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WTO AND REGIONAL TRADE AGREEMENTS MONTHLY REPORT

February 2006

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

TABLE OF CONTENTS

3/1/2006 4:35 PM (2K)
WASHINGTON 903259 v1 [903259_1.DOC]

3/1/2006 4:35 PM (2K)
WASHINGTON 903259 v1 [903259_1.DOC]

SUMMARY OF REPORTS

United States

U.S. Senate Finance Committee Holds Hearing on the Administration's Trade Agenda for 2006

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House Ways and Means Committee Holds Hearing on 2006 Presidential Trade Agenda

On February 15, 2006, the United States House of Representatives Ways and Means Committee held a hearing on the President's 2006 international trade agenda. The hearing included **on-the record** oral testimony from United States Trade Representative (USTR) Rob Portman. We review below his testimony and the discussion between the Committee and Portman.

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

USTR Releases 2006 "Top-to-Bottom" Review of China

On February 14, 2006, the Office of the United States Trade Representative (USTR) released its "top-to-bottom" review of China. The report highlights the implications of the changes that have occurred in China's trade relationship with the United States. The report also lists actions that USTR will take to strengthen the U.S. relationship with China and to ensure China's compliance with its obligations to the World Trade Organization (WTO) and the United States. We review here that report and its findings.

United States Highlights

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

- USTR General Counsel: USTR Will Increase WTO Cases in 2006
- Sen. Baucus Introduces "Trade Competitiveness Act of 2006"
- Japanese Officials: USDA Report on Accidental Bone-In Beef Export is "Insufficient"
- Members of Congress Express Concern Over UAE Port Operator and U.S. Operations

3/1/2006 4:35 PM (2K)
WASHINGTON 903259 v1 [903259_1.DOC]

- U.S. ITA Releases Report on Sugar-related Job Losses
- Court Finds President's Denial of Import Relief From Chinese Goods is "Nonreviewable Discretionary Decision"
- Graham-Dorgan Bill Would Revoke China's PNTR Status
- USTR Appoints New AUSTR for Congressional Affairs
- With House Passage of Budget Bill, Byrd Repeal "Complete"

Free Trade Agreements

Geopolitical Aspects of the U.S. Middle East Trade Area (USMEFTA) Initiative

In May 2003, President George W. Bush proposed the creation of a U.S. Middle East Free Trade Area (USMEFTA) with 18 Middle Eastern countries "to increase trade and investment with the United States and others in the world economy."[1] Experts argue, however, that the United States' main objective in the USMEFTA initiative is geopolitical, rather than economic. This report evaluates this argument by comparing USMEFTA and non-USMEFTA Free Trade Agreement (FTA) negotiations and the agreements' respective congressional approval processes.

[1] Office of the United States Trade Representative, "Middle East Free Trade Initiative: U.S. Regional Plan to Spur Economic Growth," (March 2, 2004) *available at* http://www.ustr.gov.

Free Trade Agreements Highlights

We want to alert you to the following Free Trade Agreements developments:

- U.S. and Colombia Complete FTA Negotiations
- USTR Recommends DR-CAFTA Implementation for El Salvador
- U.S. ITC To Investigate Economic Effect of U.S.-South Korea FTA
- Congressional Concern of UAE Ports Deal Could Affect U.S.-UAE FTA Negotiations
- Sec. Rice: Timing Not Quite Right for U.S.-Egypt FTA
- USTR Expresses Optimism for U.S.-Thai FTA, Says U.S-Malaysia FTA Could Be Announced in the Next Month
- Colombian President Visits Washington to Facilitate FTA Negotiations
- U.S., India Engage in Trade Dialogue Under Trade Policy Forum
- USTR Announces Creation of Middle East Economic Partnership Caucus
- Thai Government May Adopt Tougher Stance on U.S.-Thai FTA
- Senators Circulate Letter to USTR on U.S.-Korea FTA and Auto Issues
- Panama Requests Visit to U.S. Food Inspection Sites; Request Could Expedite FTA
- U.S.-Colombia FTA Talks Suspended, Will Resume in Mid-February
- United States and South Korea Announce Initiation of Formal FTA Talks
- Members of Congress Seek Support for U.S.-Malaysia FTA
- United States and Switzerland Call Off Potential FTA Negotiations

Multilateral

Status Report: U.S.-EU WTO Dispute over Civil Aircraft Subsidies

On February 17, 2006, the World Trade Organization's (WTO) Dispute Settlement Body (DSB) established a panel to resolve procedural matters in the dispute between the United States and the EU over the payment of government subsidies to the U.S. aircraft-manufacturer Boeing Company and its European rival Airbus. This is the second time the EU has requested the

3/1/2006 4:35 PM (2K)
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establishment of a panel to such procedural matters. The WTO has formed panels to hear the U.S. and EU complaints in what may become one of the largest and most contentious WTO disputes ever. The United States alleges that the governments of France, Germany, Spain and the UK have subsidized the operations of Airbus, the European aircraft manufacturer, in an amount of up to $15 billion,[2] violating the WTO Agreement on Subsidies and Countervailing Measures (ASCM). The European Union alleges that the U.S. Government and certain state governments have provided Boeing, the U.S. aircraft manufacturer, with up to $30 billion in ASCM-inconsistent subsidies.

The dispute will affect the competition in civilian and military aircraft sales for many years. Successful resolution of the dispute would remove the political risk of U.S. Congress adopting legislation detrimental to the interests of EU aerospace/defense companies. Although settlement seems the most reasonable solution, the continued tension between the two nations indicates that the parties may be unable to come to a mutually satisfactory solution, and that a formal WTO dispute settlement panel thus may be the only choice.

Multilateral Highlights

We also want to alert you to the following Multilateral developments:

- U.S. Offers New Agriculture TRQs Proposal; Faces Off With EU on Definition of "Food Aid"
- Plurilateral Offers Becoming Increasingly Complex and Difficult
- EU Requests Establishment of Panel in Boeing-Airbus Dispute
- U.S., EU, and WTO Members to Meet in Washington, London to Discuss WTO Doha Round
- WTO Members Say Retaliation Will Continue, Dismiss U.S. Claim That Byrd Amendment Has Been Repealed
- United States Requests WTO Dispute Settlement Panel on Turkey's Rice Restrictions

[2] The amount at stake in both disputes is not mentioned in the official WTO documents, but has been released through the media.

3/1/2006 4:35 PM (2K)
WASHINGTON 903259 v1 [903259_1.DOC]

REPORTS IN DETAIL

UNITED STATES

U.S. Senate Finance Committee Holds Hearing on the Administration's Trade Agenda for 2006

SUMMARY

On February 16, 2006, the United States Senate Finance Committee held a hearing on the Administration's 2006 trade agenda. The hearing's lone witness was United States Trade Representative (USTR) Rob Portman who briefed the committee on the Administration's trade priorities for 2006. We review here Portman's **on-the record** assessment of the 2006 U.S. trade agenda.

ANALYSIS

The U.S. Senate Finance Committee held a February 16 hearing on the Administration's 2006 trade agenda. USTR Portman briefed the Committee on the agenda, and Committee members addressed their interests and concerns to Portman. The hearing's main issues included: (i) U.S.-China trade relations; (ii) the World Trade Organization's (WTO) Doha Round agreements on agriculture; and (iii) continuing negotiation, implementation and enforcement efforts for Free Trade Agreements (FTAs).

- In his opening statement, **Senate Finance Committee Chair Charles Grassley (R-IA)** stated that 2006 would "be an important year for advancing both trade liberalization and trade compliance" and noted that he would develop legislation addressing U.S.-China trade relations over the next several weeks. According to Grassley, the areas of U.S-China trade relations that require Congress and USTR's attention are: (i) China's currency – an issue on which Grassley has "grown increasingly frustrated with the lack of progress;" (ii) trade enforcement; and (iii) trade enhancement "to increase benefits to Americans." He emphasized the importance of market access liberalization and stated that "the key point is that China must live up to its commitments and to its responsibilities as a major beneficiary of the trading system." With respect to a WTO Doha Round trade agreement, Grassley stated that "Congress will not accept any agreement that fails to provide meaningful market access for U.S. agricultural exports in developed and developing countries alike." In addition, he stated the U.S.-Oman FTA is "a significant building block toward achieving [a Middle East Free Trade Area (MEFTA) initiative]" and noted that "the committee will soon turn in implementation of the U.S.-Oman Free Trade Agreement." On the U.S.-Colombia FTA, he stated that

3/1/2006 4:35 PM (2K)
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"an agreement won't pass the Senate unless the final package is as least as good for U.S. agricultural producers as the DR-CAFTA agreement."

- **Senate Finance Committee Ranking Member Max Baucus (D-MT)** stated he would focus on "working to enhance the competitiveness of the U.S. economy" and look at the Administration's agenda "through the prism of whether they enhance U.S. competitiveness" in 2006. He stated that "a more competitive America requires [Congress] to focus more on trade enforcement" and noted that "there is a very real sense in the Congress that [U.S.] trading partners do not always play by the rules." On WTO negotiations, he stated that the United States offered "quite a lot, especially on agriculture" and noted that all U.S. trading partners "must realize they must give in order to get." In addition, he expressed his concern on China, Korea, and Japan's market access, in particular, their ban on U.S. beef.[3]

- **USTR Rob Portman** presented the same testimony he had given at the House Ways and Means Committee hearing on February 15, 2006 (see February 16th W&C report). On China, Portman stated that although China has made little progress on intellectual property rights (IPR) and has "not even filled their WTO commitments in some areas" of market access liberalization, it remains "a major trading partner." He stated that U.S. "policy is that China should open up more and take more responsibility." When **Senator Charles Schumer (D-NY)** pointed out that USTR's Top-to-Bottom-Review on U.S.-China trade relations released on February 14, 2006 (see February 15th W&C report) did not mention China's currency manipulation, Portman responded that it is not USTR's responsibility, but "we should do something about it." He stated that the trade deficit, trade policy and currency policy are all interrelated. With respect to the U.S.-Peru FTA, Portman stated that he sees no problems with the FTA, especially on its labor rights provisions. He also stated that a "strong agreement" with Peru could fix Peru's transparency and corruption issues that are of particular concern to corporations and investors. Sen. Grassley added that the trade agreement with Peru "should not be held up waiting for the other Andean countries." With respect to bilateral agreements with MEFTA countries, Portman noted high trade barriers within the MEFTA countries but reiterated importance that the United States places on achieving the MEFTA initiative. On WTO negotiations, Portman stated that the United States remains focused on the WTO's Doha Round and on how it could persuade its trading partners to introduce more ambitious proposals. Portman noted that agriculture negotiations have been the most difficult, but that the United States is focusing on: (i) expanding market access through

[3] As of February 2006, Korea bans imports of bone-in-beef, Japan bans imports of spinal column, and China bans imports of all beef from the United States.

tariff reductions; (ii) eliminating all export subsidies; and (iii) substantially reducing trade-distorting agricultural support. Portman stated that the United States "has set the path for the final stage of negotiations" but noted that U.S. trading partners must provide more ambitious proposals.

OUTLOOK

Portman's testimony indicates that the Administration is addressing many of the same issues that were important in 2005. On the bilateral front, Presidential Trade Promotion Authority's (TPA) potential expiration will cause USTR to work to complete FTA negotiations by the end of 2006 – including talks with South Korea, Thailand, the United Arab Emirates (UAE), and Panama – and will dictate Congressional consideration of those agreements and the already-completed FTAs with Peru and Oman. USTR will also focus on the MEFTA initiative because it has become a top agenda item for President Bush. On the multilateral front, the U.S. will continue its focus on the WTO negotiations based on the WTO's April 2006 deadline for achieving full modalities and the December 2006 deadline for reaching an agreement. The Bush Administration seems to be doing everything possible to ensure that the Doha Round moves forward and talks with the EU and several other WTO Members in February and March should provide the United States with a chance to introduce further momentum into the stalled Round.

3/1/2006 4:35 PM (2K)
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House Ways and Means Committee Holds Hearing on 2006 Presidential Trade Agenda

SUMMARY

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

ANALYSIS

On February 15, 2006, the U.S. House of Representatives Ways and Means Committee held a hearing on the President's 2006 international trade agenda. The hearing included on-the record oral testimony from USTR Rob Portman. In his opening statement, **Congressman Bill Thomas (R-CA)** stated that the U.S. trade agenda is presently "in an interesting position" and opined that "certain U.S. trading partners were bent on avoiding free trade" during the World Trade Organization's (WTO) December 2005 Ministerial Conference in Hong Kong. Thomas requested that Portman describe the steps that the United States will take in the event that WTO Members do not reach a Doha Round agreement by the end of 2006. He also stated that the United States should continue pursuing bilateral Free Trade Agreements (FTAs) and noted that U.S. exports have grown as a consequence of these FTAs. Thomas stated that Committee members were also concerned with several other trade-related issues including Japan's ban on U.S. beef, intellectual property rights (IPR) enforcement in Russia, and labor issues in all FTAs.

Robert Portman, United States Trade Representative (USTR), stated that the United States has "recently achieved certain milestones" including: (i) moving the WTO Doha Round forward by providing "bold" U.S. proposals; (ii) closing FTA negotiations with Peru and Oman; (iii) passing the U.S.-Bahrain FTA; and (iv) completing Saudi Arabia's WTO accession. Portman stated that "the United States is already the most open major economy in the world but must knock down barriers to [U.S.] goods and services abroad." He added that "trade liberalization raises productivity and real wages while expanding consumer choice and purchasing power." Portman said that the 2006 Presidential trade agenda will focus on three main topics: (i) global trade talks; (ii) bilateral and regional trade agreements; and (iii) the enforcement of trade laws and strengthening of trade agreements.

1. **Global Trade Talks.** Portman stated that the United States was still focused on the WTO's Doha Round and on how it could persuade its trading partners to introduce more ambitious proposals. In manufactured goods (NAMA) negotiations, Portman stated that the United States is "seeking real cuts in the tariffs that are applied in both developed and advanced

developing markets" and that the United States will focus on "key sectors and non-tariff barriers." In services negotiations, Portman stated that "other WTO Members, especially emerging developing countries, must improve their offers and open their markets to services." Portman noted that agriculture negotiations have been the most difficult, but that the United States is focusing on: (i) expanding market access through tariff reductions; (ii) eliminating all export subsidies; and (iii) substantially reducing trade-distorting agricultural support. Portman stated that the United States "has set the path for the final stage of negotiations" but noted that U.S. trading partners must provide more ambitious proposals. On WTO accessions, he stated that the United States will expect "major progress and possible completion" in 2006 for several accessions including Vietnam, Ukraine, Russia and Kazakhstan. The United States "is nearing completion of bilateral agreements with all four applicants," but Congress must provide the applicants with permanent normal trade relations (PNTR) status in order for them to complete their accession.

2. **Bilateral and Regional Agreements.** On the bilateral front, Portman noted that the Generalized System of Preferences (GSP) program will expire on December 31, 2006, but that President Bush has requested a five-year reauthorization for the program in the FY 2007 budget; Portman opined that he sees no complications in reauthorizing GSP. Portman also noted that U.S. FTA partners account for 15 percent of the world's GDP but total 54 percent of U.S. exports, making FTAs "an important tool in U.S. trade policy." He stated that the U.S.-South Korea FTA "will bring big benefits to the United States and South Korea" and will benefit U.S. agriculture and industrial producers, as well as services providers.

3. **Enforcing Trade Laws and Strengthening Trade Agreements.** Portman stated that the United States would continue to enforce its trade laws by bringing dispute settlement cases at the WTO. He highlighted the Boeing-Airbus case as one such example and highlighted other recent successes including the Korean semiconductors, Japanese apples, and EU geographical indications cases. Outside of traditional dispute settlement, Portman stated that the United States should continue its focus on China by working closely with the U.S. – China Joint Commission on Commerce and Trade (JCCT) and strengthening China textile safeguards and transparency initiatives. On intellectual property, Portman briefly described how USTR has established special "watch" lists under the "Special 301" provisions of U.S. trade law, which requires USTR to identify U.S. trading partners that fail to provide "adequate intellectual property rights protection for U.S. companies."

3/1/2006 4:35 PM (2K)
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Portman concluded his testimony by stating that the United States should focus on several opportunities and challenges in 2006:

- Conclude global trade talks and "realize a once-in-a-generation opportunity";
- Pursue "high-standard bilateral and regional agreements to provide new market access" for U.S. goods and services; and
- "Vigorously enforce" trade laws and trade agreements to ensure a "level playing field."

OUTLOOK

Portman's testimony indicates that USTR will continue working on those areas that were major focal points in 2005. On the multilateral front, the U.S. focus on the WTO negotiations is based on the WTO's April 2006 deadline for achieving full modalities, the December 2006 deadline for reaching an agreement, and the mid-2007 expiration of Presidential Trade Promotion Authority (TPA). TPA expiration will affect much of USTR's 2006 trade agenda because it dictates when the United States should complete both bilateral and multilateral agreements. On the bilateral front, the TPA's potential expiration will cause USTR to work to complete FTA negotiations by the end of 2006 – including talks with South Korea, Thailand, the United Arab Emirates (UAE), and Panama – and will dictate Congressional consideration of those and the already-completed FTAs with Peru and Oman. Indeed, should the Doha talks collapse in the coming months, USTR may focus more on bilateral agreements during 2006. It is clear, however, that the Bush Administration will do everything possible to ensure that such a collapse does not happen.

3/1/2006 4:35 PM (2K)
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USTR Releases 2006 "Top-to-Bottom" Review of China

SUMMARY

On February 14, 2006, the Office of the United States Trade Representative (USTR) released its "top-to-bottom" review of China. The report highlights the implications of the changes that have occurred in China's trade relationship with the United States. The report also lists actions that USTR will take to strengthen the U.S. relationship with China and to ensure China's compliance with its obligations to the World Trade Organization (WTO) and the United States. We review here that report and its findings.

ANALYSIS

On February 14, 2006, USTR released "U.S.-China Trade Relations: Entering a New Phase of Greater Accountability and Enforcement" on the implications of the changes in China's trade relationship with the United States. The report also lists actions that USTR will take to strengthen the U.S. relationship with China and to ensure China's compliance with its WTO obligations. In drafting the report, USTR led an interagency "top-to-bottom" review of U.S. China trade policy, drawing upon input received from Congressional hearings, Government Accountability Office (GAO) reports, discussions with industry associations, and written submissions and oral testimony on China's compliance with its WTO obligations.

Issues of Concern

According to the report, China is the world's third largest trading power, and its emergence "as a major international player has not only redefined the global trading system, but also has far-reaching economic and political impact on China, the United States, East Asia and the world." The report also notes that "China's integration into the global economy and progressive embrace of market principles" have been encouraged by several U.S. presidential administrations, thus "broaden[ing] and deepen[ing] relationships between the United States and China at all levels, to the benefit of both countries." However, the report states that there is "friction" between the two countries caused by China's rapid growth in the past two decades[4] and increasing U.S. presence in the Chinese market.[5]

The report notes that "the enormous scope and scale of the changes that have occurred in China's trading posture and in [the U.S.-China] bilateral trade relationship pose continual challenges" particularly with "China's focus on export growth and developing domestic industries" and its lack of focus in furthering market openness and protecting intellectual

[4] China's economy has been growing at roughly ten percent a year, and exports account for 40 percent of China's gross domestic product (GDP).

[5] The United States market has directly accounted for 22 percent of China's export growth over the last two decades. Since 2001, U.S. exports to China have grown five times faster than they have to the rest of the world, and China has gone from being the ninth to the fourth biggest export market for the United States. U.S. exports to China increased by 20 percent in 2005, making China the fastest growing export market among U.S. major trading partners.

3/1/2006 4:35 PM (2K)
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property rights (IPR) and internationally recognized labor rights. The report lists specific U.S. concerns including:

- Continued Chinese barriers to certain U.S. exports;
- Failure to protect IPR;
- Failure to protect labor rights and enforce labor laws and standards;
- Unreported and extensive government subsidies and preferences for Chinese industries;
- Environmental concerns;
- Poor compliance with certain international trade rules; and
- A large and growing imbalance in U.S.-China bilateral trade flows.[6]

The report notes that Chinese barriers to U.S. exports contribute to the bilateral trade deficit and are inconsistent with China's multilateral and bilateral commitments. These barriers "have a corrosive effect on political support for the bilateral trade relationship." It also states that "China's ascendancy as a major international trading partner brings with it certain responsibilities for the maintenance of the multilateral, global trading system," and that "China's constructive participation is increasingly critical to the international regimes governing trade practices."

Key China Trade Objectives and Priority Goals

The report states that USTR will be working to achieve six objectives regarding its bilateral trade relationship with China:

1. **Increase China's participation as a responsible stakeholder in the global economy.** The report notes that although China is becoming "an increasingly active member within [international] organizations, it still plays a modest role relative to its economic and political heft." China remains outside of several key trade arrangements, including the WTO's Government Procurement Agreement (GPA), WIPO Internet Treaties, and the World Organization for Animal Health (OIE).

2. **Increase China's implementation and compliance with multilateral and bilateral trade obligations.** The report states that "IPR enforcement is one of China's greatest shortcomings." USTR will work towards ensuring that China takes specific action in increasing criminal prosecutions of IPR

[6] The U.S. trade deficit with China was approximately $202 billion in 2005.

3/1/2006 4:35 PM (2K)
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violators, improving enforcement at the Chinese border, combating the counter piracy of movies, audio visual products and software, and addressing Internet-related piracy.

3. **Ensure that U.S. trade remedies and other import laws are enforced fully and transparently.** The report states that the U.S. Department of Commerce (DOC) will be "working aggressively" with Customs and Border Protection (CBP) to track down Chinese shippers that have evaded import duties. Additionally, USDA will increase monitoring of China's agricultural trade compliance, particularly in the area of sanitary and phytosanitary (SPS) requirements.

4. **Secure further Chinese market access and greater economic reforms.** Priority items include: (i) fostering a rules-based competitive environment in China for foreign and domestic interests alike, including the application of non-discriminatory competition laws and policies *(e.g.*, a sound anti-monopoly law; reliance on voluntary, industry-led standards; elimination of barriers created by provincial and local governments; and elimination of government control of business interests); (ii) expanding market access in IPR-intensive sectors, such as the audiovisual and publishing sectors; and (iii) addressing limitations on market access and regulatory barriers in the telecommunications and other services sectors.

5. **Pursue effective U.S. export promotion efforts in China.** The report notes that in many cases, "market access is still limited by a variety of factors to major coastal population centers" and states that "as China continues to improve its infrastructure, export promotion efforts can substantially increase U.S. exports to large inland cities in China." The report also notes that many potential U.S. exporters – particularly small and medium-sized enterprises (SMEs) – are unfamiliar with the Chinese market and its export opportunities, and that "further outreach to SMEs still promises to lead to substantially increased U.S. exports to China."

6. **Identify mid- and long-term challenges that the U.S.-China trade relationship may encounter.** The report notes that "U.S. officials have generally devoted resources to resolving the numerous problems brought to [the USTR's] attention by industry, members of Congress, and other interested parties" and states that "U.S. policy formulation could benefit from the dedication of resources to analyzing long term-trends and anticipating and addressing early on trade problems that may arise." The report also notes that as the U.S.-China trade relationship continues to grow rapidly and become more complex, the U.S. government will need to increase its information collection and analysis capabilities related to U.S.-China trade and to strengthen interagency coordination, "in order to identify

3/1/2006 4:35 PM (2K)
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challenges early and proactively engage to address them before they become major problems."

USTR's Action Items

The report concludes that "the United States is entering an important new phase in [its] trade relationship with China," and that it should "readjust" trade policy – initially focused on encouraging market-based reforms in China and bringing China into the international trading system – to strengthen its focus on China's WTO compliance and adherence to international norms. The report also recommends that the United States should focus more on: (i) the bilateral trade relationship to ensure that it is equitable and durable; (ii) U.S. trade policymaking to ensure that it is more proactive and informed by more comprehensive information regarding China's economic developments; (iii) stronger coordination within the Executive branch and between the Executive and congressional branches; (iv) China's participation in the global trading system as a responsible trading partner; and (v) the United States' role as "an active and influential economic and trading power in the Asia Pacific region."

Based on the results of the review, USTR listed a series of additional action items that it should take "to help ensure that [the United States is] best positioned to meet [U.S.] key China trade objectives." USTR announced ten initial steps (additional action items will be developed and implemented in consultation with Congress and other stakeholders in the future):

1. **Expand USTR trade enforcement capacity to better ensure China's compliance with trade obligations** by establishing a China Enforcement Task Force at USTR, to be headed by a Chief Counsel for China Trade Enforcement. The Chief Counsel position is the first ever country-specific position at USTR, indicative of the scope and importance of USTR's China-centered work;

2. **Expand USTR capability to obtain and apply comprehensive, forward-looking information regarding China's trade regime and practices to U.S. trade policy formulation and implementation** by adding personnel to USTR's China office to coordinate collection and integration of information on current and potential China trade issues from other U.S. government agencies and other sources. USTR would also establish an Advisory Committee for Trade Policy and Negotiation (ACTPN) China Task Force to provide strategic advice and recommendations related to U.S.-China trade policy;

3. **Expand U.S. trade policy and negotiating capacity in Beijing and other resources in China** to more effectively pursue top priority issues, especially IPR protection;

4. **Increase coordination with other trading partners** on China trade issues of common interest, such as IPR enforcement;

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5. **Deepen and strengthen trade relations with other Asian economies, and within the APEC forum** to maintain and enhance U.S. commercial relationships in the region;

6. **Increase the focus on regulatory reform in China** by: (i) initiating high level dialogue on steel with China under the U.S.-China Joint Commission on Commerce and Trade (JCCT); (ii) deepening and expanding the State Department's high level dialogue with China's economic planners regarding structural reform; (iii) launching an initiative to investigate China's subsidies issues; (iv) expanding initiatives led by the U.S. Department of Agriculture (USDA) to improve China's transparency and compliance with its sanitary and phytosanitary (SPS) obligations under the WTO; and (v) focusing intensive interagency efforts to address China's development of standards and of an anti-monopoly law;

7. **Increase effectiveness of high-level meetings with China's leaders** by holding annual meetings of the JCCT prior to presidential-level meetings and by conducting mid-year reviews of goals and progress under the JCCT at the Vice Minister/Deputy level;

8. **Strengthen and expand U.S.-China dialogue** on "issues of significance to the global trading system" and on bilateral trade issues, including China's participation in global institutions, market access and standards issues related to telecommunications, financial services, and transparency and the rule of law;

9. **Strengthen U.S. government interagency coordination** including through monthly review, by the Trade Policy Review Group and Trade Policy Staff Committee, of strategies and progress; and

10. **Strengthen the Executive-Congressional partnership on China trade** by creating a program of regular briefings for Congressional members and staff updating them on progress in China's trade policy.

OUTLOOK

With the United States' large and growing trade deficit with China, members of Congress are again introducing legislation meant to punish China for its "unfair trade practices" that allegedly include currency manipulation, weak IPR enforcement, and WTO-inconsistent market access restrictions. USTR's review provides members of Congress a status report of the Bush Administration's policy towards China and action items that the Administration will take in its effort to strengthen the bilateral trade relationship. The report's most notable facets are USTR's position that China should increase its bilateral/multilateral participation and the lack of any reference to China's alleged currency manipulation. USTR Portman's urging of China to increase its international participation during the December 2005 WTO Ministerial Conference

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in Hong Kong was a new tactic for the United States – one that will become a regular part of U.S. trade policy towards China. On the other hand, the report does not address China's currency situation – perhaps the U.S. Congress' greatest problem with the current U.S.-China bilateral trading relationship. Because of this omission, the report has already drawn harsh criticism from several members of Congress including Sen. Charles Schumer (D-NY). Schumer introduced legislation (S. 295) in 2005 that would have imposed an "across-the board" tariff on Chinese goods if China did not revalue the yuan or let it float freely relative to the dollar. Schumer's reaction to the USTR report shows that congressional China critics are still not impressed with the agency's China review, nor do they find USTR's action items ambitious enough. Their continued introduction of anti-China legislation is, therefore, quite likely.

The recommended policies addressed in the report are in line with the Bush Administration's "quiet diplomacy" approach (under which the United States avoids direct confrontation with China on contentious issues and instead urges change through high-level meetings and dialogues). Portman and other USTR officials, however, have recently indicated that the Bush Administration may be tiring of this approach, and that may pursue formal dispute settlement actions against China at the WTO. The USTR report did not reference such direct action. Portman noted possible WTO challenges over China's failures on IPR protection and enforcement and over its "discriminatory tax policy" on auto parts. He added, however, that the United States would continue to negotiate with China on those issues and would seek to avoid WTO litigation if possible.

According to a 2005 USTR report on China's compliance with its WTO commitments, China assesses a higher tariff on auto parts imports if its Customs service determines that the parts could be used to assemble an entire car. The policy also requires that certain key parts must be made in China or else face the higher tariff. The tariff is 10 to 15 percentage points higher than the regular auto parts tariff. USTR would like to resolve the issue before the JCCT meeting in April but will continue preparing a WTO case on the auto parts issue and will consider what steps to take if the dispute isn't resolved at the JCCT meeting.

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US Highlights

USTR General Counsel: USTR Will Increase WTO Cases in 2006

On February 23, 2006, general counsel for Office of the United States Trade Representative (USTR) James Mendenhall stated that the United States in 2006 plans to increase the number of enforcement cases that it will initiate at the World Trade Organization (WTO). He noted that cases will include an action against China. Mendenhall stated that the United States is "very seriously" considering filing a dispute settlement action against China's alleged import barriers on foreign auto parts, and that USTR is working with the EU on the potential case.

Mendenhall noted that China will not be held to a different standard, and that the United States is "going to hold China to the standard they agreed to in the WTO." On U.S. and other countries' reluctance in the past to bring cases against China in order to give China a chance to implement its WTO commitments, he stated that "the honeymoon is past." According to Mendenhall, the United States is also running out of options "short of a more formal process" on intellectual property rights (IPR) enforcement with China.

Mendenhall also stated that USTR did not need legislative help in its enforcement efforts and that "the proposals that are out there . . . [are not] necessary." On February 16, 2006, Senate Finance Committee Ranking Member Sen. Max Baucus (D-MT) introduced legislation meant to strengthen the USTR's trade enforcement capabilities and to expand Congress' role in monitoring international trade relations and eliminating foreign trade barriers. The "Trade Competitiveness Act of 2006" (S. 2317) authorizes $5 million in additional funds for "USTR's enforcement efforts." The funds would also be used in creating a Senate-confirmed Chief Enforcement Officer at USTR with a supporting Executive Branch taskforce that includes representatives from the Departments of Agriculture, Commerce, State and Treasury. The Chief Enforcement Officer would be charged with investigating and advocating action on particular trade enforcement issues. The bill also requires USTR to work closely with Congress in prioritizing and "breaking down the biggest barriers to U.S. trade worldwide." USTR would be required to provide a timeframe and a list of options for enforcing trade agreements. Other Congressional Bills targeting China – including one sponsored by Sen. Chuck Schumer (D-NY) that would slap tariffs on Chinese imports unless the government unpegs its currency – are also slated to come before Congress in the coming months.

USTR's China case would be only the second WTO dispute initiated by the United States – or any other WTO Member – against the country. On March 18, 2004, the United States requested WTO consultations with China concerning China's preferential value-added tax ("VAT") for domestically-produced or designed integrated circuits ("IC"). That case, however, never led to the establishment of a dispute settlement panel, as the parties announced in October 2005 that they had agreed to a mutually satisfactory solution. Several Members of Congress have been critical of the Bush Administration's record in bringing WTO cases, especially on sensitive issues such as China and IPR. Although Mendenhall dismissed allegations that USTR

3/1/2006 4:35 PM (2K)
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increased action at the WTO due to Congressional pressure, the timing of his statements and his direct reference to China legislation places these claims in doubt. Under a deal brokered in 2005, Congress will vote on the Schumer bill by March 31, 2006, and congressional sources have opined that it has a very good chance of passing. The enactment of such legislation would be a clear violation of the United States' WTO commitments and would have deleterious economic effects on U.S. businesses and consumers. USTR's statements may very well be targeting this and other anti-China legislation in an attempt to dissuade Congressional members from voting for the problematic measures.

Sen. Baucus Introduces "Trade Competitiveness Act of 2006"

On February 16, 2006, Senate Finance Committee Ranking Member Sen. Max Baucus (D-MT) introduced legislation meant to strengthen the United States Trade Representative's (USTR) trade enforcement capabilities and to expand Congress' role in monitoring international trade relations and eliminating foreign trade barriers. The "Trade Competitiveness Act of 2006" (S. 2317) authorizes $5 million in additional funds for "USTR's enforcement efforts." The funds would also be used in creating a Senate-confirmed Chief Enforcement Officer at USTR with a supporting Executive Branch taskforce that includes representatives from the Departments of Agriculture, Commerce, State and Treasury. The Chief Enforcement Officer would be charged with investigating and advocating action on particular trade enforcement issues. The bill also requires USTR to work closely with Congress in prioritizing and "breaking down the biggest barriers to U.S. trade worldwide." USTR would be required to provide a timeframe and a list of options for enforcing trade agreements. The legislation calls on the International Monetary Fund (IMF) to "more aggressively condemn currency manipulation for trade purposes" and requires the Administration to consider federal and state sovereignty when negotiating, implementing and enforcing trade agreements.

According to the Senate Finance Committee, S. 2317 is the first in a series of bills from the Finance Committee's Ranking Member designed to "boost U.S. competitiveness and maintain America's economic leadership in the world." Baucus stated that he wants "American companies to get aggressive about getting their products and their people into foreign markets, to bolster the U.S. presence around the world." He added that "improving enforcement of [U.S.] trade agreements will allow American companies to play hard and win big in the global marketplace." No timetable exists for Congressional consideration of the bill.

Japanese Officials: USDA Report on Accidental Bone-In Beef Export is "Insufficient"

On February 21, 2006, Japanese Minister of Agriculture, Forestry and Fisheries Shoichi Nakagawa told Japanese Prime Minister Junichiro Koizumi that the U.S. report on the recent beef export violations "is insufficient" and does not provide Japan with enough reason to resume U.S. beef imports. According to Nakagawa, "there are many points [Japan] needs to confirm that were not included in the report." The report in question was prepared by the U.S. Department of Agriculture (USDA) and analyzes "how a U.S. meatpacker ended up packaging

3/1/2006 4:35 PM (2K)
WASHINGTON 903259 v1 [903259_1.DOC]

spinal bone-in meat for exports to Japan and the failure of the U.S. inspection system to catch the mistake." On January 20, 2006, Japan reinstituted its ban on U.S. beef imports after the discovery of a U.S. shipment that included beef with spine. The United States and Japan agreed in December 2005 that Japan would resume the importation of U.S. beef; one of the agreement's terms, however, was that U.S. beef products bound for Japan would not contain backbone or vertebral column. U.S. Secretary of Agriculture Mike Johanns acknowledged this and stated that the U.S. "agreement with Japan is to export beef with no vertebral column, and [the United States has] failed to meet the terms of agreement."

Koizumi has ordered Nakagawa to coordinate efforts with other Japanese ministers to review the report and to decide whether the ban should be lifted. He noted that resumption of U.S. beef imports would be "rather difficult" and stated that Japan will ask U.S. officials for detailed explanations of the report. He also stated that Japan will implement a system to check import orders "to ensure that importers fully understand the two countries' beef export program that bans bone-in beef to Japan."

On December 12, 2005, Johanns announced that Japan would re-open its market to U.S. beef products from cattle 20 months and younger. On December 8, 2005, Japan's Food Safety Commission (FSC) approved recommendations from its Prion Expert Committee to lift the country's ban on U.S. beef. Japan instituted the import ban in 2003 after cows with bovine spongiform encephalopathy (BSE or "Mad Cow" disease) were found in the United States. Following the FSC's recommendation, Japan's Ministries of Health, Labor and Welfare and Agriculture, Forestry, and Fisheries adopted measures to resume beef importation. Nakagawa's words will likely incite a harsh response from the United States, particularly those in the U.S. Congress who have "run out of patience" with Japan's recalcitrance on the beef issue. The beef inspection issue will also continue to play an important role in the United States' negotiation of bilateral free trade agreements (FTAs), as the U.S. government seeks to avoid problems that arose in Japan by demanding that FTA partners recognize the equivalency of the U.S. meat inspection system.

Members of Congress Express Concern Over UAE Port Operator and U.S. Operations

Senators Hillary Clinton (D-NY) and Robert Menendez (D-NJ) have stated that they will shortly introduce legislation meant to prohibit companies that are owned or controlled by foreign governments from acquiring port operations in the United States. Their statements come after the Dubai Ports World, owned and controlled by the government of the United Arab Emirates (UAE), purchased British-based Peninsular and Oriental Steam Navigation (P&O) on February 13th. P&O North America, the U.S. subsidiary, manages commercial operations at the ports of New York, New Jersey, Baltimore, New Orleans, Miami and Philadelphia, as well as several other, smaller U.S. ports. Dubai Ports World's purchase of P&O would transfer control of commercial operations in these ports to the UAE-based firm. Sen. Menendez stated that the United States "cannot afford to turn [U.S.] ports over to [a foreign government]."

3/1/2006 4:35 PM (2K)
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Sens. Clinton and Menendez are not the only ones to express concern with the transaction. On February 16, 2006, Sens. Charles Schumer (D-NY), Tom Coburn (R-OK), Frank Lautenberg (D-NJ), and Christopher Dodd (D-CT) circulated a letter to the Department of Treasury and Congress urging Treasury Secretary John Snow to reopen an investigation of the transaction. Treasury serves as the chair of the Committee on Foreign Investment in the United States (CFIUS), an interagency group that reviews foreign purchases of U.S. firms for their national security implications. The panel conducts an initial 30-day review of such transactions that is followed by a more extensive 45-day investigation if CFIUS feels it is warranted. According to the Members' letter, CFIUS approved the Dubai Ports World purchase after the initial 30-day review.

The letter states that Treasury should more closely monitor the transaction and adds that the Federal Bureau of Investigation (FBI) has stated that money used for the September 11, 2001 attacks was transferred to terrorist hijackers through the UAE's banking system. The letter states that the members of Congress "are concerned that the administration is not giving this case the appropriate level of scrutiny required by law and ask that [Treasury Secretary John Snow] direct [CFIUS] to conduct a full 45-day investigation." Sen. Schumer added that "outsourcing the operations of [the United States'] largest ports to a country with a dubious record on terrorism is a homeland security and commerce accident waiting to happen." Representatives Christopher Shays (R-CT), Vito Fossella (R-NY), and Mark Foley (R-FL) also signed the letter.

U.S. ITA Releases Report on Sugar-related Job Losses

On February 14, 2006, the U.S. Department of Commerce's (DOC) International Trade Administration (ITA) released a report on the impact of sugar prices on employment in U.S. food manufacturing. The "Commerce, Justice, and State, the Judiciary, and Related Agencies Appropriations Bill" for fiscal year 2005 (H.R. 4754) directs the Secretary of Commerce "to report on whether jobs in food manufacturing (including confectionery), cane refining and related industries have been lost as a result of the movement of manufacturing facilities offshore due, in material part, to the differential between U.S. and world sugar prices, and if applicable, the report shall include an estimate of the number of jobs lost."

The report notes that the United States used approximately 17.8 billion pounds of refined sugar in 2003, and that approximately 85 percent of this sugar was produced domestically. According to the ITA, several factors contributed to the declining demand for U.S. refined sugar: (i) cost; (ii) confectionery plant closings and relocations abroad; (iii) higher refining costs for cane versus beet sugar; (iv) greater use of other sweeteners and sugar substitutes; and (v) increased imports of sugar containing products (SCPs). The ITA reports that SCP imports have grown rapidly from $6.7 billion in 1990 to $18.7 billion in 2004 and notes that "as U.S. sugar production continues to be protected, trade in sugar containing products has been liberalized." Accordingly, the trade imbalance in SCPs has increased nearly five-fold while the sugar content in imported products has also risen. As a result, ITA reports that "foreign manufacturers' access to lower-priced sugar contributes to increased imports and hinders U.S. manufacturers' abilities to compete both here and abroad."

3/1/2006 4:35 PM (2K)
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The report also states that many U.S. SCP manufacturers have closed or relocated to Canada (where sugar prices average less than half of U.S. prices) and Mexico (where sugar prices average about two thirds of U.S. prices). The report concludes that for the confectionery industry in particular, "sugar costs appear to be a major factor in relocation decisions" because high domestic sugar prices represent a larger share of total production costs than labor.

The report states that employment in SCP industries decreased by more than 10,000 jobs between 1997 and 2002 and that during the same period, non-SCP food manufacturing employment grew by 31,326. According to the ITA, 6,400 domestic confectionery jobs have been lost "due to closures, restructuring and relocations where high sugar prices were cited as a major factor." The report also states that "three confectionery manufacturing jobs are lost for every job protected in the sugar growing sector due to the price gap between U.S. and world refined sugar prices."

Sugar imports and the protection of the U.S. market are key issues in U.S. multilateral and bilateral negotiations. This report provides support for those who believe that protection and subsidization of the U.S. sugar market is short-sighted, and who seek the elimination of such protection through bilateral and multilateral trade agreements, as well as unilateral trade legislation.

The report is available at http://www.trade.gov/media/Publications/pdf/sugar06.pdf.

Court Finds President's Denial of Import Relief From Chinese Goods is "Nonreviewable Discretionary Decision"

On February 10, 2006, the U.S. Court of Appeals for the Federal Circuit held that the president's denial of a domestic manufacturer's request for import relief under the Section 421 of the U.S.-China Relations Act (19 U.S.C. § 2451) is not subject to judicial review (*Motions Systems Corp. v. Bush*, Ct. No. 04-1428 (Fed. Cir. Feb. 10, 2006). Through a "Section 421" action, U.S. firms can petition the government for relief from Chinese import competition, but the President has discretion to determine whether import relief is warranted.

The Federal Circuit case arose when a U.S. manufacturer of "pedestal actuators" sued President Bush and the United States Trade Representative (USTR) based on the President's 2003 denial of import relief to the domestic pedestal actuator industry under Section 421. The plaintiff manufacturer filed a petition with the International Trade Commission (ITC) requesting an investigation, and the ITC determined that the alleged market disruption did exist. Although the ITC's report to the President recommended import relief measures, the President declined to impose any such measures, stating that the relief would have an adverse impact on the U.S. economy clearly greater than its benefits. Following the president's decision, the lawsuit was filed.

The Federal Circuit, however, concluded that the President's action is "not subject to judicial review" because Section 421 gives the President unfettered discretion to impose import relief. Section 421 directs the President, within 15 days after receiving USTR's final

3/1/2006 4:35 PM (2K)
WASHINGTON 903259 v1 [903259_1.DOC]

recommendation, to provide relief "unless the President determines that provision of such relief is not in the national economic interest of the United States." The amendment permits the determination "only if the President finds that the taking of such action would have an adverse impact of the United States economy clearly greater that the benefits of such action."

Section 421 continues to be an unused weapon in the United States' arsenal of trade remedies laws. Indeed, the Bush Administration has never imposed Section 421 relief on Chinese imports, despite the ITC having recommended such relief in four cases. The Court ruling, coupled with the Bush Administration's "quiet diplomacy" stance toward China relations, likely means that the Administration will continue to refuse employing Section 421 relief. However, because most economists believe that Chinese imports benefit a large majority of the American public through cheaper consumer goods and industrial inputs, and because the President must take the overall economic impact into account, the President's inactivity on Section 421 might not only be warranted, but might also be a good thing for most Americans.

Graham-Dorgan Bill Would Revoke China's PNTR Status

On February 9, 2006, Senators Lindsey Graham (R-SC) and Byron Dorgan (D-ND) introduced legislation that would repeal China's permanent normal trade relations (PNTR) status. The bill (S. 2267) calls for the revocation of normal trade relations with China to allow the United States to increase average U.S. tariffs on Chinese goods. The bill would also allow China to withdraw its tariff cuts and other concessions it has made to the United States as part of its accession to the World Trade Organization (WTO). Sen. Dorgan stated that "China's track record . . . makes it clear that it has not earned permanent normal trade relations status." Sen. Graham noted that the bill will "let China know that Congress has just about had it" and that "the tipping point has been reached." Although the bill has been referred the Senate Finance Committee, no timetable has been established for congressional consideration.

The legislation refers to the 2005 U.S. trade deficit with China of $200 billion and suggests how Congress should address the deficit's continued growth. The senators also stated that China's alleged currency manipulation and intellectual property (IPR) violations demand the revocation of China's PNTR status, and that such a move would allow "Congress [to] regain substantial leverage over China and its trade policies." United States Trade Representative (USTR) Rob Portman has already stated that revoking China's PNTR status "would do nothing to help [the U.S.] trade deficit [and] in fact would hurt [the United States], relative to China."

Sen. Graham will travel to China with Sen. Charles Schumer (D-NY) in March to discuss currency-related matters with Chinese officials. Sens. Graham and Schumer introduced legislation (S. 295) in 2005 that would impose an "across-the board" tariff on Chinese goods if China does not revalue the yuan or let it float freely relative to the dollar. Both senators agreed last year to postpone a vote on that bill until March 31, 2006. Graham indicated that both senators will not likely postpone the vote again and stated that he "does not know how much more reasonable [the United States] can be."

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Congressional anti-China legislation is common and stands in stark contrast to the Bush Administration's policy of "quiet diplomacy," which chooses subtle, closed-door pressure over direct confrontation with China. Despite the persistence of the bills' sponsors, it is unlikely that Congress will approve any bill aimed at "punishing" Chinese trade practices that includes blatantly protectionist (and likely WTO-consistent) measures like PNTR revocation or the imposition of high tariffs on all Chinese imports. For example, in 2005, Representative Bernard Sanders (I-VT) introduced a bill similar to S. 2267 revoking China of its PNTR status. The bill had 57 co-sponsors but did not move past Committee hearings. The 2006 versions of such anti-China legislation will likely encounter a similar fate.

USTR Appoints New AUSTR for Congressional Affairs

On February 3, 2006, the Office of the United States Trade Representative (USTR) stated that Justin J. McCarthy, Assistant USTR (AUSTR) for intergovernmental affairs and public liaison, has been appointed AUSTR for congressional affairs. In this role, McCarthy will oversee congressional consultations and organize congressional outreach. USTR Portman stated that his "goal is to actively involve House members and senators from both sides of the aisle in the trade agenda" and noted that McCarthy's "work on Capitol Hill and his successes in the private sector have demonstrated his effectiveness in working with Congress."

McCarthy replaces former AUSTR for intergovernmental affairs and public liaison Matt Niemeyer. McCarthy has served as AUSTR for intergovernmental affairs and public liaison since September 2005. Prior to that, he served as director of government relations with Pfizer and as legislative director for Mayer, Brown & Platt's international trade practice.

With House Passage of Budget Bill, Byrd Repeal "Complete"

On February 1, 2006, the House approved the Deficit Reduction Act of 2005 (S. 1932) that contains language repealing the Continued Dumping and Subsidy Offset Act (CDSOA or the "Byrd Amendment") on October 1, 2007. The House passed the budget measure by a margin of 216-214. Because the Senate already passed the bill in December 2005, the legislation now moves to President Bush to be signed into law.

The CDSOA mandates the distribution of antidumping and countervailing duties to the U.S. companies that petitioned for trade relief. In March 2005, the World Trade Organization (WTO) allowed seven WTO Members, including the EU, Canada, Mexico and Japan, to impose retaliatory duties on U.S. imports based on the United States' failure to comply with a 2003 WTO Appellate Body (AB) decision that the law was inconsistent with global trade rules. Upon repeal of the Byrd Amendment, antidumping and countervailing duties (AD/CVD) would go to the general fund of the Treasury.

Since 2001, the U.S. government has distributed more than $1.26 billion under Byrd Amendment rules to domestic companies. More than $476 million went to the Timken Company – a U.S. bearings manufacturer – and two of its subsidiaries. According to a recent Government Accountability Office (GAO) report, more than half of 2005's $226 million in Byrd

3/1/2006 4:35 PM (2K)
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monies went to five companies, with only 34 companies receiving 80 percent of the payouts. The bearings, candles, and steel industries benefited the most from Byrd payments.

Repeal of the CDSOA is not immediate. The budget bill allows the U.S. government to disburse CDSOA payments related to **any subject goods that enter the United States before October 1, 2007**. Thus, domestic companies will continue to receive Byrd disbursements for any subject good entering the United States before October 1, 2007. Because the Byrd measure will, therefore, technically be on the books until October 2007, WTO rules allow authorized Members to continue to retaliate against U.S. imports until that time (*i.e.* until the measure is officially void). It is likely however, that the United States will attempt a negotiated settlement with one or more of the Members currently retaliating.

3/1/2006 4:35 PM (2K)
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Free Trade Agreements

Geopolitical Aspects of the U.S. Middle East Trade Area (USMEFTA) Initiative

SUMMARY

In May 03, 0050resident George W. Bush proposed the creation of a U.S. Middle East Free Trade Area (USMEFTA) with 18 Middle Eastern countries "to increase trade and investment with the United States and others in the world economy."[7] Experts argue, however, that the United States' main objective in the USMEFTA initiative is geopolitical, rather than economic. This report evaluates this argument by comparing USMEFTA and non-USMEFTA Free Trade Agreement (FTA) negotiations and the agreements' respective congressional approval processes.

ANALYSIS

The United States proposed USMEFTA as a step-by-step plan to increase Middle Eastern countries' integration in the global economy and to promote economic growth in the region. To join USMEFTA, the United States requires each Middle Eastern country: (i) to join the World Trade Organization (WTO); (ii) possibly to participate in the Generalized System of Preferences (GSP) which provides duty-free products to the United States; (iii) to enter into Trade and Investment Framework Agreements (TIFAs) that create a framework for trade and dispute resolution; (iv) to enter into Bilateral Investment Treaties (BITs) that require governments to offer foreign investors the same legal protections as domestic investors; (v) to enter into comprehensive FTAs with the United States; and (vi) to participate in trade capacity building projects whereby the United States government provides over $1 billion annually to spur government-private partnerships related to international trade in the Middle East.[8]

As of February 2006, the Bush Administration has made substantial progress in reaching agreements with several Middle Eastern countries. In January 2006, the U.S.-Morocco FTA entered into force, and President Bush signed the U.S.-Bahrain FTA into law. The United States and Oman reached a draft agreement in October 2005, and the U.S.-United Arab Emirates (UAE) FTA is in the formal negotiations stage. We provide below a comprehensive list of USMEFTA countries and each country's efforts to become a USMEFTA participant:

[7] Office of the United States Trade Representative, "Middle East Free Trade Initiative: U.S. Regional Plan to Spur Economic Growth," (March 2, 2004) *available at* http://www.ustr.gov.

[8] *See* Office of the United States Trade Representative, Middle East Free Area Initiative, http://www.ustr.gov (last visited Feb. 10, 2006).

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WASHINGTON 903259 v1 [903259_1.DOC]

Country	FTA	TIFA	BIT	WTO	GSP
Israel[9]	√	√	√	√	Not Eligible
Jordan[10]	√	√	√	√	√
Morocco	√	√	√	√	√
Bahrain	Ratified	√	√	√	Not Eligible
Egypt		√	√	√	√
Lebanon				Negotiating Accession	√
Algeria		√		Negotiating Accession	√
Tunisia		√	√	√	√
Saudi Arabia		√		√	Not Eligible
Oman	Signed	√		√	√
Kuwait		√		√	Not Eligible
UAE	Negotiating	√		√	Not Eligible
Yemen		√		Negotiating Accession	√
Qatar		√		√	Not Eligible
Syria					Not Eligible
Iraq		√		Negotiating Accession	√
Libya				Negotiating Accession	Not Eligible
Iran				Negotiating Accession	Not Eligible

Source: United States Trade Representative (January 2006)

As the table indicates, the UAE, Kuwait, Saudi Arabia and Egypt have entered into TIFAs with the United States - a first step towards initiating formal bilateral FTA negotiations. Presently, the UAE is the only USMEFTA country with which the United States is engaged in formal FTA talks. The United States and the UAE ended the fourth round of negotiations in January 2006, reaching "a very advanced stage."[11] Both countries are expecting to conclude negotiations by the end of 2006. In addition, the United States Trade Representative (USTR) for Europe and the Middle East Shaun Donnelly recently told Kuwaiti media that, "…in the case of Kuwait, we would very much like to have a long-term vision of getting to an FTA" but also

[9] Israel entered into an FTA with the United States in 1985, before USMEFTA was introduced in May 2003.

[10] Jordan entered into an FTA with the United States in 2001, also before USMEFTA was introduced.

[11] Statement of UAE delegation chief Mohammed Khalfan Bin Kharbash, *available at* Natasha Bukhari, *UAE Debate on Benefits of FTA Rekindled*, Middle East Times, February 14, 2006.

3/1/2006 4:35 PM (2K)
WASHINGTON 903259 v1 [903259_1.DOC]

noted that the United States is likely not interested in beginning new FTA talks with any Middle Eastern country, except perhaps Egypt, before the summer of 2007.[12]

The United States hopes to integrate these bilateral FTAs into a region-wide free trade area by 2013. On the United States' latest USMEFTA activities, USTR Rob Portman has stated that "these are important steps on the path to implementing the President's initiative to create a U.S.-Middle East Free Trade Area by 2013. Our efforts will advance economic growth and democracy of Middle East – an area of almost 350 million people and a $70 billion trading relationship with the United States."[13]

Many government officials and business lobby groups such as the U.S.-Middle East Free Trade Coalition and the National U.S.-Arab Chamber of Commerce emphasize the economic benefits of USMEFTA. They argue that the initiative would encourage more foreign investment, create more jobs in the region, and increase exports to the United States. This rhetoric, however, belies the fact that U.S.-Middle East trade is very small, accounting for only 8 percent of the Middle East region total trade[14] and 4-5 percent of total U.S. trade[15]. The region's oil and gas resources, however, are valuable to the United States, and although overall trade is relatively small, trade in these resources and other products has allowed the region's economies to prosper. Jordan, for example, signed its FTA with the United States as the first Arab country in 2000, and it has dramatically increased its exports to the United States from $31 million to $1.1 billion by 2005.[16] The majority of this comes from trade in oil and gas as U.S. dependence on these resources grows annually. Moreover, experts believe that securing bilateral FTAs with smaller markets like Jordan pressure more attractive markets such as the UAE, Saudi Arabia and Egypt.

Many experts argue that the incentives for USMEFTA are geopolitical rather than trade-related. USMEFTA was proposed as part of the United States' response to the September 11, 2001 terrorist attacks in the United States. The *9/11 Commission Report* recommended the creation of USMEFTA to counter terrorism and to "pull together the major strands of U.S. policy in the Middle East: 'democratize' governance of Arab countries, open them up to U.S. penetration and eventually neutralize all aggression toward Israel."[17] It is important to note that the countries with which the United States already has or will have FTAs include Israel, Morocco, Jordan, Bahrain, Oman, and UAE: all "politically moderate countries" considered to be U.S. allies in the Middle East. Some opponents see USMEFTA as an overly ambitious plan

[12] Aya Batrawy, *No US-ME Free Trade Talks This Year but with Egypt*, Kuwait News Agency, February 11, 2006.

[13] Office of United States Trade Representative, Press Release, January 19, 2006, *full text available at* www.ustr.gov

[14] Alan P. Larson, *United States Economic and Trade Policy in the Middle East*, Testimony before Senate Finance Committee on Mar.10, 2004, *full text available at* http://www.state.gov/e/rls/rm/2004/30346.htm.

[15] Mary Jan Bolle, *Middle East Free Trade Area: Progress Report*, CRA Report RL32638, Feb. 8, 2005.

[16] Peyman Pejman, United States Pursues More Free-Trade Agreements in the Middle East, The Daily Star Beirut, Apr. 26, 2005.

[17] Bilaterals.org, *U.S.-Morocco, available at* http://www.bilaterals.org (last visited Feb. 10, 2006).

3/1/2006 4:35 PM (2K)
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and believe that the United States is rushing through FTA negotiations for "overstated"[18] trade benefits. There are also international civil groups and various communities in Middle Eastern countries that express concerns over USMEFTA's potential of harming developing nations in the Middle East rather than promoting economic growth. By basing agreements on geopolitical concerns and reducing trade to the back burner, these USMEFTA opponents feel that the initiative will end up harming Middle Eastern development in the long run.

To show that geopolitical aspects drive the creation of USMEFTA and recent Middle Eastern FTAs, we have compared the negotiation timeframes and the congressional approval process of non-USMEFTA FTAs (*i.e.*, DR-CAFTA, Australia, Thailand, Singapore, and Chile) with USMEFTA FTAs (*i.e.*, Morocco, Bahrain, Oman, and the UAE).

		USTR Negotiations				**Congressional Consideration**				
									Vote Count (Yea-Nay)	
		Announced	Agreed	**Rounds**	**Duration**	Began Consideration	Passed	**Duration**	House	Senate
Non-MEFTA FTAs	DR-CAFTA	01/16/02	03/15/04	**9**	**26 months**	06/23/05	07/28/05	**20 days**	217-215	54-45
	Australia	03/01/03	02/08/04	**6**	**11 months**	02/12/04	07/15/04	**76 days**	314-109	80-16
	Thailand	10/20/03	n/a	**6+**	**28 months+**	n/a	n/a	n/a	n/a	n/a
	Singapore	11/16/00	01/15/03	**11**	**24 months**	02/28/03	07/31/03	**91 days**	272-155	66-32
	Chile	11/29/00	12/11/02	**14**	**25 month**	02/28/03	07/31/03	**91 days**	270-156	65-32
MEFTA FTAs	Morocco	01/03/03	03/02/04	**8**	**14 months**	04/02/04	07/22/04	**66 days**	323-99	unanimous
	Bahrain	05/21/03	05/27/04	**3**	**12 months**	11/16/04	12/13/04	**20 days**	327-95	unanimous
	Oman	11/14/04	10/01/05	**2**	**11 months**	10/17/05	n/a	n/a	n/a	n/a
	UAE	11/14/04	n/a	**4+**	**16 months+**	n/a	n/a	n/a	n/a	n/a

The table shows that USMEFTA negotiations take less time and pass more easily than their non-USMEFTA counterparts. For example, the U.S.-Chile FTA negotiation lasted 14 rounds through 25 months and took Congress 85 days to approve the agreement. In contrast, the U.S.-Bahrain FTA negotiations lasted only 2 rounds through 11 months and took Congress 16 days to approve.[19] Average FTA negotiations between the United States and non-USMEFTA countries lasted 9.2 rounds through 22.8 months, but average negotiations between the United States and USMEFTA countries lasted only 4.25 rounds through 13.25 months. That agreements with USMEFTA countries were completed in much shorter timeframes than non-USMEFTA agreements indicates that the Bush Administration is doing all that it can to complete the USMEFTA initiative by 2013.

[18] Emad Mekay, *TRADE: Oman Pact Boots US Agenda in the Middle East*, Inter Press Service, Jan. 21, 2006.

[19] Congressional recesses are not included in days of duration of Congressional consideration.

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Vote counts also indicate the relative ease with which Congress was able to pass USMEFTA agreements compared to their non-USMEFTA counterparts. Both the Bahrain and Morocco FTAs garnered unanimous support from the Senate, and less than 25 percent of the House opposed each agreement. Non-USMEFTA agreements, on the other hand, show larger percentages of opposition. For DR-CAFTA, the House vote was split almost evenly, and the Senate passed the implementing legislation by 11 votes. Almost 40 and 30 percent of the House and Senate, respectively, opposed the Singapore and Chile FTAs. The trend is clear that USMEFTA agreements enjoy shorter consideration times and almost complete approval from Congress. Non-USMEFTA agreements, on the other hand, suffer longer negotiations and Congressional consideration periods and attract a larger number of opponents.

The vote numbers, combined with the timeframes of each FTA's negotiations and congressional consideration, demonstrate that USMEFTA agreements enjoy special treatment compared to their non-MEFTA counterparts. Considering that the non-USMEFTA agreements lack the explicit geopolitical dynamic of the USMEFTA agreements but provide overall much larger economic benefits, it seems clear that the geopolitical consequences of the USMEFTA agreements place them on a fast-track through negotiations and Congress.

Two forces drive U.S. FTAs: economics and geopolitics. Although the non-USMEFTA agreements were driven by economic benefits to the U.S. economy and had careful and thorough negotiations, USMEFTA agreements were driven more by political circumstances and have devoted less attention to the issues on which the United States traditionally has taken a strong position during FTA negotiations. These issues include, for example, labor standards, intellectual property rights (IPR), and agricultural regulations. For example, labor issues during DR-CAFTA negotiations proved controversial and elicited long debates. According to the International Labor Organization (ILO), DR-CAFTA countries ratified an average of 36 ILO instruments prior to the agreement's Congressional passage yet still attracted concern from members of Congress, USTR, and various non-governmental organizations (NGOs). On the other hand, Congress easily passed the U.S.-Bahrain FTA despite the strong concerns of the Labor Advisory Committee[20] and the ILO. Bahrain and Oman have ratified only 8 and 4 ILO instruments, respectively. Yet even with concerns from the Labor Advisory Committee and the ILO, the Bahrain and Oman FTAs received, at most, a few statements from several Senators and Representatives expressing mild concern over the countries' labor situations. Debate on labor during Congressional consideration of the Bahrain FTA was limited compared to the contentious labor debates during DR-CAFTA's Congressional consideration.

The contrast in Congressional attention to labor standards between DR-CAFTA and the U.S.-Bahrain FTA, despite the DR-CAFTA countries relatively better labor standards further indicates that the USMEFTA agreements' geopolitical aspects trump the economic and political concerns that traditionally impact FTA negotiations and Congressional passage. The evidence demonstrates that Congress focuses on traditional trade issues such as labor and IPR when the

[20] Labor Advisory Committee for Trade Negotiations and Trade Policy, "Report on the U.S.-Bahrain Free Trade Agreement," (July 14, 2004)

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FTA has an economic basis. On the other hand, when geopolitics motivates the trade agreement, Congress seems willing to skim over traditional trade-related issues.

Hence, the Administration's rigorous efforts to reach FTAs with USMEFTA countries as quickly as possible appear to stem from its geopolitical interest in building a coalition of support within the Middle East region rather than on trade interests. The geopolitical concerns trump traditional trade-related "sticking-points" and have led to the expeditious completion of USMEFTA agreements.

OUTLOOK

The swift negotiation and passage of the Middle Eastern FTAs differs from the drawn-out negotiations and bitter Congressional fights over agreements like DR-CAFTA. The agreements' different political courses are likely due to the geopolitical importance of USMEFTA, rather than any economic advantages that the FTAs might possess over agreements such as DR-CAFTA. Indeed, the economic bilateral trade flows stemming from DR-CAFTA will likely dwarf those of an agreement like the U.S.-Bahrain FTA. USTR has argued that trade will increase between the United States and USMEFTA countries with each FTA's passage. However, trade between the United States and these small economies represents a small percentage of overall U.S. trade with global trading partners. On the other hand, the commodities traded are more important than those from many of the non-USMEFTA countries. In the case of USMEFTA countries, valuable natural resources including oil and natural gas are vital to the United States' economy and form a central component of each FTA with a USMEFTA country. Presently, total exports of the entire Middle East region in 2004 totaled $379 billion, three-quarters of which came from oil exports.[21]

The other important commodity traded between the United States and USMEFTA countries is security. By building a coalition of allies and support in the Middle East through trade agreements, the United States hopes to afford itself more security and defense from terrorists other security threats. In this sense, the creation of USMEFTA is driven by geopolitical and security reasons, with trade playing a secondary role. It is these geopolitical concerns that place USMEFTA bilateral agreements on a fast-track during both formal negotiations and the Congressional approval process. These concerns also appear to quell traditional opposition to the FTAs on issues like labor and the environment, despite USMEFTA countries' lackluster records. The Bush Administration will continue pushing for USMEFTA's creation throughout 2006, and Congressional consideration of Oman and continued FTA negotiations with the UAE will ensure that USMEFTA stays in the minds of Congress and the public. Should form hold, however, these agreements should encounter few obstacles on their paths to passage and implementation.

[21] U.S. Encourages Trade Expansion with Arab World, Yemen Observer Newspaper, May 24, 2005.

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Free Trade Agreements Highlights

U.S. and Colombia Complete FTA Negotiations

On February 27, 2006, the United States and Colombia completed Free Trade Agreement (FTA) negotiations. United States Trade Representative (USTR) Rob Portman and Colombian Minister of Trade, Industry, and Tourism Jorge Humberto Botero made the joint announcement. Portman stated that the FTA will "enhance economic growth and prosperity between the U.S. and Colombia," and that the agreement "with Colombia will generate export opportunities for U.S. agriculture, industry, and service providers, and help create jobs in the United States." Portman added that "an agreement with Colombia is an essential component of [the U.S.] regional strategy to advance free trade within [the Western] hemisphere, combat narco-trafficking, build democratic institutions, and promote economic development" and that "in addition to eliminating tariffs, Colombia will remove barriers to trade in services, provide a secure, predictable legal framework for U.S. investors operating in Colombia, provide for effective enforcement of labor and environmental laws, protect intellectual property, and provide an effective system to settle disputes."

Portman's February 22, 2006 statements that the United States and Colombia would "soon bridge their differences" in the negotiations foretold today's announcement. According to officials, by the end of the week of February 20, the two sides had concluded chapters on investment and textiles, but agricultural market access and sanitary and phytosanitary (SPS) issues remained unresolved. On SPS measures, Colombia sought to assure that Colombian fruits and vegetables can move quickly through the U.S. inspection process by having the U.S. Environmental Protection Agency (EPA) set limits for acceptable pesticide residues for fruits and vegetables. On agriculture market access, according to sources, Colombia continued to resist U.S. demands for increased access to the Colombian market for U.S. rice, poultry and corn. Colombia demanded that it retain the right to invoke a rice safeguard if imports reach a certain volume and if prices drop to a certain level even after the tariff-rate quota (TRQ) has been phased out. Colombia also presented a proposal to create a TRQ for chicken with a 20-year phase-out and a review in the ninth year to determine whether it is feasible to open its market completely. Colombia also sought to require import certificates for corn imports under a proposed TRQ based on a U.S. exporter's Colombian corn purchases. The delegations also discussed beef access. Presently, Colombia cannot export beef to the United States because the United States does not recognize Colombian beef as free of foot-and-mouth disease. Colombia would also like the United States to provide a separate TRQ for its beef, but the United States has countered that it can only expand country-specific access after it has filled the beef TRQ negotiated at the World Trade Organization (WTO).

The Colombian agreement was part of the U.S.-Andean FTA, which included Peru and Ecuador as well. The U.S.-Andean talks stalled in late 2005 over intellectual property and agriculture issues. Since then, the United States and Peru completed a bilateral FTA, and President Bush formally notified Congress of the United States' intent to enter into the agreement. Given that 2006 is an election year, Congress will likely consider any completed

3/1/2006 4:35 PM (2K)
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trade agreements before mid-summer when the election season begins. With Colombia's FTA negotiations complete, USTR has afforded Congress with time to consider the Colombian agreement together with the Peru FTA. The Ecuadorian agreement is next on the docket, but neither side has stated when negotiations will resume. According to Portman, "it is in the U.S. interest to expand an FTA with Peru to include Colombia and other Andean countries," and he is hopeful that all three FTAs could move through Congress together. However, given the short timeframe for congressional consideration this year, the Ecuadorian FTA must move quickly, or the Colombian and Peruvian agreements will likely move through Congress without it.

USTR Recommends DR-CAFTA Implementation for El Salvador

On February 24, 2006, the Office of the United States Trade Representative (USTR) reported that it has recommended that President Bush implement the Dominican Republic – Central America Free Trade Agreement (DR-CAFTA) for El Salvador as of March 1, 2006. El Salvador is the first DR-CAFTA country to receive USTR's blessing, and USTR stated that it has "worked closely with El Salvador over the past several months to ensure its legislative and regulatory regime reflects the obligations and responsibilities set forth in DR-CAFTA." According to USTR, "El Salvador has been the furthest along in implementation" and recently passed a "satisfactory" intellectual property protection law. President Bush will next consider USTR's recommendation.

On December 30, 2005, USTR announced that the United States would not implement DR-CAFTA by its January 1, 2006 target date. USTR delayed implementation because several Central American countries had yet to change their national laws to conform to the FTA's provisions. USTR officials consistently maintained that DR-CAFTA would not enter into force on its original implementation date unless the Central American countries amended their domestic laws. According to USTR, this action is the only way to ensure that its trading partners are bound by the agreement. In contrast, Guatemala and Honduras maintain that DR-CAFTA obligations "prevail over [domestic] laws," thereby making domestic law alteration unnecessary. USTR has urged Central American countries to amend their domestic laws to be consistent with the FTA's provisions on intellectual property rights (IPR) enforcement and trademark and copyright protections. As USTR's recommendation for El Salvador indicates, the United States will implement DR-CAFTA on a rolling basis as countries make sufficient progress to complete their commitments under the agreement. According to USTR, under this process, "entry into force would occur on the first day of the month with a country that the USTR determines is ready by the middle of the preceding month." USTR has not provided a timetable for when other DR-CAFTA countries are eligible for the agreement's implementation.

U.S. ITC To Investigate Economic Effect of U.S.-South Korea FTA

On February 22, 2006, the International Trade Commission (ITC) requested input on its investigation into the probable economic effects of the U.S.-South Korea Free Trade Agreement (FTA). The Office of the United States Trade Representative (USTR) made the request that ITC provide advice on the probable economic effect that the provision of duty-free access to the U.S.

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market for Korean products would have upon U.S. consumers and U.S. industries producing similar or competitive articles. The ITC will also advise President Bush on the probable economic effects on the U.S. economy of eliminating tariffs on certain Korean agricultural products. Presidential Trade Promotion Authority (TPA) requires the ITC to submit to the President and the Congress this report no later than 90 calendar days after the President enters into the agreement. ITC officials expect to submit the confidential report to USTR by July 14, 2006. The ITC will hold a public hearing on South Korean FTA on April 20, 2006. Interested parties wishing to testify at this hearing must file their formal requests with the ITC no later than 5:15 p.m. on March 29.

Congressional Concern of UAE Ports Deal Could Affect U.S.-UAE FTA Negotiations

United States Trade Representative (USTR) Rob Portman has stated that the controversy surrounding a United Arab Emirates (UAE) firm's purchase of a port management company will not affect current Free Trade Agreement (FTA) negotiations. Some sources indicate, however, that the dispute will have a negative effect on the FTA negotiations and will sour congressional opinions of the bilateral agreement. The controversy centers on Dubai Ports World, owned by the UAE, and its February 13 purchase of British-based Peninsular and Oriental Steam Navigation (P&O). P&O North America manages commercial operations at the ports of New York, New Jersey, Baltimore, New Orleans, Miami and Philadelphia, as well as several other, smaller U.S. ports. Dubai Ports World's purchase of P&O would transfer control of commercial operations in these ports to the UAE-based firm.

USTR Portman stated that the UAE "has been a solid partner [with the United States] in the war on terror" and added that the United States works "closely with them to screen container destined for the United States and United Arab Emirates." He also stated that the Department of Homeland Security, the Bureau of Customs and Border Protection (CBP), and the U.S. Coast Guard would continue to handle port security. Members of Congress, however, have expressed concern with the purchase. Sens. Hillary Clinton (D-NY) and Robert Menendez (D-NJ) have stated that they will shortly introduce legislation meant to prohibit companies that are owned or controlled by foreign governments from acquiring port operations in the United States. Sens. Charles Schumer (D-NY), Tom Coburn (R-OK), Frank Lautenberg (D-NJ), and Christopher Dodd (D-CT) have circulated a letter to the Department of Treasury and Congress urging Treasury Secretary John Snow to reopen an investigation of the transaction. Treasury serves as the chair of the Committee on Foreign Investment in the United States (CFIUS), an interagency group that reviews foreign purchases of U.S. firms for their national security implications. The panel conducts an initial 30-day review of such transactions. Senate Majority Leader Bill Frist (R-TN) stated that "the decision to finalize this deal should be put on hold until the Administration conducts a more extensive review of this matter" and added that he plans to introduce legislation "to ensure that the deal is placed on hold until this decision gets a more thorough review."

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Sources indicate that congressional response to the deal will likely affect the FTA negotiations. William A. Reinsch, president of the National Foreign Trade Council, stated that "the UAE cannot help but be offended" and added that the response "complicates [U.S.] diplomatic efforts in the Middle East because it sends the signal that Congress doesn't distinguish between Middle Eastern nations that have supported [the United States] and those that don't." Government sources have echoed these opinions. Furthermore, several government sources stated that that the recently signed U.S.-Oman FTA will receive greater scrutiny when it undergoes congressional examination, due to the UAE ports deal.

The controversy surrounding the ports deal surprised the Bush Administration and most industry insiders, and the congressional uproar over the purchase has exponentially grown over the past couple of days. The Administration has made every possible assurance to Congress that the deal does not affect the security of the United States. Regardless, until a more thorough investigation of the deal is done, or until the Administration can somehow convince Congress that the purchase does not weaken national security, members of Congress will likely continue to protest. Mid-year elections could well play a part in this controversy as members of Congress up for re-election attempt to secure more votes by playing the "security card." Such protest, however, may affect the U.S.-UAE FTA negotiations and sour relations between the two countries. After several "remarkable" negotiating rounds, the ports deal controversy could slow down negotiations and complicate what was once an amicable relationship between the two countries.

Sec. Rice: Timing Not Quite Right for U.S.-Egypt FTA

On February 17, 2006, Secretary of State Condoleeza Rice stated that the "timing was not quite right" for the United States to initiate formal free trade agreement (FTA) negotiations with Egypt. Rice stated that the FTA would benefit economic reform in Egypt but noted that the Administration is still concerned with Egypt's tenuous political situation and alleged human rights violations. On January 17, 2006, the United States ceased bilateral negotiations with Egypt over a potential FTA to protest the Egyptian government's imprisonment of leading Egyptian political dissident Ayman Nour. In late December 2005, an Egyptian court sentenced Nour to five years of forced labor for alleged election law violations. American officials believe these are false charges. Nour won seven percent of the vote in the September 2005 multiparty elections, placing second to current President Hosni Mubarak. The United States also found Egypt's September 2005 elections to be "highly flawed" and condemned Egyptian security forces firing upon protesters during the country's November-December parliamentary elections. Rice also noted that Egypt postponed municipal elections that were to be held in April.

Despite signaling further delay for the FTA negotiations, Rice stated that United States Trade Representative (USTR) Rob Portman has continued a dialogue with Egyptian Trade Minister Rashid Mohamed Rashid. Rice will meet with Rashid during her visit to Egypt the week of February 20 to discuss, among other things, the FTA but noted that "it's important that [both sides] have the right atmosphere for free trade agreements because they have to . . . go through Congress."

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Because Egypt's recent political actions have delayed formal trade talks, it is unclear whether the nations will have sufficient time to complete an agreement should they resolve human rights differences. USTR has consistently maintained that it will not enter into bilateral FTA negotiations unless it reasonably believes that the FTA can be completed before the President's Trade Promotion Authority (TPA) is set to expire in mid-2007. Thus, time is running out for the initiation of FTA negotiations with any new countries, including Egypt. Egypt remains cautiously optimistic that it can work out an FTA, and the United States has not officially cancelled potential FTA negotiations. However, unless Secretary Rice's visit produces significant progress on the human rights front, the chances that the two sides will begin FTA talks grows increasingly unlikely.

USTR Expresses Optimism for U.S.-Thai FTA, Says U.S-Malaysia FTA Could Be Announced in the Next Month

United States Trade Representative (USTR) Rob Portman has expressed optimism in continuing Free Trade Agreement (FTA) negotiations with Thailand. Portman stated that USTR officials believe that "Thailand does have the necessary will" and that "enough progress has been made" to continue bilateral FTA negotiations. In recent weeks, both U.S. and Thai officials have expressed more pessimistic views on the agreement's future. U.S. trade negotiators indicated that the sixth round of U.S.-Thai FTA negotiations, which focused on services, ended January 13th with "disappointing results." Barbara Weisel, Assistant United States Trade Representative (AUSTR) for the Asia-Pacific region stated that the United States and Thailand made progress in several areas, but that "there was less progress made in a few other areas. Meanwhile, Thai government officials stated that Thailand might adopt a tougher stance in FTA negotiations with the United States. On February 7, 2006, the Thai Cabinet approved the appointment of Karun Kittisataporn, a permanent secretary of the Ministry of Commerce, as the new chief negotiator for the FTA talks. Karun has stated that there will not be any formal changes to Thailand's negotiating strategy but did note that he would focus on "Thailand's national interest" during the talks and "take steps to ensure any adverse impacts of the agreement on the local economy were minimized." Neither side provided a timetable as to when the next round of negotiations would take place.

Separately, USTR Portman stated that the United States and Malaysia have made "good progress" on financial services issues, and that the United States could initiate formal FTA negotiations with Malaysia by late March. Portman added that the United States has also achieved moderate success in securing larger market access in Malaysia but noted that the United States "is still not quite there yet" on certain issues including agriculture. Portman lauded Malaysia for expressing "not just a willingness to engage with [the United States], but a willingness to take on some tough issues." USTR officials met with their Malaysian counterparts in a January meeting that Assistant USTR for Japan, Korea, and APEC Affairs Wendy Cutler described as "very positive."

Sources have opined that USTR has used the potential Malaysia FTA to motivate U.S.-Thai negotiations and that U.S.-Malaysia FTA negotiations could replace U.S.-Thai negotiations

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in the event that the Thai negotiations sour further. Portman's latest statements, however, indicate that the United States is not giving up on the Thai FTA despite its problems, and that USTR would be willing to negotiate the two bilateral agreements simultaneously. On the other hand, should the United States and Thailand have another "disappointing round" of negotiations, USTR could abandon the Thai FTA for the Malaysian agreement to ensure the Malaysian FTA's completion before the President's Trade Promotion Authority (TPA) is scheduled to expire in mid-2007. Although this scenario appears unlikely, USTR's rhetoric seems to indicate that Malaysia has been more willing to make concessions to U.S. demands, thus making formal FTA negotiations an easier process.

Colombian President Visits Washington to Facilitate FTA Negotiations

Colombian President Alvaro Uribe met with President Bush on February 16, 2006 to facilitate free trade agreement (FTA) negotiations occurring in Washington during the week of February 13. The topics of discussion between the two leaders focused on sensitive areas of agriculture and the trafficking of illicit drugs. Although President Uribe described the exchange as "very constructive," President Bush did not speculate on a timeline for completion of FTA negotiations. President Uribe also met with United States Trade Representative (USTR) Rob Portman and discussed agriculture. Portman stated that there are still some "significant barriers" in the Colombian market for increased U.S. exports, and that the two sides must still resolve certain agricultural issues, including sanitary and phytosanitary (SPS) measures. Similar to its SPS demands related to the implementation of Dominican Republic-Central American Free Trade Agreement (DR-CAFTA), the United States is pushing Colombia to recognize the equivalency of U.S. food safety standards and the U.S. meat inspection system.

The Colombian agreement was part of the U.S.-Andean FTA, which also included Peru and Ecuador. The U.S.-Andean talks stalled in late 2005 over intellectual property and agriculture issues. Since then, the United States and Peru completed a bilateral FTA, and President Bush formally notified Congress of the United States' intent to enter into the agreement. For Colombia and Ecuador, agriculture remains the most contentious issue and will likely require additional negotiations, further distancing those agreements from the completed Peruvian FTA.

U.S., India Engage in Trade Dialogue Under Trade Policy Forum

On February 16, 2006, the United States and India began a two-day high-level dialogue on the removal of existing trade barriers between the two countries and ways to double trade in the coming years. Deputy United States Trade Representative (USTR) Karan Bhatia led the U.S. delegation and stated that both sides have established working groups on agriculture, tariff and non-tariff barriers (NTBs) to industrial goods, services, investment, and intellectual property rights (IPR) protection. Bhatia also noted that the two countries have begun discussions on sanitary and phytosanitary (SPS) issues and restrictions on foreign direct investment (FDI).

On November 12, 2005, the United States and India launched the India-United States Trade Policy Forum. USTR Rob Portman and Indian Minister of Commerce and Industry Kamal

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Nath described the forum as a "hub" around which the two countries can strengthen economic ties and resolve bilateral trade issues. Portman also envisioned that the forum will serve as an "early warning system" for any impending trade problems and a forum for open communication. Both officials stated that they expect merchandise trade to double by 2008, but that NTBs remain a contentious issue that the nations must resolve for the forum to provide the most benefits. According to USTR, the next meeting of the forum will occur "later in the year."

USTR Announces Creation of Middle East Economic Partnership Caucus

On February 15, 2006, United States Trade Representative (USTR) Rob Portman joined a bipartisan Congressional group in announcing the creation of the Congressional Middle East Economic Partnership Caucus (MEEPC). The group will work to strengthen economic ties with "moderate Middle Eastern nations." MEEPC has six co-chairs: Reps. Ben Chandler (D-KY), Phil English (R-PA), Darrel Issa (R-CA), William Jefferson (D-LA), Gregory Meeks (D-NY), and Paul Ryan (R-WI). The Middle-East Free Trade Coalition – composed of 1100 U.S. companies and trade associations – lauded the creation of the caucus, as did the National Foreign Trade Council (NFTC).

MEEPC will likely concentrate on expanding President Bush's proposed U.S.- Middle East Free Trade Area (USMEFTA), which the Bush Administration would like to complete by 2013. Through USMEFTA, "the United States seeks to expand trade and investment in Middle East countries to further their domestic reforms and the rule of law, protect intellectual property, and create a foundation for economic growth and prosperity." President Bush announced USMEFTA in May 2003, and the United States has completed free trade agreements (FTAs) with Bahrain, Morocco, and Oman and initiated formal FTA negotiations with the United Arab Emirates (UAE).

Thai Government May Adopt Tougher Stance on U.S.-Thai FTA

Thai government officials have stated that Thailand might adopt a tougher stance in Free Trade Agreement (FTA) negotiations with the United States. On February 7, 2006, the Thai Cabinet approved the appointment of Karun Kittisataporn, a permanent secretary of the Ministry of Commerce, as the new chief negotiator for the FTA talks. Karun has stated that there will not be any formal changes to Thailand's negotiating strategy but did note that he would focus on "Thailand's national interest" during the talks and "take steps to ensure any adverse impacts of the agreement on the local economy were minimized." He added that Thailand does not feel bound by the spring 2006 deadline that both sides have informally imposed. Thai Prime Minister Thaksin Shinawatra has also adopted a similar stance to that of Karun. At a February 11th meeting with the National Economic and Social Advisory Council, Thaksin stated that the Thai negotiating team was prepared to walk away from negotiations if the FTA would prove "detrimental to the country."

Responding to Thaksin and Karun's comments, U.S. officials maintain that USTR remains committed to concluding FTA negotiations by April 30. U.S. trade negotiators indicated that the sixth round of negotiations ended January 13th with "disappointing results." Barbara

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Weisel, Assistant USTR for the Asia-Pacific region stated that the United States and Thailand made progress in several areas, but that "there was less progress made in a few other areas." Weisel also stated that completing the FTA by the spring deadline "is achievable, [but] it will require both sides to redouble their efforts and consider creative solutions to the remaining issues." Textiles, intellectual property rights (IPR), telecommunications, foreign investment and services remain unresolved issues. With a fast-approaching spring deadline and numerous contentious issues still left on the table – including sugar and trucks – both sides are now considering whether completing the agreement is possible. The remaining issues to be discussed are not small matters and will likely require several more rounds of negotiations.

The potential impact of Thaksin and Karun's comments on the U.S.-Thai FTA negotiations, however, should not be overblown. Not only has Thaksin's government faced significant public backlash against the U.S.-Thai FTA, but he and his family have also faced recent allegations of corrupt corporate dealings. Indeed, 28 Thai Senators have filed a petition with the Thai Constitution Court to have Thaksin impeached. The Thaksin government, therefore, may have adopted a firmer rhetoric towards U.S.-Thai FTA negotiations in an attempt to curry favor at home. Whether this rhetoric portends a firmer Thai stance – and thus further delay or possible collapse – in the negotiations remains to be seen.

Senators Circulate Letter to USTR on U.S.-Korea FTA and Auto Issues

Senators George Voinovich (R-OH) and Carl Levin (D-MI), co-chairmen of the Senate Auto Caucus, expressed concern over auto trade issues related to the U.S.-South Korean Free Trade Agreement (FTA) in a February 2, 2006 letter to members of Congress and United States Trade Representative (USTR) Rob Portman. In the letter, the Senators state that they "remain troubled by the pervasive automotive trade imbalance between the United States and Korea." Voinovich and Levin write that Korea "remains the most closed auto market in the developed world" and note that Korea's auto sales and exports to the United States have "increased exponentially over the years." The senators urge Portman to "ensure that [the FTA] addresses all existing tariff and non-tariff auto barriers" and "ensure that future non-tariff barriers are not introduced to restrict access to the Korean auto market." The senators state an FTA "that fails to address all of Korea's auto trade barriers will constitute a significantly flawed agreement."

The Senate Auto Caucus consists of Senators with significant automobile manufacturing constituencies and has expressed similar concerns over the automobile-related provisions in other FTAs. For example, the caucus, domestic automakers and autoworkers have vigorously protested the removal of U.S. tariffs on light trucks as part of the U.S.-Thai FTA. Considering that the Korean auto sector maintains a far greater share of the U.S. market than its Thai counterparts, it is quite likely that the caucus will fight even harder to influence the U.S.-South Korea negotiations. Moreover, the Korean market has been the subject of specific allegations of protection, including U.S. auto industry claims that Korean environmental regulations prevent U.S., European and Japanese automakers from selling their automobiles in Korea. That Voinovich and Levin sent this letter so early in the U.S.-Korea FTA negotiations is, therefore, not surprising.

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Panama Requests Visit to U.S. Food Inspection Sites; Request Could Expedite FTA

On February 13, 2006, U.S. Chief Agricultural Negotiator Richard Crowder announced that Panama has asked to review the U.S. Department of Agriculture's domestic food safety and inspection system. Crowder stated that the United States has agreed to the request, and that the "visit will give the Panamanian government an even greater comfort level with [the U.S.] regulatory system and the safety of U.S. food." The United States and Panama are in the midst of Free Trade Agreement (FTA) negotiations, in which the United States has insisted that Panama formally recognize the equivalency of the U.S. meat and poultry inspection system.

Meat inspection appears to be the last large hurdle to completing the U.S.-Panama FTA. United States Trade Representative (USTR) Rob Portman stated that the United States and Panama made progress during the tenth round of FTA talks last week but noted that sanitary and phytosanitary (SPS) issues and the equivalency of the U.S. food inspection system remained unresolved. He stated that although the both sides "were not quite there yet," they "are close [to achieving a FTA and] can see the light at the end of the tunnel." During the ninth round of negotiations in January, Panamanian Minister of Agriculture Laurentino Cortizo resigned and stated that the FTA would "expose Panama to a greater danger of importing animal diseases."

Because USTR and USDA have found it difficult to convince countries to reopen their markets to U.S. beef imports following a 2003 case of mad cow disease in the United States, meat inspection equivalency has become a key issue in U.S. bilateral trade relations. USTR did not secure formal equivalency provisions in the Dominican Republic – Central American Free Trade Agreement (DR-CAFTA), and this failure has delayed implementation of the agreement – originally expected on January 1, 2006. Because of these problems, USTR has insisted that meat inspection equivalency be formalized in any future FTAs, including the U.S.-Panama agreement. Although Panama has protested the inclusion of such provisions in the FTA, the latest efforts of Panama's new negotiators indicate that the country may now be a willing to recognize in some form the equivalency of the U.S. food inspection system. Panama's request to visit U.S. inspection sites might assuage the country's fears related to inspection equivalency, thus expediting the FTA's conclusion.

U.S.-Colombia FTA Talks Suspended, Will Resume in Mid-February

The United States and Colombia have suspended Free Trade Agreement (FTA) talks but will resume the negotiations in mid-February. Officials from both countries met in Washington the week of January 25th and decided to table the talks until the week of February 13th. United States Trade Representative (USTR) Rob Portman stated that the talks were positive, but that the two countries "were not quite there" on certain agricultural issues, including sanitary and phytosanitary (SPS) measures. Similar to its SPS demands related to the implementation of Dominican Republic-Central American Free Trade Agreement (DR-CAFTA), the United States is pushing Colombia to recognize the equivalency of U.S. food safety standards and the U.S. meat inspection system. Colombian officials stated that the country is open to receiving "assurances from the United States . . . that would create more certainty than exists now about

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timetables and requirements for SPS work plans." Colombian negotiators advocated the creation of a separate SPS working group with specific timetables and requirements. Portman also stated that neither side could discuss the sensitive issues of sugar, rice, and poultry, but hopes that the delegations will discuss these topics at the February meetings.

U.S.-Andean talks stalled in late 2005 over intellectual property and agriculture issues. Since that time, the United States and Peru have completed a bilateral FTA, and President Bush formally notified Congress of the United States' intent to enter into the agreement. Although the United States will continue negotiations with Colombia and Ecuador, it maintains that these negotiations' problems will not hinder the Peruvian agreement's progress. With agriculture and SPS serving as (at least publicly) the most contentious remaining items, it is unlikely that these issues will be resolved at the February meeting. Instead, they will likely require additional negotiations, further distancing the Colombian and Ecuadorian agreements from the completed Peruvian FTA.

United States and South Korea Announce Initiation of Formal FTA Talks

The United States and South Korea have agreed to enter formal bilateral Free Trade Agreement (FTA) negotiations. United States Trade Representative (USTR) Rob Portman stated February 2nd that "this is the most commercially significant free trade negotiation [the United States has] embarked on in 15 years" and that "removing trade and investment barriers between [the] two nations through an FTA will increase market access for our farmers, ranchers, workers and businesses to the dynamic and growing Korean economy, boosting trade in goods and services." Portman also noted that "few countries better represent the promise of open markets, democracy and economic reform than Korea." The parties have not set a date for the first round of negotiations.

South Korea has made several moves to encourage the FTA talks. On January 26, USTR announced that South Korea agreed to reform its "screen quota" system by halving the 146 days/year that Korean movie theaters must show Korean films to 73 days/year. Days later, the Korean government partially lifted its ban on U.S. beef imports. Both issues were Bush Administration trade priorities.

Sources indicate that although both countries are enthusiastic about the possible FTA, negotiations will be "drawn out" and difficult, as they will involve "non-traditional issues" (*i.e.*, issues other than tariff/quota elimination) like non-tariff barriers (NTBs) and subsidies. For example, the U.S. auto industry alleges that Korean environmental regulations prevent U.S., European and Japanese automakers from selling their automobiles to the Korean market. Auto imports make up only two percent of the Korean auto market. Also, the Korean government's designation of agricultural products (particularly rice), electronics, and chemicals as "sensitive products," will be a likely point of contention. Sources further indicate that Korean negotiators will likely push for a bilateral dispute settlement mechanism to avoid subjecting Korean imports to U.S. trade remedies laws. U.S. trade remedy laws have never been considered in a U.S.

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bilateral trade agreement and are quite sacred among most in the U.S. Congress. Tampering with these laws in any way, therefore, will likely cause a stir on Capitol Hill.

These and other contentious issues will make the FTA's completion before the mid-2007 expiry of Presidential Trade Promotion Authority (TPA) a difficult proposition. However, the recent cancellation of U.S.-Swiss FTA talks and the unofficial halt to U.S.-Egypt FTA talks may afford USTR the time and resources necessary to hammer out an agreement in time.

Members of Congress Seek Support for U.S.-Malaysia FTA

On January 30, 2006, Representatives Pete Sessions (R-TX) and Gregory Meeks (D-NY) – members of the Malaysia Trade, Security, and Economic Cooperation Caucus – circulated to their fellow members of Congress a letter supporting the initiation of formal free trade agreement (FTA) negotiations with Malaysia. Although the Office of the United States Trade Representative (USTR) has yet to announce the start of the bilateral negotiations, sources have indicated that recent discussions between USTR officials and their Malaysian counterparts have been positive and could lead to formal FTA negotiations.

In the letter, Reps. Sessions and Meeks note that "Malaysia is the [United States'] tenth largest trading partner in the world, creating nearly $40 billion in two-way trade per year." They also highlight the active role of large U.S. companies in Malaysia's information technology (IT) sector and opine that the FTA "would create new opportunities in a cross section of American economic sectors from agriculture, financial services, and automobiles." Sessions and Meeks based their support for the FTA on their belief that "Americans cannot be left behind by [U.S.] foreign competitors," as "Malaysia is currently being aggressively courted by economic competitors like China, India and the EU for their own trade agreements." They add that the FTA "is supported by major American business associations" including the U.S. Chamber of Commerce and the National Association of Manufacturers (NAM).

The letter also outlined geopolitical reasons for a U.S.-Malaysia FTA, stating that initiating FTA negotiations with Malaysia would "increase ties to a strategically important geographic region." The letter added that the FTA would solidify relations with a majority Muslim Democratic nation, which in turn could strengthen Malaysia's role as a critical U.S. counter-terrorism partner and a leading defense cooperation partner for the U.S. military.

In the last month USTR has officially cancelled potential U.S.-Switzerland FTA negotiations due to agriculture concerns and has unofficially halted a potential U.S.-Egypt FTA based on human rights issues. Prospects for a formal announcement on a U.S.-Malaysia FTA have, therefore increased by, if nothing else, process of elimination. USTR Rob Portman is also expected to announce soon the initiation of bilateral talks with South Korea. It now appears that, based on USTR's latest negotiations with the Malays and the geopolitical issues related to a potential FTA, an announcement on U.S.-Malaysia FTA talks is not far behind.

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United States and Switzerland Call Off Potential FTA Negotiations

The United States and Switzerland have ended discussions related to a potential bilateral Free Trade Agreement (FTA) and will instead pursue a Trade and Investment Cooperation Forum. United States Trade Representative (USTR) Rob Portman issued a statement on January 28 following his January 25th meeting with Swiss Economic Affairs Minister Joseph Deiss before the World Trade Organization (WTO) World Economic Forum in Davos, Switzerland. Portman stated that the trade and investment forum will focus on "specific areas where [the United States and Switzerland] share mutual interests with a view to concluding agreements or other arrangements that offer real opportunities for workers, farmers, service providers, manufacturers, and consumers in [the] two countries." Portman noted that both countries would begin working on "details of the forum" and its initial work program "in the coming weeks." According to congressional sources, USTR canceled the proposed FTA because it "would not hold enough benefit for U.S. farmers." The Swiss agricultural market is one the most protected in the world, and Swiss trade negotiators were reportedly reluctant to reduce Swiss tariffs on farm products.

USTR's formal cancellation of the potential Swiss FTA comes only weeks after its unofficial decision to postpone the initiation of formal FTA negotiations with Egypt. These decisions further increase the likelihood that USTR will begin formal FTA negotiations with South Korea and Malaysia – countries that the United States is also considering for bilateral free trade talks. As of now, USTR has not indicated that it is prepared to begin FTA discussions with any other country, and considering the deadlines that the mid-2007 expiry of Presidential Trade Promotion Authority (TPA) has placed upon U.S. trade negotiations, other FTAs are somewhat unlikely. However, given the removal of Egypt and Switzerland from the Bush Administration's FTA agenda and its desire to pursue FTAs with Middle Eastern nations as part of the U.S.-Middle Eastern Free Trade Area (USMEFTA), it is not out of the question that another country could emerge as the focus of potential FTA talks.

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MULTILATERAL

Status Report: U.S.-EU WTO Dispute over Civil Aircraft Subsidies

SUMMARY

On February 17, 2006, the World Trade Organization's (WTO) Dispute Settlement Body (DSB) established a panel to resolve procedural matters in the dispute between the United States and the EU over the payment of government subsidies to the U.S. aircraft-manufacturer Boeing Company and its European rival Airbus. This is the second time the EU has requested the establishment of a panel to such procedural matters. The WTO has formed panels to hear the U.S. and EU complaints in what may become one of the largest and most contentious WTO disputes ever. The United States alleges that the governments of France, Germany, Spain and the UK have subsidized the operations of Airbus, the European aircraft manufacturer, in an amount of up to $15 billion,[22] violating the WTO Agreement on Subsidies and Countervailing Measures (ASCM). The European Union alleges that the U.S. Government and certain state governments have provided Boeing, the U.S. aircraft manufacturer, with up to $30 billion in ASCM-inconsistent subsidies.

The dispute will affect the competition in civilian and military aircraft sales for many years. Successful resolution of the dispute would remove the political risk of U.S. Congress adopting legislation detrimental to the interests of EU aerospace/defense companies. Although settlement seems the most reasonable solution, the continued tension between the two nations indicates that the parties may be unable to come to a mutually satisfactory solution, and that a formal WTO dispute settlement panel thus may be the only choice.

ANALYSIS

On February 17, 2006, the WTO's DSB established a panel to resolve procedural matters in the dispute between the United States and the EU over the payment of government subsidies to the U.S. aircraft-manufacturer Boeing Company and its European rival Airbus. This is the second time the EU has requested the establishment of a panel to resolve such procedural matters. At the last DSB meeting, the EU explained that the dispute needed to be resolved quickly because the EU considered that "it has been deprived of its rights to access documents relevant to the dispute," including NASA and Department of Defense subsidies documents. The EU also requested that the DSB further initiate the procedures for developing information-gathering under Annex V of the ASCM. The DSB agreed to establish the panel, despite the United States' protests.

The United States opposed the EU's second panel request because it believes that the best approach "would have been a mutual agreement on this panel request." The United States has

[22] The amount at stake in both disputes is not mentioned in the official WTO documents, but has been released through the media.

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asked for consultations with the EU regarding the relationship between this panel and the one established on July 20, 2005 (DS317) that dealt with the same matter. The United States also stated that it is not in a position to accept the EU's request to begin an information-gathering process. According to the United States, "the Annex V procedures could not start until the parties agreed on the modalities, noting that the Annex V procedures initiated on September 23, 2005 for the civil craft dispute were inadequate."

The subsidy problems underlying the dispute began in the 1970s and led to the conclusion of the 1992 *EU-US Agreement on Trade in Large Civil Aircraft*. Unsatisfied with the continued flow of European subsidies (and Airbus' success), the United States withdrew from the agreement and initiated a formal WTO dispute settlement action. The EU countersued. The parties claim that a number of subsidies, including launch aid, government-funded Research and Development (R&D), federal tax breaks, sub-federal incentives, and foreign subsidies are illegal under the ASCM. The dispute has put pressure on EU governments, European aerospace/defense companies, and the world trading system. Although settlement seems the most reasonable solution, the continued tensions between the two nations indicates that the parties may be unable to come to a mutually satisfactory solution, and that a formal WTO dispute settlement panel thus may be the only choice.

I. Background of the Dispute

A. Competition between Airbus and Boeing in Civil Aircraft

The expected launch of Airbus' new plane – A350, designed to compete with Boeing's new 787**,** was the decisive factor triggering Boeing to request the first WTO panel. After losing its lead in the large civil aircraft (LCA) market, Boeing planned to recapture the midsize market with the release of its new fuel-efficient 787 Dreamliner. Rising gas prices, and airlines' pressure on aircraft manufacturers to focus on fuel efficiency have made the new generation of aircraft (Boeing 787 and Airbus 350) key to the future success of both companies. The launch of 787 Dreamliner, Boeing's first new plane in over 10 years, allowed Boeing to sell more aircraft than Airbus in 2005, the first time in five years. Airbus' plans to launch A350, its new competitor to the 787 Dreamliner, have pushed Boeing to lobby the U.S. government to initiate a WTO dispute. Major airlines[23] planning to decide soon whether to purchase 787 or A350 may decide the market trend for years to come. By requesting WTO consultations, Boeing seeks to dissuade potential customers from purchasing Airbus planes (potentially sabotaging the formal launch of the A350 business development program).[24]

[23] Singapore Airlines, Qantas, and British Airways

[24] Airbus will launch the A350 program only if it secures a sufficient number of orders justifying the program.

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B. Competition between EU and U.S. Companies in the Defense Procurement Market

Competition between U.S. and EU defense companies in military procurement further influenced Boeing's decision to initiate WTO litigation. While civilian aircraft constitutes the bulk of Airbus' business, the company competes with Boeing in several defense markets, including the military cargo sector. Airbus' parent companies, European Aeronautic, Defense, and Space Company (EADS) and BAE Systems operate in both the European, and the U.S. defense markets. The decreasing military procurement budgets in the EU have pushed European defense companies to enter (by acquisitions or bidding for government contracts) the lucrative U.S. defense market, where they encroached on a territory dominated by U.S. companies. The tensions in the defense sector, coupled with a number of expected defense procurement opportunities and military procurement's susceptibility to political pressures, could have contributed to Boeing's decision to escalate the dispute.

Competition between Boeing and Airbus for the Pentagon's air-to-air tanker contract could have further compelled Boeing to seek WTO litigation. After an investigation into procurement improprieties led to the cancellation of a contract between the U.S. Government and Airbus for the supply of air-to-air tankers, the Pentagon is now considering whether to re-launch the tender. EADS has announced its interest in competing for the contract with the A330, and experts speculate that EADS is well positioned to win the contract. The perspective of Airbus cutting into an additional market monopolized by Boeing may have contributed to Boeing's decision to launch a WTO challenge.

II. History of the Dispute

The aircraft subsidy controversy between the European Union and the United States began in the 1970s and has resulted in a number of international agreements, including the GATT Agreement on Trade in Civil Aircraft, the EU-U.S. Agreement on Trade in Large Civil Aircraft, and the EU-U.S. agreement on how to negotiate the aircraft dispute. It has also led to WTO consultations and formation of WTO panels.

A. Agreements on Trade in Civil Aircraft and U.S. Withdrawal from the 1992 Agreement

The emergence of Airbus as a counterweight to Boeing, and the perceptions of both companies and their governments that their counterparts have benefited from excessive subsidies led to conclusion of two agreements: the *1980 Tokyo Round Agreement on Trade in Civil Aircraft*, and the *1992 EU-U.S. Agreement on Trade in Large Civil Aircraft.* The 1992 Agreement: (i) prohibited government funding of LCA production; (ii) limited direct government support for development costs of new aircraft programs at 33% of the total development cost; and (iii) limited indirect government support, *inter alia*, via government sponsored research & development at three percent of the total LCA industry's annual turnover, and at four percent of the annual turnover of any single LCA manufacturer. In practice, the 1992 Agreement provided

3/1/2006 4:35 PM (2K)
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a legal framework for continued flow of public aid to Airbus (direct development support) and Boeing (indirect R&D support) at the capped amounts.

In late 2004, the United States withdrew from the 1992 Agreement. While the Agreement had limited the subsidies received by both aircraft manufacturers, it had not slowed down Airbus' market advance. Airbus' success, coupled with the receipts of large amounts of public aid, triggered the United States to try to renegotiate the terms of the 1992 Agreement. As the negotiations stalled, the United States withdrew from the 1992 Agreement.

B. WTO Litigation

The United States filed a request for WTO consultations with the European Union and the governments of France, Germany, Spain and the United Kingdom over Airbus subsidies on October 6, 2004, and the EU responded with its request for consultations with the United States on Boeing subsidies the same day.[25] The parties concluded a temporary agreement on terms for negotiations to end subsidies for LCA on January 11, 2005. The agreement called on both parties to amicably resolve the dispute within three months, and froze the WTO proceedings, as well as government approval of new subsidies for LCA development or production. The deadline envisioned by the January agreement passed on April 11, 2005 and the parties had not resolved their differences.

The parties filed official requests for the formation of WTO panels to decide the dispute on May 31, 2005. The EU amended its request for consultations and added new subsidy programs on July 1, 2005. The WTO officially formed two separate panels on July 20, 2005. At its September 23, 2005 meeting, the DSB initiated the procedures provided in Annex V of the ASCM on data-gathering. The data-gathering, however, did not occur following the initiation of Annex V procedures. As discussed above, the dispute has not proceeded smoothly since the establishment of the panels at the request of the EU.

III. Legal Issues in the Dispute

The parties claim that the following five types of government support constitute illegal subsidies under the ASCM: (a) launch aid, (b) government-funded R&D, (c) federal tax breaks, (d) sub-federal support, and (e) subsidies provided by the Government of Japan. The parties also raise other issues discussed in point (f) below.

A. Launch Aid

The United States claims that launch aid**,** *i.e.* provision of funds to develop a new aircraft model, provided to Airbus by the governments of France, Germany, Spain and the United Kingdom violates the EU's obligations under the ASCM. Although the details of the program depend on the government in question, Boeing generally claims that Airbus' obligation to repay the loans depends on the commercial success of the plane. If the new plane is not

[25] We analyze the specific claims of these requests in Part III of this Report.

successful, debt is forgiven. If the plane is successful, the company must repay the loan and pay sales royalties. The United States claims that Airbus has received over $15 billion in launch aid, bestowing an economic benefit of over $40 billion, which facilitated development of aircraft models impossible to develop without the aid. The EU governments respond that only three of Airbus' planes have benefited from government launch aid, and most of the aid has been repaid. Launch aid is central to the United States' case, as Airbus is on the verge of formally approving development plans for the A350, which could in turn trigger the approval of new launch aid. The EU governments claim that the launch aid for A350 planned in the amount of €1.3 billion complies with the 1992 Agreement, as it is less than 1/3 of the €4.35 billion development cost. They counter the United States' allegation that Airbus is dependant on aid by noting that development of A350 will continue regardless of whether aid is provided.

B. Government-sponsored R&D

The EU claims that Boeing has benefited from preferential transfer of resources under Department of Defense (DOD) and the National Aeronautics and Space Administration (NASA) procurement in the amount of over $20 billion, in violation of the ASCM. In particular, the EU points to a number of NASA and DOD research and development projects, which benefit Boeing's LCA development. The EU also claims that NASA and DOD regulations facilitate the transfer of intellectual property developed with public money to Boeing. The EU makes a similar claim against the National Institute of Standards and Technology. The United States makes an analogous R&D claim against the EU, pointing to the "EU Framework Programs", as well as government programs in France, Germany, Spain and the United Kingdom.

C. Federal Tax Breaks

The European Union complains of the federal tax incentives provided to Boeing by U.S. government. In a recent circulated draft report on U.S. compliance with the FSC/ETI rulings, the WTO found the United States still not in compliant with the earlier rulings. The EU claims that Boeing is one of the biggest beneficiaries of the FSC/ETI scheme, and estimates the benefits enjoyed by Boeing since the WTO's decision finding the FSC/ETI law illegal at $1 billion.

D. Local Tax Breaks and Preferential Treatment

The European Union claims that Boeing has benefited from significant state incentives, such as tax breaks, and relocation assistance provided by states of Washington, Kansas, and Illinois. The EU has calculated the aid provided by the State of Washington alone to amount to over $7.4 billion.

E. Subsidies provided by the Government of Japan

The European Union claims that Japan has provided the Japanese Aircraft Development Corporation, a manufacturer of Boeing's component parts such as wings and fuselage subassemblies with up to $1.6 billion in subsidies illegal under the ASCM. Because the United States Government refused to include the Japanese subsidies in its settlement talks with the EU,

and because the EU refused to sign an agreement without addressing the Japanese subsidies, these subsidies have been one of the most contentious issues in the negotiations. Because Japan is not a respondent in the complaint brought by the EU, however, it seems rather unlikely that the WTO will analyze anytime soon the subsidies provided by the Japanese government. The EU's request for consultations, as well as a request for establishment of a WTO panel do not mention the Japanese subsidies.

F. Other claims

Other claims raised by the United States against the European Union include: (1) aid provided to Airbus by the European Investment Bank; (2) public investments by the German, French, U.K., and Spanish authorities in facilities and infrastructure for Airbus; (3) debt assumption and forgiveness; and (4) equity grants and infusions through government-owned or government-controlled banks. The other issues raised by the European Union against the United States include: (1) NASA and DOD cost-plus contracts, according to the EU providing excessive remuneration to Boeing; (2) Boeing's use of NASA and DOD R&D facilities; and (3) employee training subsidies by U.S. Dept. of Labor.

IV. Practical Problems Caused by the Dispute

The dispute has had a number of practical consequences. First, Boeing hopes that the dispute may influence the decisions of the governments of France, Germany, Spain and the United Kingdom on their decisions to grant launch aid. Second, the dispute may accelerate the trend to outsource production of aircraft components by both companies. While Boeing has outsourced the major parts of its production to other countries (including Japan, Italy, UK, France, Russia and Poland), Airbus has been slower to follow suit. As evidenced by the problems faced by the EU with addressing Japanese and Italian subsidies to Boeing's subcontractors, Boeing's strategy to involve many parties in the production process has complicated the EU's response. Third, the dispute has led to the introduction of protectionist legislation in the U.S. Congress, further pressuring EU aerospace/defense companies to seek political support in the United States by finding American business partners.[26] In the face of the expected consolidation of the aerospace and defense industry, companies on both sides of the Atlantic are further pushed to invest in each other's markets to offset the political risk.

OUTLOOK

In the long term, the Airbus-Boeing dispute imperils the interests of both parties. First, both sides are (or pretend to be) deeply convinced of the merits of their case, and the lack of merits of the other party's claims. Each side enjoys popular support from its local media, as well as the political elites. Pressure to continue the case is considerable, and political obstacles to a settlement seem considerable. Second, the amounts at a stake are unprecedented: while the

[26] For example, the UK's BAE Systems has recently finalized the purchase of American military vehicle manufacturer United Defense Industries, EADS has partnered with Northrop Grumman in its bid for Pentagon tanker contract)

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largest WTO award to date has been $4 billion, the cases jointly entail $45 billion. The political fallout from the cases, in particular if the WTO authorizes retaliation in any way approximating the above amount would be enormous. Third, the dispute has already damaged the relations between EU and the U.S. trade diplomats. Fourth, the EU – U.S. cooperation in the months to come will be crucial if the Doha Round of multilateral trade negotiations is to succeed. A major irritant in relationship between the two powerhouses, coupled with the poor state of the Doha negotiations at the moment, may jeopardize the greater Doha Round.

Most commentators agree that settlement of the dispute is the only reasonable solution. Settlement would give each of the parties a victory in removing some of the other side's distortions and would minimize any defeat by allowing them to maintain the most crucial elements of support. Only a settlement can appropriately balance the win-to-lose ratio and leave both parties in full control of the outcome. In the absence of a settlement, both parties are likely to lose the cases filed against them, and win the cases filed by them. Neither party will be eager to remove its subsidies, and both will face a difficult choice of imposing retaliatory tariffs, which would trigger imposition of the retaliatory tariffs by the other party, or ignoring its victory. The result would closely resemble the fallout from the earlier WTO decisions in the Brazil-Canada aircraft subsidy battle between Embraer and Bombardier, in which both parties lost and won cases filed against and by them, respectively, neither party implemented the WTO decisions, and neither party retaliated. Legal uncertainties surrounding the nature of the subsidies and each case's facts make settlement even more attractive. Moreover, because the economic outlook for the aerospace/defense industry has recently improved, and because Boeing has received significantly more orders than Airbus in the 787/A350 sector, the economic underpinnings of the case may wane.

A possible settlement could also cover the companies' activities in the defense sector. It has been rumored that one possible settlement would trade EU's decision not to grant launch aid for Airbus A350, for U.S. commitment to provide EU companies enhanced market access to the U.S. defense procurement. Pentagon's air-to-air tanker contract has repeatedly been mentioned in this context.

Despite this unquestioned logic, tensions between the two trading powers continue to build. The EU's latest panel request – and the U.S. opposition to it – demonstrates that the parties are finding it rather difficult to settle the dispute amicably. Should the panel rule in favor of the EU and require the United States to produce the evidence that the EU seeks, the EU may have further support for its case and be even more reluctant to settle. The United States will likely be further rankled if it is forced to provide evidence that it deems confidential based on national security concerns. Moreover, the parties continue to fight over several issues – most notably agricultural market access – during the Doha Round negotiations. Should the parties continue to quarrel at these various levels, settlement just might not be an option, despite its overwhelming logic.

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Multilateral Highlights

U.S. Offers New Agriculture TRQs Proposal; Faces Off With EU on Definition of "Food Aid"

The United States has offered a new proposal for expanding tariff-rate quotas (TRQs) for "sensitive" agriculture products as part of the World Trade Organization's (WTO) Doha Round of multilateral trade negotiations. Under the U.S. proposal, TRQs for sensitive agriculture products would be expanded based on the current level of domestic consumption of those products. Sources note that the proposal could lead to significant increases in EU TRQs but would not greatly increase TRQs in Japan. The United States circulated the proposal at an agriculture meeting in Geneva during the week of February 13. WTO Members are presently reviewing the proposal.

The U.S. proposal includes two variables that would impact the expansion of a TRQ. The first variable is the current base TRQ for a commodity and its size relative to domestic consumption. Under the U.S. approach, TRQs that represent a small percentage of domestic consumption would expand more quickly than TRQs that represent a large share of consumption. The second variable is the extent to which a country deviates from the standard tariff reduction formula for a sensitive product covered by a TRQ. Under the U.S. approach, the size of the deviation from the formula would dictate how much the TRQ would be expanded.

Chairman of the WTO agriculture negotiations Crawford Falconer stated that the "shape" of an agriculture agreement is centered on food aid. He noted that WTO Members still disagree over what definitions to use for food aid "emergencies," under which Members could deliver bulk commodities as food aid. He also opined that Members are close to agreeing that nations can deliver bulk commodity food aid in the case of appeals by the United Nations' World Food Program. Sources note, however, that the United States and the EU still have not reached an agreement on how to define these emergencies or on how to discipline food aid outside a "safe box" that would cover emergency food aid. The EU is demanding that Members provide all food aid outside the safe box in cash form, rather than as surplus commodities that organizations sometimes sell for cash.

Tension between the United States and the EU continues to dog the faltering WTO agriculture negotiations. That the new U.S. proposal on TRQs greatly expands EU TRQs might not do much to ease tensions between the two trading powers. Moreover, the unresolved food aid issue continues to divert attention and resources away from even more contentious issues, such as the EU's steadfast refusal to offer a more ambitious proposal on agricultural market access. A prolonged debate on food aid will place the April 30 deadline for full modalities in agriculture in further jeopardy.

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Plurilateral Offers Becoming Increasingly Complex and Difficult

Sources indicated that efforts to achieve a better services deal in the World Trade Organization's (WTO) Doha Round by negotiating plurilateral initiatives in certain services sectors have run into "unexpected difficulties" in Geneva. According to these sources, WTO Members that advocate the plurilateral offer process, including the EU and the United States, face a number of initiatives and substantive issues. According to Brazil's WTO Minister Clodoaldo Hugueney, a "growing perplexity" exists among the plurilateral advocates on how to handle the numerous issues surrounding the offers.

Close to 20 plurilateral requests under negotiation face resource problems; WTO Members are finding it increasingly difficult to attend plurilateral meetings along with bilateral and cluster meetings. Sources also note that some of the requests involve issues sensitive to the United States and the EU, including audiovisual services, maritime services, and the movement of natural persons ("mode 4").

Under the Hong Kong ministerial declaration, WTO Members have until February 28, 2006 "or as soon as possible thereafter" to submit requests for plurilateral initiatives. Sources expect WTO Members on February 28 to present plurilateral requests on 10 to 14 sectors, including telecommunications, computer and related services, express delivery and logistics. The United States is also preparing a plurilateral request on the classification of interactive online software games that will likely face opposition from WTO members, including the EU. EU officials have stated that they would like to define online gaming as part of the audiovisual industry, not the recreation and entertainment industry as the U.S. request will suggest. The EU has long made clear that it will seek to maintain its current most-favored nation ("MFN") limitation on audiovisual services.

The United States has also run into problems with the plurilateral request on financial services. Sources indicate that the terms demanded by the United States make the request "insufficiently ambitious" for several countries, including Switzerland. Switzerland has refused to sign on to the plurilateral request due to the United States' refusal to ease existing restrictions on the cross-border supply ("mode 1") of services for securities and its refusal to endorse a proposal that would allow foreign entities to sell securities in the Unites States to certain institutional customers, such as banks or brokerage houses. U.S. officials have stated that the U.S. regulatory system does not allow cross-border supply of securities and requires commercial presence for securities sales. U.S. officials maintain that the U.S. Securities Exchange Commission (SEC) approves the individual sale of securities by foreign entities, but that U.S. law requires the foreign entity to have a U.S. commercial presence to make the sale through a "chaperone" (*i.e.*, a U.S. subsidiary of the foreign entity). Without such a "chaperone," the foreign entity cannot make the sale or directly approach a customer in the United States.

WTO Members have expressed concern that under the current timeframe established at the Hong Kong Ministerial Conference there might not be enough time to consider all the plurilateral requests. Members will have one cluster of services meetings in late March and early

3/1/2006 4:35 PM (2K)
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April to focus on plurilateral requests before the April 30 deadline for modalities in agriculture and non-agriculture market access. Members must submit their revised services offers by July 30. Given the difficulties Members have encountered attempting to meet the February 28 deadline for plurilateral requests, it is unclear whether the Hong Kong declaration's schedule is feasible.

EU Requests Establishment of Panel in Boeing-Airbus Dispute

On February 17, 2006, the World Trade Organization's (WTO) Dispute Settlement Body (DSB) established a panel to resolve procedural matters in the dispute between the United States and the EU over the payment of government subsidies to the U.S. aircraft-manufacturer Boeing Company and its European rival Airbus. This is the second time the EU has requested the establishment of a panel to such procedural matters. At the last DSB meeting, the EU explained that the dispute needed to be resolved quickly because the EU considered that "it has been deprived of its rights to access documents relevant to the dispute," including NASA and Department of Defense subsidies documents. The EU also requested that the DSB further initiate the procedures for developing information-gathering under Annex V of the Subsidies and Countervailing Measures (SCM) Agreement. The DSB agreed to establish the panel.

Both the United States and the EU have filed competing complaints with the WTO alleging that Airbus and Boeing, respectively, receive illegal government assistance. In early 2005, the U.S. House of Representatives voted to bar Pentagon contracts with Airbus because of the ongoing trade tensions. The United States' complaint focuses on the EU's "launch aid" program under which European governments cover startup costs for Airbus' new aircrafts; Airbus does not repay these "loans" unless the plane is a success. The EU contends that Boeing receives preferential tax breaks and similar "launch aid" from the U.S. military and Japan, especially for Boeing's 787 Dreamliner that competes against the Airbus A-350.

The United States opposed the EU's second panel request because it believes that the best approach "would have been a mutual agreement on this panel request." The United States has asked for consultations with the EU regarding the relationship between this panel and the one established on July 20, 2005 (DS317) that dealt with the same matter. The United States also stated that it is not in a position to accept the EU's request to begin an information-gathering process. According to the United States, "the Annex V procedures could not start until the parties agreed on the modalities, noting that the Annex V procedures initiated on September 23, 2005 for the civil craft dispute were inadequate."

WTO Members who reserved their third-party rights were Japan, Australia, Canada, Brazil and China.

U.S., EU, and WTO Members to Meet in Washington, London to Discuss WTO Doha Round

U.S. and EU officials will meet in Washington, D.C. on February 21-22, 2006 to continue high-level discussions as part of the World Trade Organization's (WTO) Doha Round of

3/1/2006 4:35 PM (2K)
WASHINGTON 903259 v1 [903259_1.DOC]

multilateral trade negotiations. United States Trade Representative (USTR) Rob Portman and European Trade Commissioner Peter Mandelson will discuss, among other issues, agricultural negotiations that have remained stalled since the December 2005 WTO Ministerial Conference in Hong Kong. Portman has stated that the EU must show some flexibility in its agriculture proposal in order to ensure agreement from other WTO Members. Mandelson, on the other hand, has stated that the EU will not move forward on agriculture until WTO Members, especially developing economies, offer new proposals on services. The two trade officials will also discuss bilateral trade disputes including the Boeing-Airbus dispute over government support for large civil aircraft and tax breaks for aircraft exporters. Portman has stated that prospects for settling the Boeing-Airbus dispute through the WTO are slim and added that the United States will "aggressively" continue to pursue its case against the EU at the WTO. Portman and Mandelson will also meet in London on March 10-12, 2006 to discuss the status of WTO negotiations with India, Brazil, Australia, and Japan. Sources indicate that the meetings will likely focus on agricultural issues, and that agricultural ministers from these different countries will join the discussions.

The scheduled talks indicate WTO Members' concern with the stagnant Doha Round. Although its is unlikely that the United States or the EU will radically change their current negotiating positions following the Washington and London discussions, both sides can hope to gain a better understanding of the other's position and to tweak their own proposals to move the Doha Round forward. Without any push on either end, the WTO's April 2006 deadlines for achieving full modalities will be almost impossible to meet. Because the U.S. government insists that any agreement must be completed by the end of 2006 to avoid problems with the mid-2007 expiration of Presidential Trade Promotion Authority (TPA), failure to meet the April 2006 deadlines could jeopardize the entire round.

WTO Members Say Retaliation Will Continue, Dismiss U.S. Claim That Byrd Amendment Has Been Repealed

On February 17, 2006, U.S. officials informed the World Trade Organization's (WTO) Dispute Settlement Body that the recent repeal of the Continued Dumping and Subsidy Offset Act (CDSOA or the "Byrd Amendment") reflects the United States' compliance with a WTO dispute ruling. Several WTO Members, however, dismissed the U.S. claim and stated that they would continue imposing retaliatory duties on U.S. imports until the Byrd Amendment ceased operation.

On February 1, 2006, the House approved the Deficit Reduction Act of 2005 (S. 1932) that calls for repeal of the Byrd Amendment on October 1, 2007. The CDSOA mandates the distribution of antidumping and countervailing duties to the U.S. companies that petitioned for trade relief. In March 2005, the WTO allowed eight Members to impose retaliatory duties on U.S. imports based on the United States' failure to comply with a 2003 WTO Appellate Body (AB) decision that the law was inconsistent with global trade rules. The complainants – including the EU, Japan, Canada, Mexico, Brazil, India, South Korea, and Chile – have stated

3/1/2006 4:35 PM (2K)
WASHINGTON 903259 v1 [903259_1.DOC]

that "transitional provisions under the budget bill" allow U.S. companies petitioning for relief to continue receiving illegal Byrd payments through October 2007 and beyond.

The EU, Japan, Canada, and Mexico might apply additional duties on certain U.S. imports. India, Brazil, South Korea, and Chile have been granted WTO authorization to impose retaliatory duties but have not yet applied sanctions. Canadian officials stated that the United States "has not yet complied" with WTO rulings and recommendations and noted that until Byrd payments fully cease, "the United States will remain in violation of its WTO obligations." Japanese officials echoed Canada's statements that stated that the United States had not yet implemented "the necessary steps" to remove the Byrd Amendment, and Brazilian officials that stated that Byrd disbursements "could still occur [for] many years" after the October 2007 repeal date.

Because the 2005 budget measure allows the Byrd Amendment to govern the disbursement of duties collected on any good that enters the United States before October 2007, distribution of "Byrd monies" could continue well into 2009. Complaining WTO Members, therefore, may continue to retaliate until the Byrd Amendment becomes inoperative. It is likely, however, that the United States will seek to end the Members' retaliation through a negotiated settlement.

United States Requests WTO Dispute Settlement Panel on Turkey's Rice Restrictions

On February 6, 2006, the United States requested the formation of a World Trade Organization (WTO) dispute settlement panel related to its challenge of Turkey's alleged restrictions on U.S. rice imports. In a statement to the WTO Dispute Settlement Body, United States Trade Representative (USTR) Rob Portman stated that over the past three years, the United States "has tried to resolve this issue without resorting to litigation" and noted that U.S. concerns "have not been addressed and [the United States] must move forward to see the establishment of a WTO panel." The WTO's dispute settlement body (DSB) will consider the U.S. request. WTO rules allow Turkey to block the DSB from creating a panel at its next meeting, but the United States can again request a panel, which Turkey cannot block.

According to USTR, Turkey's current rice import regime requires importers to possess an import license to import rice. USTR notes that Turke**y** fails to grant these licenses at its bound duty rate for rice and also alleges that Turkey maintains a tariff-rate quota (TRQ) for rice imports that requires importers to match import purchases with purchases of domestic rice in order to receive reduced tariff rates. Importers must make the domestic rice purchases from the Turkish Grain Board, Turkish producers or producer associations. USTR claims that these measures are inconsistent with Turkey's WTO obligations under Article 2.1 of the WTO's Trade-Related Investment Measures (TRIMs) Agreement and has cited a two-thirds decline in U.S. rice exports to Turkey as a result of the measures.

The United States initiated in November 2005 WTO dispute settlement proceedings against Turkey for its failure to lift the rice import-licensing requirements. Under WTO rules,

3/1/2006 4:35 PM (2K)
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the United States and Turkey first attempted to resolve the issue through bilateral consultations. Because the parties could not reach an agreement, the United States was able to request a WTO panel.

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