WTO Members and USTR would have to overcome numerous challenges within and outside the negotiations, including the following:

- *Within the negotiations*, they would have to (i) reach agreement on the key issues of agricultural and non-agricultural market access; (ii) address service issues; (iii) decide whether to include differentiation, particularly among the developing countries; and (iv) overcome divisions on the issue of GATS Mode 4 on the temporary movement of natural persons.
- *Outside the negotiations*, they would have to (i) choose a new WTO Director-General;<sup>2</sup> (ii) resolve current disputes between the US and the

<sup>2</sup> Currently, there are four candidates to succeed Supachai Panitchpakdi, including (i) former EU Trade Commissioner Pascal Lamy, (ii) former WTO General Council Chairman Carlos Perez del Castillo, (iii)

EU over numerous issues such as the subsidization of aircraft producers; (iii) overcome growing opposition to free trade; and (iv) within the US, secure the renewal of Trade Promotion Authority (TPA), among other issues.

Ambassador Hills encouraged passage of the Doha Round, in order to ensure greater economic prosperity and enhanced national security to all WTO Members.

## **II. Barshefsky Urges US Administration To Adjust Trade And Economic Policies Towards China**

Ambassador Charlene Barshefsky, who served as USTR under the second Clinton Administration from 1996 to 2001, provided her views on China as a growing economic and political problem for the US. She stated that China had become the US's main priority within the Asia-Pacific region as a result of the following developments:

- China is becoming more integrated within the region, with countries (like the ASEAN) realigning and increasingly focusing their trade and investment on China;
- China is rapidly becoming the US's largest trade partner; and
- China's growth is putting pressure on U.S. manufacturing industries and contributes to an increasing unemployment rate in this sector.

Barshefsky urged the Bush Administration to acknowledge these developments and adapt its trade and economic policies, in order for the US to become more competitive. She mentioned that it is "absolutely critical" for the US to pressure China to comply with its WTO commitments and further open its markets.

She raised as key issues to monitor in relations with China:

- Energy – China is pressuring supplies and prices;
- Finance – China has some stability problems; and
- Aging populations – The associated costs of growing aging populations (especially in the US) may increase manufacturing trade frictions, which trade policy alone cannot resolve.

When asked how the US should react over China's expanding regional agreements within the Asia-Pacific region which exclude the US, Barshefsky replied that the US should be clear it would perceive such agreements as "hostile and extremely damaging."

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Brazilian Ambassador to the WTO Luiz Felipe De Seixas Correa, and (iv) Mauritius Trade Minister Jaya Krishna Cuttaree. WTO Members expect to decide on a candidate by the end of May 2005.

### III. Yeutter Sees Conclusion of Agriculture Negotiations as Key to Successful Conclusion of Doha Round

Ambassador Clayton Yeutter, who served as USTR under the second Reagan Administration from 1985 to 1989, discussed the negotiations on agriculture under the Doha Round. He said that to conclude Doha negotiations on agriculture, WTO Members would have to reach an agreement on the following issues:

- **Market access:** Stated that lowering market-access barriers is the most challenging issue. All members would have to push to (i) lower traditional tariffs, (ii) increase and cap tariff quotas, (iii) include special safeguard provisions, as well as (iv) provide a list of their sensitive products. Achieving modalities and safeguards in particular are critical for negotiations to proceed.
- **Domestic subsidies:** Thought that reducing domestic subsidies would also be a major hurdle since WTO Members would have to provide sufficient compensatory market access opportunities. Members must also define and clarify different types of subsidies. Moreover, they must persuade developing countries not to seek exclusions from any elimination.
- **Sanitary and Phytosanitary (SPS) issues:** Yeutter opined that this would not be a difficult issue, as most members were satisfied with the agreement reached during the 1986-1994 Uruguay Round. (The SPS Agreement is also not up for negotiation in this Round.)
- **Export subsidies:** Yeutter said that since most WTO Members are in agreement to eliminate the remainder of their export subsidies, negotiations on this issue should be concluded successfully.

Yeutter also noted that the conclusion of agriculture negotiations would be key not only to a successful conclusion of the Doha Round, but also to move negotiations forward on the Free Trade Area of the Americas (FTAA). He was optimistic that this will be achieved.

### IV. Kantor Insists Congress Will Not Approve DR-CAFTA in Current Form

Ambassador Mickey Kantor, who served as USTR under the first Clinton Administration from 1993 to 1996, provided his perspectives on the ongoing concerns about labor and environmental standards in Free Trade Agreement (FTA) negotiations. He criticized the Bush Administration for not sufficiently addressing these issues in US-Dominican Republic-Central America FTA (DR-CAFTA) talks. He indicated that the US has moved backwards since the US-Jordan FTA, which included a dispute settlement mechanism for all provisions.

Kantor believes that Congress would not approve DR-CAFTA in its current form, adding that there would not be a vote until all labor and environmental agreement standards were reviewed. When asked what has changed since the US-Chile FTA, which contains the same standards and was approved in 2003, Kantor remarked that Congressional sentiments on free trade has since become less favorable.

**V. Brock Urges US Administration to Call a “Cease-Fire” in FTA Negotiations and to Focus on the Doha Round**

Ambassador William Brock, who served as USTR under the first Reagan Administration from 1981 to 1985, provided his perspectives on the U.S. negotiations of bilateral FTAs. Questioning the Administration’s choice of FTA partners, he urged them to “have a cease-fire” on its negotiations of bilateral FTAs and instead to focus on the Doha Round as the top priority. He also stressed the importance of renewing TPA to enable the Administration to conclude the Round.

When asked how current and potential FTA partners, and particularly Egypt, would react to a retraction in bilateral negotiations, Brock replied that USTR must make it clear that their resources are too limited to focus on both bilateral and multilateral talks. He also added that while Egypt has made significant strides toward economic liberalization, it is not yet ready to launch FTA negotiations with the US.

***OUTLOOK***

The former USTRs agreed that the Administration’s priority in 2005 should be to make further progress in Doha Round negotiations, particularly on agriculture, but also on other sectors including services and non-agricultural market access (NAMA). Hills suggested it would not be possible to finish the negotiations by the Hong Kong Ministerial in December; rather, she foresees a successful conclusion by 2007. Yeutter also believes momentum in Doha negotiations will revive the stalled FTAA negotiations.

Barshefsky also suggested the administration alter its approach to China, including to recognize its more prominent role in Asia and as a global exporter. She insisted that China must comply with its WTO commitments and further open its market. Nevertheless, she cautioned that trade policy alone will not solve all bilateral frictions. Rather, the US needs to address systemic issues in order to improve competitiveness.

Some speakers including Kantor believe Congress might postpone the controversial DR-CAFTA legislation until 2006. Kantor insisted that in its current form with weak labor and environment protections, the agreement would not garner enough support among Members of Congress. Hills warned, however, that a failure to obtain Congressional passage would have a negative impact on Doha negotiations since it would embolden free trade opponents. Moreover, most speakers recognized that Congressional and other sentiments on free trade have become less favorable than in the past.

Brock concluded the panel by echoing a growing sentiment that the U.S. pursuit of FTAs could undermine progress in Doha negotiations. A recent report from a commission chaired by former WTO Director-General Peter Sutherland made a similar warning against regionalism. The Sutherland report asserted that regionalism is a major threat to the multilateral trading system –citing most trade is now conducted on a preferential and discriminatory basis. The report’s message, and that of the former USTRs, urges the US and other Members to focus their efforts on concluding the Doha Round.



## UNITED STATES

### USTR Annual Review of China's WTO Compliance Offers Praise and Criticism

#### SUMMARY

The U.S. Trade Representation (USTR) has published the annual review of China's compliance with its obligations under the World Trade Organization (WTO) as mandated by the U.S.-China Relations Act of 2000. The third annual report delivered to Congress, praises efforts by China in 2004 to meet its WTO obligations, but also raises ongoing and new areas of concerns. For example, the report cites as a major accomplishment the results of the April 2004 meeting of the Joint Committee on Commerce and Trade (JCCT). USTR's report raises as a chief area of concern the lack of enforcement of intellectual property rights (IPR). The report also highlights the importance that China meet key obligations in services sectors due as of December 11, 2004.

#### ANALYSIS

The 2004 USTR report on China's compliance with its WTO obligations provides a detailed overview of current and potential trouble areas. We review here the report's major findings:

#### I. Enforcement of Intellectual Property Rights

USTR criticized China's inadequate efforts at enforcing intellectual property rights, which has resulted in "epidemic levels" of counterfeiting and piracy. At the April 2004 JCCT, China pledged to adopt improved legal measures in order facilitate increased criminal prosecution of IPR infringement. USTR notes that it will continue to use the Special 301 provisions of U.S. trade law to monitor China's efforts to curb IPR infringement.

#### II. Trade Rights and Distribution Services

USTR applauded China's implementation of its trading rights commitments nearly six months ahead of schedule. This has allowed companies to import and export goods in China without the use of a middleman. With respect to distribution services, The Chinese Ministry of Commerce has (MOFCOM) issued regulations eliminating national treatment and most favored nation (MFN) treatment restrictions on joint ventures providing services for wholesaling, commission agents, direct retailing and franchising. MOFCOM, however, has since delayed clarifying procedures to secure approval certificates and therefore prevented foreign enterprises from providing these services. Moreover, regulations on direct sales services are overdue.

#### III. Customs and Trade Administration

##### A. Customs Valuation

USTR asserted that China is not acting in compliance with its agreement on customs valuation. The US is particularly concerned with China's practices of reference pricing (which results in higher dutiable values), valuation of royalties and licensing fees. An additional concern lies with China's uneven enforcement of the valuation of duties applied to

physical floppy disks and CD-ROMs, and not the data stored. The US will continue to work on customs valuation issues with China in 2005.

## **B. Rules of Origin**

China agreed to adopt the internationally harmonized rules of origin, which were scheduled to take effect on January 1, 2005. While China did not release a draft of these rules for public comment, the US urged China to make these regulations available. This would allow WTO members to review them, raise concerns and seek clarifications from China as needed.

## **C. Import Licensing and Technical Barriers**

In its WTO accession agreement, China committed to issue unconditionally import licenses and without performance requirements of any kind, for example local content, technology transfer, research and development, etc. Nevertheless, since China's WTO accession, the US has raised concerns over the clarity of China's licensing procedures and urged China to eliminate possible trade-distorting or trade-restrictive effects. Trade distorting effects stem from China's tariff-quota systems, sanitary and phytosanitary measures, and inspection-related requirements.

## **IV. Non-Tariff Measures**

As of January 1, 2004, China had eliminated import quotas, licensing and tendering requirements on hundreds of products including refined oil and natural rubber and tires, machine tools and aerials. However, import quotas remain on automobiles and auto parts, chemicals, civil aircraft and other products, despite China's agreement to phase-out this and other non-tariff measures by January 1, 2005. The lack of transparency and tardiness in allocating quota rules has made it difficult for the US to assess if China is in compliance with its WTO obligations.

## **V. Tariff-Rate Quotas on Industrial Goods**

China agreed to tariff-rate quotas (TRQs) on specific industrial products, such as the fertilizer chemical DAP, to improve market access. However, US DAP exports to China were down in 2003 due to the lack of transparency and administrative guidance on TRQ regulations. These factors have made it difficult for DAP and other US TRQ holders to fully exploit the benefits accorded under the TRQs.

## **VI. Anti-Dumping and Countervailing Duties**

China still has shortcomings with transparency and procedures in its Anti-Dumping (AD) practice. The US continues to press China through a Trade Remedies Working Group, established at the April 2004 meeting, to clarify and address these concerns on a bilateral basis. China has launched antidumping cases, but has not launched a CVD investigation either pre- or post- WTO accession. China's rules generally follow the WTO Subsidies and Countervailing Measures (SCM) agreement, but some areas still require clarification.

## **VII. Export Regulations**

China maintains export restrictions on many products, which runs counter to its WTO commitment if those restrictions create a tax or indirect protection. The restrictions are

decreasing market access for Chinese goods abroad and increasing raw material and intermediate product costs for foreign buyers. Recent examples include the sudden rise of steel-related coke prices.

## **VIII. Internal Policies Affecting Trade**

### **A. Tax**

In March 2004, the US initiated a WTO consultation with China over its discriminatory Integrated Circuit (IC) Value Added Tax (VAT) policy, which rebated a 17 percent IC VAT back to consumers if the product purchased was made in China. The US and China settled the dispute in July 2007 after China recognized that its policy was inconsistent with WTO rules and agreed to eliminate the VAT rebate by November 1, 2004. China, however, still uses consumption taxes to unfairly benefit some domestic products including tobacco, cosmetics, rubber, motorcycles and automobiles.

### **B. Standards and Technical Regulations**

China maintains a homegrown 3G telecommunications standard for its computer and wireless telephone communications, making it more difficult for US companies to compete. Commitment periods established by China for the Technical Barriers to Trade (TBT) measures continue to be unacceptably brief in some cases. In other cases, written comments submitted by the US and other foreign parties are often disregarded or given insufficient time by Chinese regulatory authorities before regulations are adopted.

## **IX. Services**

China committed to a substantial opening of a broad range of service sectors through the elimination of multiple limitations on market access. Horizontal commitments, which apply to all sectors listed in its services schedule, were made in the areas of acquired rights (of ownership) and a more streamlined and transparent licensing process. While implementation of these commitments remain uneven, progress has been made on some fronts.

### **A. Financial Services**

Geographic restrictions on the banking and insurance sectors were gradually lifted in 2004. Foreign banks can now conduct local currency business in 18 Chinese cities. China is also improving market access for insurance companies, but discrimination over branching rights remains. For motor vehicle financing and telecommunications ventures, the US will continue to urge China to lower its capital requirements level.

### **B. Legal Services**

Some market entrants have claimed that procedures for establishing a new or additional legal services office are overly time consuming. Additionally, Chinese laws require an economic needs test for foreign offices that want to establish a law firm in China. Both provisions appear to undermine GATS commitments on legal services.

### **C. Express Delivery Services**

China's domestic postal service has a monopoly on the delivery of packages that weigh less than 350 grams. This restriction severely inhibits market access for US and other foreign express delivery companies. Resolving this issue is a US priority.

### **D. Other Services**

China has made varying degrees of progress in other services sectors. For aviation services, an agreement was signed to double the number of US airlines in China and create a five-fold increase in the number of passenger and cargo flights between the two countries. A five-year maritime agreement gives US-registered companies the legal flexibility to perform shipping and logistics activities in China, including the establishment of branch offices without geographic limitations. Decrees 113 and 114 enacted by China in September 2002, however, impose more restrictive conditions for US construction firms to engage in projects.

## ***OUTLOOK***

US-China bilateral trade tensions are likely to increase, despite the increased opportunities arising from China's implementation of its WTO commitments. For example, the growth in China's trade surplus will create more pressure towards enforcement of China's WTO obligations.

Among the key concerns is China's lack of vigilance on intellectual property rights enforcement. A ruling by China's supreme court reinterpreting IPR laws has already been criticized by the US as a failure to meet China's JCCT commitments. More recently, China's imposition of an export tax on textiles has drawn criticism from US Department of Commerce Undersecretary Grant Aldonas, who has described the tax as WTO-inconsistent.

Congressional interest in China's trade policies will remain high during the 109<sup>th</sup> Congress, as in previous years. During the confirmation hearing of Secretary Commerce nominee Carlos Gutierrez, several senators expressed concerns about China's failure to effectively implement WTO commitments, as well as China's ongoing manipulation of its currency.

Regardless of who succeeds Robert Zoellick at USTR, the trade relationship with China will remain at the top of the US trade agenda in 2005.

## Administration and Business Community Struggle Over U.S. Visa Policies and Their Impact on Trade

### SUMMARY

Representatives of the U.S. Administration and the business community debated the United States' post-9/11 visa policy and its implications on trade at a recent discussion hosted by the Global Business Dialogue (GBD). While representatives of the State Department and the Department of Homeland Security highlighted recent successes in facilitating visa procedures, the speaker from the private sector emphasized the lack of progress in areas most crucial to the trade community. A former Congress trade staffer added her views on the cooperation needed between USTR and Congress to encourage Congressional approval of international trade agreements containing visa provisions. In her view, U.S. visa policy will soon come under greater scrutiny in the WTO Doha Round negotiations on services.

### ANALYSIS

On February 1, 2005, the Global Business Dialogue held an event featuring discussions on U.S. post-9/11 visa policy and its impact on U.S. business interests. Among the speakers were Janice Jacobs from the Department of State, Lora Ries from the Department of Homeland Security, William Reinsch from the National Foreign Trade Council, Viji Rangaswami, a former Congress staffer, and Randall Hulme, a Washington-based immigration lawyer.

#### I. State Describes New Immigration Policies; DHS Emphasizes Improvements in Achieving "Open Borders"

Emphasizing that U.S. immigration policy is based on two principles: achieving security and retaining open borders, both Jacobs and Ries focused on the recent improvements in administration of U.S. immigration laws towards achieving "open borders."

##### A. Jacobs of State Discusses Recent Changes to U.S. Visa Policy

Jacobs emphasized that the U.S. government is conscious of the economic, social and cultural contributions gained from high-level and other cross-border exchanges of individuals.

Jacobs discussed the following major changes to U.S. visa policies:

- ***Issuance of visas containing biometric information ("biometric visas")*** - As requested by Congress, the State Department deployed a system of fingerprinting and photographing visa applicants in all of its over 200 foreign missions (Consulates);
- ***Interviewing majority of visa applicants*** - The State Department began interviewing most visa applicants, even those previously exempt (certain groups of business travelers). The increased number of interviews resulted in delays of up to 30 days in certain countries. The Department is trying to remedy the problem with increased staffing at the relevant Consulates.
- ***Increased number of checks preceding issuance of visa*** - The State Department began carrying out background checks on a greater number of visa applicants,

consulting with other federal agencies in the U.S. prior to issuing a visa. However, according to Jacobs, currently 97% of all visa issued by the U.S. are issued within 1-2 days of the decision to issue the visa. The State Department has increased the staffing of its office responsible for checks and, according to Jacobs, managed to reduce wait time for visas including background checks to fourteen days (down from 75 days) and enabled applicants to check wait-times on Consulate websites.

- ***Facilitation of business travel*** – The State Department encouraged Consulates to facilitate handling of business visa requests. While consulates have autonomy in choosing facilitation measures, Ms. Jacobs mentioned creation of special time-slots, queues, or consuls for handling business visas. Mr. Jacobs also discussed the creation of the Business Facilitation Center (BFC) within the Department of State, which focuses on Chinese visitors. A US person organizing an event (such as trade conference or business negotiations) wishing to invite Chinese visitors has the opportunity to provide the BFC with all the relevant information before a Chinese visitor applies for a visa abroad. The BFC then contacts the relevant post and provides all the information, thus expediting the handling of the visa request.
- ***Visa waiver program*** – The State Department will, pursuant to Congress’ mandate, require all foreign travelers participating in the visa waiver program (mostly from the European Union) to hold passports containing biometric data. The original deadline for implementation of biometric passports has already been once postponed until October 26, 2005. Progress has been made with the passage of the EU Biometric Passport Directive in December 2004. According to data obtained by the State Department, while Germany will start producing biometric passports by that deadline, most countries will either barely miss the deadline (the United Kingdom and France) or miss it by a longer time. In Ms. Jacobs’ opinion, the Congress might be willing to extend the deadline, because the purpose of the deadline is to encourage the implementation of biometric passports, deconstruction of the visa waiver program. In addition, Ms. Jacobs pointed out that the consular staff in visa waiver eligible countries has been cut back, and reintroduction of visas in those countries would lead to considerable problems.

#### B. Ries of DHS Cites Improvements in Foreign Entries

Lora Ries, representing the Department of Homeland Security, emphasized the improvements on the receiving end of U.S. immigration laws. She highlighted a 16% increase in international arrivals, as well as an increased number of issued F, J, and M visas over the previous year; mandatory civility training programs recently administered to customs and immigration officials at the border to improve the impression made on new entrants to the US; and extension of the standard business/travel visa issued to Chinese travelers from six to twelve months.

In addition, Ms. Ries was very critical of the widely discussed speech by Bill Gates delivered at the Davos meeting of the World Economic Forum, in which Bill Gates criticized the impact of more stringent U.S. visa policies on the competitiveness of U.S. economy. Ms. Ries asserted that the speech was “based on misconceptions” and is spreading false stereotypes. She urged the public to view the most recent data available on U.S. immigration policies to understand that those misconceptions no longer hold true.

## II. **NFTC Rebuffs Claims of Improvements in Immigration Policies**

William Reinsch from the National Foreign Trade Counsel (“NFTC”) disputed the claims of general improvements in the administration of U.S. immigration policies. While he admitted that some improvements have been made on the global scale, he pointed out that there has been deterioration, or no improvements, in the areas needing most attention.

Reinsch raised the following concerns and issues:

- ***Fight against espionage, not terror*** – Pointed out that the most serious problems are encountered with respect to businesspeople and workers from countries not perceived as terrorist threat, but as a potential source of commercial espionage, mainly China, Russia, India and Vietnam. He also pointed to the Mantis Program, discussed by Ms. Jacobs and Ries, as having anti-espionage, not anti-terrorism origins. He said he could not identify the connection between 9/11 and the worsening of visa policies with respect to those countries.
- ***Foreign businesspeople’s inability to enter the US*** – Claimed that the majority of problems result from the inability of foreign businesspeople (particularly from those four mentioned countries) to enter the U.S., even for short periods of time, for legitimate business purposes. He identified three groups of foreigners mostly affected by this change: businesspeople coming to the U.S. for a conference, business negotiations, or examination of merchandise; foreign customers’ employees coming to the U.S. for training, and foreign customers’ employees arriving to the U.S. to take possession of the merchandise (in many cases the problems arise even though an export license has already been issued for the merchandise in question).
- ***Some improvement regarding Chinese applicants*** – Acknowledged, as mentioned by Ms. Jacobs and Ms. Ries, that there are some improvements with respect to the Chinese applicants. However, he attributed those improvements mostly to the aggressive pursuit of visa policy liberalization by the American Chamber of Commerce in China, which cooperates with its members and the U.S. officials in China.
- ***Concern about “intent to emigrate” visa denials*** – Expressed concern about the rising number of the so-called “Section 214(b) denials” – named after a statutory provision justifying denial of a U.S. visa if the applicant cannot prove that the applicant does not intend to emigrate to the United States. In Mr. Reinsch’s opinion, the suddenly rising number of visa denials based on this provision means it has become a “catch-all provision” used by U.S. officials to deny visas when they cannot justify the denial under another statutory basis.
- ***Detrimental consequences of restrictive visa policies*** – Emphasized that U.S. companies, universities and institutes are competing with other countries for the best customers, managers, employees, professors, students and researchers, and that restrictive visa policies could decrease the allure and competitiveness of the United States. He cited as an example the experience of a U.S. company that lost a sale to a Chinese client to its European subsidiary when the potential customer’s employee was denied a visa to inspect the merchandise.
- ***Two visions of immigration reform*** – Opined that from his and the NFTC’s experience, there are two approaches to immigration reform. The first is

represented by the “tweakers” – those who react to problems as they arise (e.g. increase the number of consular officers in a post where there are large delays). The second is the “overall approach” under which the entire system of U.S. immigration law needs revision from top to bottom. Under the second approach, however, it appears that the equilibrium between the objectives of U.S. immigration law, security and open borders is off balance. Rather, security advocates have gained a disproportional advantage over advocates of open borders. He said that for the sake of international trade and cooperation, he hoped the equilibrium would be restored.

- ***Immigration reform and the Doha Round*** – Concluded by suggesting that immigration reform in the United States might also be triggered by the developments in the Doha Round. He explained that several developing countries have been pushing for liberalization of visa policies in developed countries as part of the negotiations on services, under the so-called “Mode 4” provision on the temporary movement of labor.

### **III. Former Congress Staffer Discusses Problems with Visa Provisions in Chile and Singapore FTAs; Warns of Looming Battle in the Doha Round**

Viji Rangaswami, a former democratic Trade Counsel at the House Committee on Ways and Means (currently at the Carnegie Endowment for International Peace), discussed the interplay between international trade negotiations and immigration policy in the U.S. Congress. She described in particular the controversy over Congressional consideration of the Chile and Singapore free trade agreements (FTAs), which provide for an annual number of U.S. visas for temporary workers from the two countries. During consideration of the implementing legislation, Members of Congress were very critical of USTR for negotiating changes to U.S. visa policies. Although the legislation for both FTAs finally passed, the Congress warned USTR never to include such provisions in future FTAs. It even threatened to cut USTR funding in the 2004 Appropriations Bill if USTR were to do so again.

In Ms. Rangaswami’s opinion, the problems in Congress resulted mainly from the USTR’s reluctance to negotiate the implementation of the FTAs with Congress. She also pointed to the fact that the cap on temporary worker visas guaranteed for Chile and Singapore was unusually high (a number of times larger than the amount of H1B visas issued to the nationals of these countries annually), and that, as originally proposed, the visas covered by the FTAs were not counted against the existing numerical cap on H1B visas (that has been changed in the implementing legislation).

Ms. Rangaswami also suggested that a battle over U.S. immigration reform might be triggered by the developments in the Doha Round. Specifically, Ms. Rangaswami pointed out three factors:

- Congress is very sensitive to the Administration’s attempts to reform visa policy through trade agreements;
- Developing countries, such as India, have been very insisted on liberalization of the movement of people (Mode 4) as part of WTO negotiations on services;



- If the US refuses to negotiate visa policies as part of the Doha Round, the lack of movement might affect developing countries' will and ability to negotiate agriculture and services and might ultimately lead to the collapse of the Doha Round.

Ms. Rangaswami concluded by urging the USTR to work closely with Congress on any visa-related matters of interest in order to avoid any future confrontations.

### ***OUTLOOK***

While it seems that administration of U.S. visa and border entry policies has somewhat improved, it is apparent that controversy surround immigration policy is far from settled.

Despite the delays and burdens associated with changes in U.S. immigration policies after 9/11, the international backlash against it have not been as severe as feared. Rather, DHS claims that contrary to public perceptions, international arrivals have been on the increase and more visas issued in various categories. Moreover, for some visitors like Chinese businesspersons, their visas are being expedited.

Nevertheless, U.S. business interests are still highly critical of the restrictiveness of U.S. visa policies and its impact on higher education and competitiveness and innovativeness of U.S. business. Despite the improvements, many stories abound that U.S. universities, businesses and others are losing out to foreign competitors due to visa-related problems. Although the U.S. government seeks to improve its handling of visa policy, some private sector representatives believe the government is only "tweaking" the system and being reactive rather than looking at comprehensive reform.

Looking ahead, a major battle might be looming as U.S. immigration policy will come under pressure from the Doha Round negotiations on services. It is already obvious that the U.S. government will not tackle immigration issues in bilateral FTAs. Although the U.S. Congress has been resistant to dealing with visa matters in trade agreements, it might realize the stakes are far greater in a multilateral negotiation where the US stands to gain from liberalization in services, agriculture and other sectors. The Round thus presents a serious chance, as well as a great challenge – for broader reform of U.S. immigration laws.

## **United States Highlights**

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### **February 2005 US Highlights**

#### **Congress Introduces Legislation Targeting China's Currency and Trade Practices**

Senate Democrats recently introduced a bill that would impose a 27.5% tariff on all imports of Chinese goods unless China abandons its fixed exchange rate policy (S.14). The measure, similar to a bill introduced by Senator Charles Schumer (D-New York) during the 108th Congress, would give the President 180 days to certify that China was no longer manipulating its currency to gain a competitive advantage. The measure on Chinese currency is part of a broader bill that includes proposals for increasing the minimum wage and providing trade adjustment assistance for service workers. No hearings to review S. 14 have been scheduled.

In a related development, a group of 61 members of the House are seeking to revoke permanent normal trade relations (PNTR) with China (H.R.728). Led by Representative Bernard Sanders (I-Vermont), the bill cites growing trade deficits and layoffs in the manufacturing sector as justification for revoking China's trade status. At a press conference introducing the measure, Representative Sanders acknowledged that repealing PNTR for China would put the US in violation of its commitments under the World Trade Organization. The bill enjoys bipartisan support. A similar measure was introduced in 2003 by Representative Sanders but was never considered either at the committee level or on the House floor.

#### **President Bush Submits FY2006 Budget Proposal to Congress**

On February 7, 2005, the President submitted his budget proposal for FY 2006 to Congress. The President's budget would keep growth in discretionary spending (2.1%) below the rate of inflation (2.6%), resulting in a real spending decrease for a number of departments. Some 150 federal programs are targeted for reduction or elimination. For FY 2006, the budget deficit is expected to reach \$427 billion, which does not include supplemental spending for the war on terrorism. Security related agencies, including the Department of Defense, and Homeland Security would receive modest increases under the President's proposal.

With respect to trade-related agencies, the President's budget includes:

- A reduction in agricultural support payments of \$586 million. The cuts are achieved through capping the amount of subsidies available to individual farmers to \$250,000;
- An increase of \$5.4 million for the Container Security Initiative and \$8.2 million for the Customs-Trade Partnership Against Terrorism;
- An additional \$10 million for infrastructure upgrades for the Bureau of Industry and Security;
- A \$2 million reduction in the budget for the International Trade Administration (Dept. of Commerce); and

- A \$2.7 million reduction in the budget for the US Trade Representative (USTR). However, USTR would be authorized to "borrow" up to 10% of its budget from other Executive Branch agencies. The USTR would also be required to negotiate at the WTO for a recognition of the right of members to distribute monies collected from the imposition of trade remedies (Byrd Amendment).

Congress will now review the President's budget submission and hold hearings with officials from the Treasury Department and Office of Management and Budget. Members of Congress from both parties starting have begun expressing opposition to the President's proposed cuts, which includes programs ranging from Amtrak to community development block grants.

The full text of the President's budget proposals can be found at <http://www.whitehouse.gov/omb/budget/fy2006/>.

### **Gutierrez Sworn In As Commerce Secretary**

On February 7, 2005, former Kellogg CEO Carlos Gutierrez was sworn in as the 35<sup>th</sup> Secretary of the Department of Commerce. In his new position, Gutierrez will be responsible for promoting and advocating U.S. businesses both within the U.S. and around the world.

### **Agreement Granting PNTR To Laos enters Into Force**

On February 11, 2005, the United States Trade Representative (USTR) published a notice in the Federal Register (70 FR 7319), announcing that the trade agreement obligating permanent normal trade relations (PNTR) between the US and Laos entered into effect as of February 4, 2005. As signed on September 18, 2003, the agreement ensures that all products of Laos entered, or withdrawn from warehouse for consumption, shall be granted most-favored-nation treatment by the US.

### **ITC Institutes Investigation On 2004 GSP Review; Announces Hearing**

On February 16, 2005, the International Trade Commission (ITC) announced in the Federal Register (70 FR 7968) that it has instituted investigation No. 332-466, which aims to provide advice on the probable economic effects of certain modifications to the U.S. General System of Preferences (GSP) under the 2004 GSP review. The Commission aims to submit the results of the investigation by May 9, 2005. The United States Trade Representative (USTR) requested the investigation on February 7.

The ITC will hold a public hearing in connection with the investigation on March 23, 2005. Persons wishing to testify at the hearing should file a letter with the ITC by March 4, 2005. Any prehearing statements or briefs should be filed by March 7, 2005, and any posthearing briefs or statements by March 30, 2005.

### **Senate Confirms Zoellick As Deputy Secretary Of State; Rumors Over New USTR Continue To Swirl**

On February 16, 2005, the Senate confirmed United States Trade Representative (USTR) Robert Zoellick as the new Deputy Secretary of State. Zoellick is expected to formally resign from USTR in the coming days. During his confirmation hearing, Zoellick

pledged to continue to be active in trade issues, and pledged to focus on economic issues, particularly in Asia.

Speculation about Zoellick's replacement has grown since his confirmation. Sources from Commerce have confirmed that Undersecretary Grant Aldonas has submitted his letter of resignation to the White House and will leave government on March 31, 2005. Aldonas, who was at one point a frontrunner to replace Zoellick, is said to be exploring opportunities in the private sector.

With Aldonas apparently out of the running to replace Zoellick attention has turned to the health of Gary Edson, a former White House official rumored to be among the leading candidates to become USTR. Edson is recovering from surgery to remove a brain tumor and sources have suggested he could be ready for work in a few weeks. Deputy USTR Josette Shiner is expected to serve as acting USTR until a new USTR is confirmed. Shiner is also rumored to be leaving USTR to join Zoellick at the State Department following the confirmation of a new USTR.

In related news, USTR General Counsel John Veroneau has resigned to join the law firm of Piper Rudnick. James Mendenhall, Assistant USTR for Services, Investment and Intellectual Property has been tapped to serve as acting general counsel.

## Free Trade Agreements

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### DR-CAFTA Signatories Discuss Benefits of FTA; USTR Announces CAFTA Briefing Book

#### SUMMARY

On February 9, 2005, the Heritage Foundation hosted a lecture on how DR-CAFTA benefits all its signatories. The Ambassadors of the Dominican Republic and Central American signatories discussed the benefits of the FTA for the region, including the positive effects on the economies, foreign policy, labor standards, and environment, textile, manufactures and the agricultural sectors.

The U.S. business sector, represented by the Vice President, Western Hemisphere Affairs, of the U.S. Chamber of Commerce stated that the U.S. business community is working hard for the implementation of DR-CAFTA, the largest trade agreement the US has negotiated in the last 10 years.

USTR, in preparation for congressional consideration of DR-CAFTA, announced the availability of the online CAFTA briefing book, which contains background information and fact sheets on the agreement.

#### ANALYSIS

We review here the remarks delivered by the speakers at the Heritage Foundation's event and highlight key auto and electronics provisions of the USTR CAFTA briefing book.

#### I. Heritage and U.S. Chamber of Commerce Representatives Tout CAFTA Benefits

Mr. Brett D. Schaeffer, member of the Center for International Trade and Economics of the Heritage Foundation, remarked that DR-CAFTA will benefit every partner involved. He emphasized that the Central American countries will acquire significant economic gains, political stability, security, and job creation.

The Vice President, Western Hemisphere Affairs, of the U.S. Chamber of Commerce, Mr. John G. Murphy, emphasized that the DR-CAFTA is the largest trade agreement that US negotiated in the last 10 years and that the U.S. business community is working hard for the approval of the agreement. He mentioned three major benefits: i) new exports, ii) larger incomes for workers and iii) more jobs. The agreement will bring immediate tangible benefits to American workers, business and consumers, he said.

Mr. Murphy remarked that the trade agreement would increase output across industries, increase earning for workers, and create tens of thousands of new jobs. He stated that:

- **In the first year of implementation**, the DR-CAFTA would generate \$3.1 billion in new sales and nearly \$700 million in new earnings for

workers in the seven states profiled<sup>3</sup>. It would also create over 20,000 new jobs.

- **Nine years after implementation**, the agreement would boost sales by over \$17 billion in the six states for which data are available<sup>4</sup>. The agreement would also raise workers' earnings by \$3.5 billion and create more than 100,000 new jobs in the six states profiled.
- The agreement will level the playing field for U.S. exporters to the region; making over 80 percent of U.S. exports tariff-free immediately.
- It would open markets for U.S. service providers, creating a framework of rules and regulations that will provide greater certainty for companies doing business in the region.

## **II. Ambassadors Emphasize Support for DR-CAFTA in the Central America Region**

The Dominican Republic and Central America ambassadors stressed the benefits of DR-CAFTA for the region, including the positive effects it will have on the economy, foreign policy, labor and environmental standards, textiles, manufactures and agricultural sectors, and political reforms.

The Ambassadors of Costa Rica, Mr. Tomás Dueña; the Dominican Republic, Mr. Flavio Dario Espinal; El Salvador, Mr. René León Rodríguez; Guatemala, Mr. Guillermo Castillo and Nicaragua, Mr. Salvador Stadthagen, stated that the main benefits of the DR-CAFTA are:

- Major access to the U.S. market
- Major access to services
- New rules on transparency, labor and environmental issues. Central American countries comply with the International Labor Organization standards, but have to improve labor conditions in certain areas. DR-CAFTA provides a mutual commitment to respect and encourage workers rights. The signatories could be subject to trade sanctions if they do not comply with labor standards. The FTA also considers child labor and discrimination.
- More certainty provided by rule of law and institutional reform. Consolidation of democratic institutions and mutual commitment to democracy.
- Fight for reduction of poverty and creation of new employment opportunities, which would help reduce the illegal immigration of Central American citizens to the US.

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<sup>3</sup> California, Florida, Louisiana, New Jersey, New York, North Carolina and Texas.

<sup>4</sup> California, Florida, New Jersey, New York, North Carolina and Texas.

- Improved textile manufacturing conditions. The agreement assures U.S. market access for Central American products, thus providing security for manufacturers that stay in the region. This provision directly relates to the termination of quotas in the WTO Multifiber Agreement, which could lead manufacturers to relocate to China.
- On the agricultural sector, it will benefit both US and Central America producers. Focusing on sugar, one of the more sensitive products, the major access provided to Central American countries would only negligibly affect US producers. Quotas currently enforced will be increased from 107,000 tons in the first year to 151,000 tons over 15 years, about 1.4 percent of 2003-2004 US production in the first year.

In their concluding comments, the Ambassadors emphasized that DR-CAFTA is currently spurring all the desired changes, even before U.S. congressional approval. DR-CAFTA, they said, is more than a trade agreement, and is supported by 75 % of the population of their countries.

### **III. U.S. Administration Announces CAFTA Briefing Book**

USTR on February 14 announced the CAFTA online briefing book, which contains information on the background of DR-CAFTA and benefits for U.S. workers and farmers, both generally and in particular sectors and states. We highlight below key provisions of the CAFTA briefing book dealing with the transportation sector, which includes motor vehicles and parts, and the electronics sector.

#### Transportation Sector

- Central American and Dominican tariffs on transportation products range from 0 to 30 percent, and average from 3.9 to 9.2 percent, depending on the country. The highest tariffs in this sector apply to motor vehicles.
- U.S. MFN tariffs applied to the transportation sector range from 0 to 25 percent, with an average of 2.4 percent. All products in this sector are duty-free under the Caribbean Basin Initiative (CBI) and Caribbean Basin Trade Promotion Authority (CBTPA) tariff preferences, however.
- Tariffs will be phased out according to five tariff elimination categories: immediate elimination, equal cuts over five years, cuts over 5 years where there is a one year deferment and four years of equal cuts, equal cuts over 10 years, and non-equal cuts over 10 years.
- The United States agreed to consolidate all CBI and CBTPA tariff preferences into the final tariff elimination schedules. As a result, all Central American and Dominican exports of transportation equipment will continue to receive duty-free treatment.
- Many U.S. exporters face consular transactions - complex paperwork requirements stipulating that documents be certified in the United States at the embassy or consulate of the partner country that will receive the

goods. Consular transactions will be eliminated immediately upon implementation of the agreement for exports to Central America and the Dominican Republic.

- Dealer protection laws have led to severe consequences for U.S. exporters when they terminate a contract with a dealer or distributor in Central America. The agreement requires each partner country to amend its laws such that U.S. products cannot be denied the right of importation due to contract disputes.

#### Electronics and Instrumentation Sector

- Central American and Dominican tariffs on electronics and instrumentation range from 0 to 20 percent, with average tariffs varying by country from 2.1 to 5.5 percent. The highest tariffs are generally applied to televisions, recorders, and sound players.
- U.S. MFN tariffs in the sector range from zero to 16 percent. The highest tariffs apply to televisions, video monitors and optics parts. All products in this sector receive duty-free treatment under the Caribbean Basin Initiative (CBI) and Caribbean Basin Trade Partnership Act (CBTPA), however.
- Tariffs will be phased out according to four tariff elimination categories: immediate elimination, equal cuts over five years, equal cuts over 10 years, and non-equal cuts over 10 years.
- The United States agreed to consolidate all CBI and CBTPA tariff preferences into the final tariff elimination schedules. As a result, all Central American and Dominican exports of electronics and instrumentation products will continue to receive duty-free treatment.
- Many U.S. exporters face consular transactions - complex paperwork requirements stipulating that documents be certified in the United States at the embassy or consulate of the partner country that will receive the goods. Consular transactions will be eliminated immediately upon implementation of the agreement for exports to Central America and the Dominican Republic.
- Dealer protection laws have led to severe consequences for U.S. exporters when they terminate a contract with a dealer or distributor in Central America. The agreement requires each partner country to amend its laws such that U.S. products cannot be denied the right of importation due to contract disputes.

The complete briefing book is available at [http://www.ustr.gov/Trade\\_Agreements/Bilateral/CAFTA-DR/Briefing\\_Book/Section\\_Index.html](http://www.ustr.gov/Trade_Agreements/Bilateral/CAFTA-DR/Briefing_Book/Section_Index.html).



## ***OUTLOOK***

The DR-CAFTA provisions will not enter into effect until legislatures in all of the signatory countries approve the agreement. In the past years, the U.S. Congress has approved FTAs with Australia, Chile, Morocco and Singapore. However, DR-CAFTA faces several challenges in the U.S. Congress due to concerns regarding labor, environment, and sensitive sectors. Analysts are predicting a tough debate in the House of Representatives, similar to the debate held over Trade Act of 2002. That bill passed the House by a single vote.

The Administration and the private sector will intensify lobbying efforts to garner U.S. congressional support during the next few months. The DR-CAFTA provisions in many cases, including the transportation and electronics sectors, makes permanent tariff benefits that Central American countries enjoy under the Caribbean Basin Initiative/ Caribbean Basin Trade Partnership Act. The Bush administration insists that the agreement will “level the playing field” for U.S. businesses in the region, lend momentum to complete the FTAA, and strengthen opportunities to work together in other multilateral negotiations such as the WTO.

Lobbyists, analysts and Members of Congress are monitoring U.S. congressional consideration of DR-CAFTA not only because of the effects on their respective sectors and constituents, but also because the agreement is expected to serve as a bellwether for congressional consideration of future FTAs, including the FTAA.

## **Free Trade Agreements Highlights**

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### **February 2005 FTA Highlights**

#### **House Democrats Issue Letter Criticizing Ecuador's Labor Laws**

On February 1, 2005, 38 House Democrats sent a letter to Ecuadorian trade minister Ivonne Baki criticizing Ecuador's labor practices. The letter claims that Ecuador has failed to live up to its commitments made just prior to the passage of the Andean Trade Promotion and Drug Eradication Act (ATPDEA) of 2002. The letter cites particular concerns about the lack of freedom of association for Ecuadorian workers. The letter concludes by warning Ecuador that failure to live up to its labor commitments under ATPDEA could negatively affect Congressional consideration of the Central American Free Trade Agreement.

## US-EUROPEAN UNION

### **Mandelson Discusses Transatlantic Relationship And WTO Doha Round During First Official US Visit**

#### *SUMMARY*

From February 9-11, 2005, European Union Trade Commissioner Peter Mandelson traveled to the United States for his first official visit since he took office in November 2004. Mandelson met with various US officials, including outgoing United States Trade Representative (USTR) Robert Zoellick and Secretary of the Treasury John Snow, to discuss ways to:

- strengthen the transatlantic relationship between the EU and the US; and
- complete the negotiations under the World Trade Organization's (WTO) "Doha Round".

Mandelson concluded the visit by attending a luncheon of the US Chamber of Commerce, where he commented on the current status and future priorities of the transatlantic relationship.

#### *ANALYSIS*

### **I. Zoellick And Mandelson Take Stock Of Negotiations To Boeing-Airbus Subsidization Dispute; Discuss Other Issues**

During their meeting on February 10, 2005, Mandelson and Zoellick focused on the status of the negotiations between the EU and the US to resolve the dispute regarding their alleged unfair subsidization of Airbus and Boeing. Launched with the signing of the "EU-US Agreement on Terms for Negotiation to end Subsidies for Large Civil Aircraft (LCA)"<sup>5</sup> on January 11, 2005, these negotiations aim to eliminate all subsidies to LCA producers and have to be concluded by next mid-April. (*Please see W&C January 2005 EU Report*)

Mandelson said afterwards that although both parties were committed to negotiate a solution and were making good progress, reaching an agreement by the set deadline would be difficult. He excluded continuing the negotiations after mid-April because it would disrupt plans by both aircraft producers to develop new aircraft.

Sources indicate that Zoellick and Mandelson further discussed the following issues:

- The priorities for completing the negotiations under the WTO's Doha Round.
- The dispute between the US and the EU regarding the EU's unilateral decision on September 1, 2004 to raise customs duties on US brown

<sup>5</sup> [http://europa.eu.int/comm/trade/issues/respectrules/dispute/pr110105\\_agr\\_en.htm](http://europa.eu.int/comm/trade/issues/respectrules/dispute/pr110105_agr_en.htm).

rice.<sup>6</sup> The US has argued that the EU raised the tariffs above the rate it had agreed to in the 1986-1994 Uruguay Round.

- US concerns about a new EU directive requiring wood used in packing material for goods to be “debarked” to ensure that it is insect-free,<sup>7</sup> which could affect 50% of all US exports to the EU. Mandelson noted that pursuant to the US concerns, the Commission has proposed to delay the March 6, 2005 implementation date of the directive for one year.

## II. Progress In Doha Round And Strengthening Regulatory Dimension Of Transatlantic Relationship Are EU-US Priorities For 2005

On February 11, 2005, Mandelson attended a luncheon of the US Chamber of Commerce, where he discussed the current status and future of the transatlantic relations.<sup>8</sup> In general, Mandelson urged the US and the EU to reinvigorate their relationship and particularly to improve trade and investment, which he described as “the bedrock of the relationship”.

### A. “Balanced Progress” Across The Board In Doha Round Should Be Main Priority In 2005

Mandelson stressed that the main priority for both parties was to complete the negotiations under the Doha Round before the expiration of Trade Promotion Authority (TPA) in the US in 2007. In 2005, he wanted to achieve “balanced progress” across the board:

- **Agriculture:** the US needs to match the EU’s reform of its Common Agricultural Policy (CAP) and reduce and discipline agricultural domestic support and export credit.
- **Market access for industrial goods:** the negotiating process on the reduction of tariffs should become more intensive.
- **Services:** the EU is prepared to improve its offer of June 2003, and the US and other developed countries should also review their offers in order to be able to get serious commitments from the more advanced developing countries.
- **Trade rules:** the WTO members particularly need to move fast on anti-dumping and Geographical Indications (GIs). Mandelson requested that the US be more flexible on the latter.

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<sup>6</sup>[http://www.ustr.gov/Document\\_Library/Press\\_Releases/2005/January/Unfair\\_EU\\_Restrictions\\_on\\_U.S.\\_Rice\\_Force\\_U.S.\\_to\\_Notify\\_WTO\\_of\\_Intent\\_to\\_Raise\\_Tariffs.html](http://www.ustr.gov/Document_Library/Press_Releases/2005/January/Unfair_EU_Restrictions_on_U.S._Rice_Force_U.S._to_Notify_WTO_of_Intent_to_Raise_Tariffs.html).

<sup>7</sup> [http://europa.eu.int/eur-lex/lex/LexUriServ/site/en/oj/2004/l\\_309/l\\_30920041006en00090025.pdf](http://europa.eu.int/eur-lex/lex/LexUriServ/site/en/oj/2004/l_309/l_30920041006en00090025.pdf).

<sup>8</sup>[http://europa.eu.int/comm/commission\\_barroso/mandelson/speeches\\_articles/temp\\_icentre.cfm?temp=sppm014\\_en](http://europa.eu.int/comm/commission_barroso/mandelson/speeches_articles/temp_icentre.cfm?temp=sppm014_en)

Mandelson stressed that for the Doha Round to succeed, the US and the EU had to provide more leadership, and all WTO members needed to make more efforts to promote development.

**B. EU And US Should Define Strategy To Improve Regulatory Dimension Of Transatlantic Relationship**

Mandelson urged the EU and the US to make further progress on the decision that was taken at the EU-US Summit on June 26, 2004 to define a strategy to strengthen the transatlantic relationship, and not to let disputes dominate their agenda. He thought that such a strategy should emphasize regulatory improvement and convergence instead of bilateral tariff reductions.

Mandelson said that both parties also needed to look at other issues, such as (i) the relationship between trade and security, (ii) government procurement, (iii) intellectual property, and (iv) the idea of mutual recognition of services as a complement to the Doha Round, with particular reference to licensing and recognition of professional qualifications on both sides of the Atlantic.

In response to a question about the EU's decision to lift the arms embargo against China, Mandelson said that he believed in "embracing China instead of feeding fear of it". He aimed to make China more mindful of its responsibilities in international trade and particularly within the WTO, and urged the US to cooperate with the EU to realize this.

When asked to comment on the dispute between the EU and the US over the "American Jobs Creation Act of 2004" (the "Jobs Act")<sup>9</sup>, Mandelson said that the EU would seek to resolve the issue through negotiations, and was hopeful that both parties would be able to resolve this "amicably". The Jobs Act was adopted to repeal the Foreign Sales Corporation/Extraterritorial Income (FSC/ETI) tax bill after the WTO ruled that the tax cuts it provided to US companies were an illegal subsidy. The EU recently challenged the legality of the Jobs Act and particularly of (i) the provision of a two-year transition period to repeal the FSC/ETI and (ii) the "grandfathering" provision that allows companies with permanent contracts in effect after September 17, 2003 to continue to receive the FSC benefits beyond 2006.

**OUTLOOK**

Mandelson concluded that his visit to the US had shown him the difficulties and complexities of the transatlantic agenda, and was optimistic that it would be possible to improve the relationship and resolve the current disputes.

Mandelson's visit is part of a series of recent attempts by both the EU and the US to strengthen their relationship, including visits by outgoing US Secretary of State Condoleezza Rice's President George W. Bush to Europe.

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<sup>9</sup> Pub. L. No. 108-357.

## US-LATIN AMERICA

### FTAA

#### Deputy USTR Allgeier Emphasizes Parallel Nature of Doha and FTAA Negotiations

##### *SUMMARY*

On February 7, 2005, the U.S. section of the Brazil-US Business Council hosted a luncheon with Deputy US Trade Representative Ambassador **Peter Allgeier**. Allgeier, who is responsible for Western Hemisphere issues within USTR, emphasized the link between progress on the Doha agenda and the Free Trade Area of the Americas (FTAA). Allgeier highlighted agriculture as the central issue to regional and global trade negotiations, noting the importance of a balanced approach to subsidy elimination and market access.

Brazil and the US plan to meet at the end of February to try and establish the broad parameters for the resumption of FTAA negotiations.

##### *ANALYSIS*

We review here the remarks delivered by Ambassador Allgeier before a luncheon of the Brazil-US Business Council:

#### **I. Completion of Doha Round By December 2006 Essential**

Ambassador Allgeier opened his remarks with a discussion of the Doha round. Concentrating his remarks on agriculture, Allgeier reiterated the U.S. view that the Doha round must produce i) a date certain end to export subsidies, ii) significant cuts in domestic supports, and iii) greater market access through reduced tariffs. Allgeier stated that Brazil and the US share some common agricultural interests in the Doha round, particularly with respect to export subsidy elimination.

Allgeier also discussed the importance of trade facilitation as part of the broader Doha agenda. He stated that Brazil and US would reap benefits from the modernization of customs clearance procedures and greater transparency in the processing of imports and exports.

Completion of the Doha round by December 2006 is essential to ensuring the success of the round. Allgeier stated that Brazil and the US share a common vision on a timeline for completing Doha. This timeline includes the finalization of modalities by the Hong Kong ministerial in December 2005 so that World Trade Organization (WTO) members can use 2006 to negotiate schedules for meeting agreed upon commitments.

#### **II. FTAA Stalled Over Core Commitments**

Allgeier stated that the FTAA remains stalled due to an inability of Brazil and the US to agree on the common commitments all FTAA members will have to undertake. Intellectual property (IP) and domestic agricultural supports remain the key obstacles to progress on the FTAA. He also clarified that the US is not seeking WTO-plus commitments on intellectual property. Rather, the US is seeking to ensure full and efficient implementation

of current WTO obligations. On agriculture, Allgeier conceded that progress on the FTAA would be contingent on the progress of agriculture talks at the WTO.

Brazil and the US will meet at the end of February in an attempt to re-start FTAA negotiations. While the meeting is not expected to produce an agreement on the common commitments to be included in the FTAA, the meeting will seek to lay a foundation for further talks without prejudicing concerns over agriculture and IP. The US continues to oppose an agreement comprising only market access.

### **III. Allgeier Addresses Questions on U.S. Budget and Trade Remedies**

Attendees at the luncheon questioned Allgeier on U.S. trade remedy laws and objections raised by Brazil over the application of those laws. Allgeier responded that countries such as China, India, and Mexico are increasingly making use of trade remedy laws. Furthermore, the US has agreed to negotiate changes to the relevant disciplines on trade remedies within the WTO. Allgeier also noted that transparency in the administration of trade remedies is an important issue for the US.

Participants asked Allgeier to comment on the significance of the Bush administration's proposal to cut farm subsidies by \$586 million in FY 2006. Allgeier responded that, while not addressing the core concerns of Brazil and others, the move should be viewed as an expression of willingness on the part of President Bush to tackle domestic support reduction.

### ***OUTLOOK***

With the fates of the Doha Round and FTAA intertwined, real progress on the latter may have to wait until later this year. Negotiators in Geneva continue to struggle to find a balance between non-agricultural market access, and the reduction of subsidies and tariffs on agricultural goods. A reconvening of the full FTAA negotiating group is possible before the end of 2005, but the success of such a meeting will depend on the success of WTO negotiators ahead of the Hong Kong ministerial in December 2005.

## **NAFTA**

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### **U.S.-Mexico Trade Disputes Continue in 2005; Mexican Senate Expected to Approve Rules of Origin Modifications**

#### ***SUMMARY***

We would like to alert you to the following NAFTA developments:

- U.S.-Mexico Trade Disputes Likely to Continue in 2005.
- Mexican Senate Expected to Approve Rules of Origin Modifications During Spring Term.
- US and Mexico Open Additional FAST Lanes at U.S.-Mexico Border.

#### ***ANALYSIS***

##### **U.S.-Mexico Trade Disputes Likely to Continue in 2005**

U.S.-Mexico trade disputes are likely to continue in 2005. U.S.-Mexico trade disputes involving cement, trucking, high-fructose corn syrup (HFCS), and certain agricultural products could renew tension in the bilateral relationship if U.S. and Mexican negotiators fail to resolve them.

The prospects of prompt solutions to these issues are slim due to congressional concerns in both countries. The United States is resistant to modifying the trucking safety compliance requirements and the Mexican Congress is unlikely to repeal the 20 percent tax on HFCS in the spring congressional session.

The US and Mexico are also likely to clash at the WTO where a WTO panel has been established to conduct an investigation on U.S. anti-dumping measures imposed on Mexican cement. Another panel could be established to challenge Mexico's tax on HFCS.

##### **Mexican Senate Expected to Approve Rules of Origin Modifications During Spring Term**

Congressional sources report that the Mexican Senate is expected to approve the modifications to Annex 401 of the North American Free Trade Agreement (NAFTA) on Rules of Origin (ROO) during the spring session, which will open formally next March. The Senate was scheduled to consider the ROO modifications last December but the discussion over the 2005 budget delayed the consultation process.

In order to harmonize the ROO for certain industrial products, the NAFTA working group on ROO mandated the United States, Canada, and Mexico make modifications to NAFTA Article 401. The United States and Canada finalized amendments to NAFTA ROO and these entered into force on January 1, 2005. Mexico is the last one of the three NAFTA partners to approve the amendments.

The amendments would liberalize the rules of origin of several products, including: (i) motor vehicles and their parts; (ii) plastics and rubber, (iii) chemicals, (iv) cooper, and (v)



pharmaceuticals. The modifications aim to improve the tariff benefits in the North American region.

### **US and Mexico Open Additional FAST Lanes at U.S.-Mexico Border**

Mexico and the United States opened two additional lanes for cargo trucks enrolled in the Free and Secure Trade (FAST) Program. FAST is a paperless cargo release mechanism, which aims to harmonize clearance of low-risk commercial shipments at the U.S.-Mexico border while promoting secure trade. The expansion of FAST lanes will provide U.S. importers and Mexican exporters enrolled in the program faster and more efficient clearance of shipments.

The FAST lanes opened at two key ports of entry, Calexico and Mexicali. FAST lanes now operate at seven locations, including Tijuana, Juarez, Nuevo, Laredo, Reynosa, and Matamoros. These ports handle over 90% of commercial trade on the U.S.-Mexico border. In 2005, additional FAST lanes will open at seven different ports of entry: Tecate, CA, San Luis, AZ, Douglas, AZ, Santa Teresa, NM, Del Rio, TX, Eagle Pass, TX, and Rio Grande City, TX.

### ***OUTLOOK***

NAFTA partners in 2005 are expected to focus on the following: (i) implementing NAFTA ROO to decrease the costs associated with rules of origin; (ii) resolving outstanding trade disputes; and (iii) deepening trade integration.

NAFTA partners have acknowledged the benefits of NAFTA since it entered into force, but are aware that they need to do more to improve the region's competitiveness. While testifying at a confirmation hearing of the Senate Foreign Relations Committee, Secretary of State Condoleezza Rice noted that the United States is already looking into new ways to strengthen NAFTA. At the Inter-Parliamentary Annual Meeting held in January, Canadian and Mexican deputies also stressed the need to maximize the benefits of NAFTA (i.e. reducing transaction costs and harmonizing tariffs). While NAFTA partners will continue to seek ways to resolve trade irritants, it is clear that they will also focus their efforts to improve North American competitiveness in light of global competition among emerging trade blocks in other world regions.

## MULTILATERAL

### WTO Panel Rules Against U.S. Imposition of Countervailing Duties on Korean Computer Chips (DRAMs)

#### SUMMARY

A WTO Panel has ruled that the U.S. imposition of countervailing duties on computer chips from Korea violated the obligations of the United States under the WTO *Agreement on Subsidies and Countervailing Measures* (SCM Agreement). The Panel found that the United States Department of Commerce (DOC) did not have a sufficient evidentiary basis to conclude that the Korean government had "entrusted or directed" private creditors to provide financial contributions to the Korean computer chips exporter, Hynix Semiconductors Inc.

#### ANALYSIS

##### I. Applicable Disciplines on Subsidies: "entrusting or directing" a private body to provide a financial contribution

Article 1 of the SCM Agreement defines when a subsidy will be deemed to exist. In general terms, the definition of a "subsidy" comprises two elements: a "financial contribution" by a government, and the conferral of a "benefit" on the recipient.

The Agreement also defines what is meant by a "financial contribution by a government." Such a financial contribution will exist where:

- There is a direct transfer of funds (such as by a grant or loan) or a potential direct transfer of funds or liabilities (such as a loan guarantee);
- Government revenue that is otherwise due is foregone or not collected (such as tax credits);
- The government provides goods or services; or
- The government makes payments to a funding mechanism, or "entrusts or directs a private body" to carry out one or more of the type of functions listed above, which "would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments."

This case turned on the meaning and scope of the term "entrusts or directs", as discussed below.

##### II. Factual Background: Korea "had a policy to prevent Hynix' failure"

This dispute arose from a countervailing duty investigation by the U.S. Department of Commerce on imports of dynamic random access memory semiconductors (DRAMs) from Korea. The DOC imposed countervailing duties after it determined that one of the Korean DRAM exporters, Hynix Semiconductor Inc., received subsidies in the form of financial contributions by its creditors.

The United States argued that the Government of Korea (GOK) had established a policy to save Hynix from its financial difficulties because of the importance of the Korean semiconductor industry. In its determination, the DOC stated that:

[t]he GOK had a policy to prevent Hynix' failure. The GOK attached such great importance to Hynix' survival because it feared that the company's collapse would have serious repercussions for [Korea's] corporate, labour and financial markets, and because Hynix was part of an industry sector considered to be of 'strategic' importance to the GOK.

The DOC found that financial contributions were provided by a number of banks owned or controlled by the Korean government, as well as by a larger number of private bodies that were "entrusted or directed" by the Korean government to do so.

Korea argued that the DOC improperly found that the private creditors were "entrusted or directed" by the Korean government to participate in the financial contributions to Hynix, and therefore their participation fell outside the scope of the SCM Agreement.

### **III. "Entrust or direct": act of delegation can be implicit**

Korea and the United States differed over the issue of when a government will be considered to "entrust or direct" a private body to make a "financial contribution" for the purposes of the SCM Agreement. Korea argued that an investigating authority must demonstrate "an explicit and affirmative government action addressed to a particular party to perform a particular task or duty." The United States argued that there was no need for "express proof of private body-by-private body, transaction-by-transaction" entrustment or direction. In the U.S. view, entrustment or direction could be established on the basis of broader evidence.

The Panel found that in order for a government to entrust or direct, three elements must be present. There must be:

- (i) an affirmative action, either delegation or command;
- (ii) addressed to a particular party; and
- (iii) the object of which is a particular task or duty.

The Panel said that of these three elements, the first - affirmative action of delegation or command - was determinative. Yet what kind of "affirmative action" was required? The Panel in *United States - Export Restraints* had said that the affirmative action had to be "explicit." The *DRAMs* Panel disagreed, stating that "the affirmative act of delegation or command could be explicit or implicit, formal or informal."

In the view of the Panel, the fact that the "addressee and object of the act of delegation or command" was not described in detail would not preclude a finding of entrustment or direction. Rather, this was an evidentiary issue. The Panel reasoned that "although the plain meaning of entrustment or direction requires that something be delegated to someone, or that someone must be commanded to do something, the plain meaning of those terms does not require that such someone or something must necessarily be specified in great detail." Importantly, the Panel added: "[t]hat being said, the evidence of entrustment or direction must in all cases be probative and compelling." In the context of this dispute, this

meant that "the evidence must demonstrate that each private entity allegedly providing, or participating in, a financial contribution was entrusted or directed by the government to do so."

The Panel stressed that the "while it is important that [the "entrust or direct" provision] should not be interpreted so broadly that it covers the conduct of private bodies acting independently of government delegation or command, neither should that provision be interpreted so narrowly that it allows Members to escape the disciplines of the SCM Agreement by acting indirectly through private bodies."

**IV. DOC determination of entrust or direct: Panel finds "too many irregularities and shortcomings in the DOC's reasoning"**

Turning to the DOC investigation at issue, the Panel recalled the DOC's finding that the Korean government "had a policy to prevent Hynix' failure." However, in the view of the Panel, this was an insufficient basis on which to establish entrustment or direction. The Panel said that in order to meet the requirements of the provision, the DOC was required to gather evidence of affirmative acts of delegation or command by the Korean government vis-à-vis the private creditors.

The Panel noted that the DOC had established that the Korean government had the means to influence certain creditors through government shareholders, and that the Korean government had certain regulatory authority over such shareholders. However, the DOC had not properly established that the Korean government actually exercised such influence or regulatory authority so as to entrust or direct the private creditors to participate in the financial contributions for the restructuring of Hynix. After a review of the facts, the Panel concluded that although the Korean government had a certain capacity to influence the company's creditors, the DOC had not properly demonstrated that that Korean government availed itself of that capacity to entrust or direct the creditors to participate in the financial contributions. For this reason, the Panel concluded that the DOC could not properly have found that there was sufficient evidence to support a "generalized finding" of entrustment or direction of private bodies. In the view of the Panel, there were "simply too many irregularities and shortcomings in the DOC's reasoning to properly sustain such a broad determination."

Therefore, the Panel concluded that the DOC's determination of entrustment or direction by the Korean government of financial contributions by Hynix's creditors was inconsistent with the SCM Agreement.

## **V. DOC's "benefit" determination WTO-inconsistent**

The Panel recalled the well-established case law that a financial contribution confers a "benefit" within the meaning of the SCM Agreement when it is made available on terms that are more favourable than the recipient could have obtained on the market. Moreover, in order to determine the existence of "benefit", it is necessary to identify an appropriate benchmark against which to assess the terms of the financial contribution.

In the present case, the DOC rejected certain private creditors as market benchmarks, because the DOC had determined that they were acting pursuant to government entrustment or direction, rather than market principles, when they participated in the Hynix restructuring. The Panel recalled that it had already ruled that the DOC could not properly have found that these private creditors had been entrusted or directed by the Korean government. Therefore, the entrustment or direction of these creditors could not have been a proper basis for the DOC to reject them as market benchmarks. As a result, the Panel concluded that the DOC's benefit determination violated the SCM Agreement.

## **VI. DOC's "specificity" analysis WTO-inconsistent**

Under the SCM Agreement, a subsidy is subject to countervailing duties only if it is "specific to an enterprise or industry or group of enterprises or industries."

The United States argued that the Korean subsidy program was directed at Hynix, and therefore it was "specific" within the meaning of the SCM Agreement. The Panel noted that the DOC's finding of specificity for certain creditors was based on its determination of entrustment or direction of these private creditors in the Hynix restructuring program. However, the Panel recalled that the DOC's determination of entrustment or direction was "factually flawed" and inconsistent with the Agreement. Therefore, the DOC's finding of specificity with respect to these private creditors was inconsistent with the SCM Agreement. (The DOC's finding of specificity with respect to Hynix's public body creditors was based on government "activity specifically focused on" Hynix, which the Panel found to be "specific" within the meaning of the SCM Agreement.)

## **VII. USITC Breaches the "Non-Attribution" Rule**

Korea also challenged the determination by the U.S. International Trade Commission (USITC) that the subsidized imports had caused injury to the U.S. industry. The panel rejected most of Korea's injury arguments.

However, the Panel agreed with Korea that the USITC had not properly demonstrated a "causal link" between the imports of the Korean products and the injury to the U.S. industry. Article 15.5 of the SCM Agreement provides in part that "[i]t must be demonstrated that the subsidized imports are, through the effects of subsidies, causing injury within the meaning of this Agreement." The requirement to establish causation is coupled with a so-called "non-attribution" rule: factors other than imports that are causing injury to the domestic industry must not be attributed to imports.

The Panel found that the USITC violated the non-attribution rule in this case, as it had failed to "separate and distinguish the injurious effects of other factors from those of the alleged subsidized imports." Korea had put evidence before the USITC that the U.S. industry

was adversely affected by a drop in demand for products that use DRAMs, such as personal computers. The Panel found that the USITC had not properly explained how it ensured that the injury caused by such decline in demand was not attributed to the allegedly subsidized imports. The Panel concluded that the USITC violated its obligation not to attribute to subsidized imports the injury caused by other factors.

The decision of the Panel in *United States - Countervailing Duty Investigation on Dynamic Random Access Memory Semiconductors (DRAMs) from Korea* was released on February 21, 2005.

### ***OUTLOOK***

This case provides an extended analysis of one of the key disciplines of the SCM Agreement, which deems a subsidy to exist when a government "entrusts or directs" a private body to provide a financial contribution. But the Panel has established a standard that may be difficult to apply in practice, and which conflicts with the prior jurisprudence on a fundamental threshold issue.

The SCM Agreement prevents governments from doing indirectly what they cannot do directly. A subsidy will be deemed to exist where a government makes a "financial contribution" that provides a "benefit." The Agreement adds that a subsidy will also exist where the government "entrusts or directs" a private body to make the financial contribution.

When will a government be found to have "entrusted or directed" a private entity to make a financial contribution? The Panel adopted a three-part test: it said that there must be (i) an affirmative action, either delegation or command; (ii) addressed to a particular party; (iii) the object of which is a particular task or duty.

The 2001 decision in *United States - Export Restraints* had ruled that the first element - the affirmative delegation or command - must be explicit. Korea had urged the *DRAMs* Panel to adopt a similar test. However, the *DRAMs* Panel rejected the notion that the delegation or command must be explicit, ruling that it could be "explicit or implicit, formal or informal." At the same time, the evidence of the entrustment or direction must be "probative and compelling."

The Panel's ruling raises the prospect that investigating authorities may make some highly subjective - and possibly highly questionable - determinations that there was "implicit or informal" delegation or command by a government to private entities. This means that CVD investigations may find "entrustment or direction" where none was intended, or existed.

At the same time, the Panel's notion of "probative and compelling" evidence may be very difficult to apply to the concept of "implicit or informal" delegation. Depending on the facts, "compelling" evidence of "implicit" delegation connote almost contradictory standards.

Although Korea won on the facts of this case, the tests established by the Panel are potentially troubling. Moreover, given the conflict with the ruling in *United States - Export Restraints* (which was not appealed), the Appellate Body will likely need to determine whether the delegation or command must be explicit, or may indeed be "implicit or informal."