



March 2007

**Japan External Trade Organization
WTO and Regional Trade Agreements
Monthly Report**

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Summary of Reports

United States

Senate Finance Committee Holds Hearing on 2007 Administration Trade Initiatives

On March 8, 2007, the Senate Finance Committee held a hearing on the Bush Administration's 2007 trade agenda. Committee Chairman Max Baucus (D-MT) discussed several trade-related issues with the hearing's witnesses, who provided their **on-the-record** testimony on issues such as China, Presidential Trade Promotion Authority (TPA), and the status of ongoing Free Trade Agreement (FTA) negotiations. We review the hearing below.

ITC Holds First of Three Hearings on U.S.-China Trade and Investment

On March 8, 2007, the U.S. International Trade Commission (ITC) held an investigative hearing on U.S.-China trade and investment and the causes of the United States' growing trade deficit with China. The hearing focused on trade and investment trends in Asia and their effect on the bilateral economic relationship. The ITC heard **on-the-record** testimony from a number of witnesses including economists and representatives from U.S. business, industry, and labor groups. The hearing marks the beginning of a six-month investigation the ITC will conduct on Asian trade and investment trends and will conclude with a report to the House Ways and Means Committee in October 2007. The request is part of growing Congressional sentiment that the Administration has been reluctant to take action to address the U.S. trade deficit with China and China's alleged unfair trade practices such as currency manipulation and industrial subsidization.

Ways and Means Trade Subcommittee Holds Hearing on NME Trade Remedies Act of 2007

On March 15, 2007, the House of Representatives Ways and Means Trade Subcommittee held a hearing on proposed legislation (H.R. 1229) that would direct the Department of Commerce (DOC) to apply U.S. countervailing duty (CVD) law to non-market economies (NMEs) such as China. The bill would also require Congressional approval of any DOC decision to graduate an NME country to "market economy" status and would require the U.S. International Trade Commission (ITC) to prepare an annual report on Chinese government policies that support or influence China's domestic manufacturing industry. This report highlights the key points of Subcommittee Members' opening statements and testimony from

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witnesses including government and private sector representatives from the steel, legal and academic communities. Transcripts of full statements and testimony is available on the Subcommittee's website.¹

GAO Issues Report on WTO Doha Negotiations: Key Decisions in Congress Likely to Affect Outcome

On March 5, 2007, the Government Accountability Office (GAO) issued a report on the status of World Trade Organization (WTO) Doha Round negotiations. GAO's study assesses the current status of negotiations and developments since the talks' July 2006 breakdown, the divisive issues among WTO Members, and the possible consequences of another collapse to the Doha Round. According to the report, agriculture and development are the main issues of contention among WTO Members, specifically regarding agricultural tariffs and subsidies and market liberalization. The report states that with these issues at the forefront of the negotiations, the U.S. Congress has the ability to "make or break" negotiations with its decisions on Presidential Trade Promotion Authority (TPA) and the U.S. Farm Bill, both set to expire in 2007. The report concludes that because the United States is a major player in the global trade arena, Congress's policy implementations are likely to determine Doha's fate. Although WTO Members debate the impact of a possible failure in the Doha Round, some argue that it could have serious implications for the WTO and the future of global trade.

The full GAO report is available at <http://www.gao.gov/cgi-bin/getrpt?GAO-07-379>.

United States Highlights

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

- U.S. Legislators Introduce Several China-Related Bills
- WITA Hosts Briefing on 2007 Trade Prospects with Under Secretary of Commerce Frank Lavin

¹ <http://waysandmeans.house.gov/hearings.asp?formmode=detail&hearing=537>

Free Trade Agreements

U.S. and Korean Negotiators Make Some Progress in Eighth Round; Key Issues Remain Unresolved as March Deadline Approaches

On March 8-12, 2007, U.S. and Korean negotiators held the eighth and final round of formal negotiations on the U.S.-Korea (KORUS) Free Trade Agreement (FTA). The talks achieved agreements for three of the FTA's chapters and neared agreement on seven other chapters. However, the negotiators' failure to resolve long-standing differences on agriculture, automobiles, trade remedies and other contentious issues prevented them from reaching a comprehensive agreement on all chapters. Despite setbacks in talks on these issues, however, both sides remain optimistic that they can complete the FTA by the end of March, when the Office of the United States Trade Representative (USTR) has indicated that it must submit the agreement's text to Congress. Negotiators are addressing the outstanding issues in last-minute, high-level talks that began on March 19 in Washington and Seoul. Neither side has ruled out the possibility of a second round of high-level talks before March 31. With less than two weeks remaining before the deadline, failure to resolve these issues in the talks would likely result in the agreement's collapse.

Ways and Means Trade Subcommittee Holds Hearing on KORUS FTA

On March 20, 2007, the House of Representatives Ways and Means Subcommittee on Trade held a hearing on the Korea-U.S. (KORUS) Free Trade Agreement (FTA) negotiations. The hearing examined the status of the ongoing negotiations as the completion deadline approaches. The Office of the United State Trade Representative (USTR) has stated that it must submit a completed agreement to Congress for review by March 31 to comply with Presidential Trade Promotion Authority (TPA). U.S. and Korean negotiators concluded an eighth and final round of formal negotiations on March 12 but completed only three of the FTA's chapters. Both parties agreed to address unresolved issues in two rounds of high-level talks during the weeks of March 19 and 26. This report highlights the key points of Subcommittee Members' statements and testimony from witnesses including government officials and private sector representatives from the automotive, agricultural, pharmaceutical and services industries. A full list of witnesses and transcripts of full statements and testimony is available on the Subcommittee's website.²

² <http://waysandmeans.house.gov/hearings.asp?formmode=detail&hearing=542>

Free Trade Agreements Highlights

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

- House Democrats Unveil Trade Compromise on Labor, Environmental Provisions in Pending FTAs
- AUSTR Weisel Discusses Status of Malaysia FTA Negotiations
- U.S.-UAE FTA Negotiations Remain Stalled on Several Key Issues
- House Members Urge USTR to Re-Assess Pharmaceutical IP Provisions in FTAs
- USTR Announces DR-CAFTA Entry Into Force for the Dominican Republic

Multilateral

Multilateral Highlights

We want to alert you to the following Multilateral developments:

- China Terminates Subsidy Program; US Welcomes Announcement But Continues Pressing China on Other Subsidies
- U.S. Will Comply with AB Ruling on Zeroing But Believes DSB Findings are Without Legal Basis

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Reports in Detail

United States

Senate Finance Committee Holds Hearing on 2007 Administration Trade Initiatives

Summary

On March 8, 2007, the Senate Finance Committee held a hearing on the Bush Administration's 2007 trade agenda. Committee Chairman Max Baucus (D-MT) discussed several trade-related issues with the hearing's witnesses, who provided their **on-the-record** testimony on issues such as China, Presidential Trade Promotion Authority (TPA), and the status of ongoing Free Trade Agreement (FTA) negotiations. We review the hearing below.

Analysis

I. Administration Trade Agenda and February 15 Trade Hearing

The March 8th hearing is the second hearing that the Senate Finance Committee has held in the past several months on the Administration's 2007 trade agenda. On February 15, 2007, United States Trade Representative (USTR) Susan Schwab presented the Administration's 2007 trade agenda and discussed those trade issues on which the Administration will focus for the year with the Senate Finance Committee. Those focus issues include: (i) the World Trade Organization (WTO) Doha Round; (ii) TPA; (iii) FTAs; and (iv) trade enforcement and dispute resolution. USTR officially delivered the Administration's "2007 Trade Policy Agenda and 2006 Annual Report" to Congress on March 1, 2007, pursuant to Section 163 of the Trade Act of 1974, as amended (19 U.S.C. § 2213).³

At the February 15th hearing, Chairman Baucus criticized USTR's enforcement of existing trade agreements and noted that concessions from the Administration on FTAs' labor and environmental protections would be a "major factor" in determining whether Congress renews TPA.⁴ Baucus was also

³ The Administration's "2007 Trade Policy Agenda and 2006 Annual Report" is available online at http://www.ustr.gov/assets/Document_Library/Reports_Publications/2007/2007_Trade_Policy_Agenda/asset_upload_file278_10622.pdf.

⁴ TPA is scheduled to expire on June 30, 2007. Under TPA deadlines, the Administration must complete all pending trade negotiations by March 31 in order for Congress to consider those completed FTAs under TPA.

critical of the Administration's lack of consultation with Congress on trade agreements under TPA⁵; he noted that the Administration will have to listen closely to Congressional suggestions and consult closely with the Committee on future trade agreements if it wants to ensure that Congress approves the agreements.

II. March 8th Trade Hearing

The Senate Finance Committee held the March 8th hearing in order to obtain expert witnesses' perspectives on the Administration's 2007 trade agenda. These expert witnesses included former government officials and private sector individuals.

- **Chairman Baucus** noted in his opening remarks that that TPA could expire before he develops legislation renewing "fast-track" authority. He added that the TPA reauthorization process could provide lawmakers the opportunity to draft a "broader bill" that deals with other trade-related issues.
- **Ranking Member Charles Grassley (R-IA)** stated in his opening remarks that the Committee will need to address a number of pressing trade issues in 2007, including the implementation of trade agreements with Peru, Colombia, and Panama, as well as the completion of FTA negotiations with Korea and Malaysia. He also stated that Congress must reauthorize TPA so that the United States "remains a relevant voice at the negotiating table" and so that U.S. trading partners receive assurances through a renewed TPA that the Doha agreement they complete will remain intact once the U.S. Congress considers it. According to Grassley, the United States must also take another look at its unilateral preference programs to determine whether it makes sense to retain or reform the current programs.
- **Lawrence Summers, Charles E. Eliot University Professor, Harvard University**, served as President Bill Clinton's Treasury Secretary from 1999 to 2001. Summers warned lawmakers against introducing legislation aimed at forcing China to revalue its currency and noted that that such legislation could "further unsettle international financial markets." He remarked that forcing China to abandon its fixed exchange rate policy could be counterproductive because foreign-exchange

⁵ Under TPA, implementing legislation of completed trade agreements is sent to Congress for a straight up-or-down vote; prior to this, the Senate Finance and House Ways and Means Committees are given a limited timeframe to review the implementing legislation and suggest amendments to the Administration. However, the Administration is not required to implement Congress' suggestions. The issue reached a boiling point in early 2006 when Democrats on the Senate Finance Committee suggested adding a provision to the Oman FTA that would prohibit trade in goods made with slave labor. The Administration did not add the provision to the final implementing legislation of the Oman FTA and in failing to do so, angered many Democrats.

markets are unstable and noted that Chinese authorities would find it "absolutely unacceptable to change policy based on a threat from the outside." He added that such threats would likely make the Chinese government more defensive and less willing to change its exchange rate policy. Summers feels that the United States would be more likely to succeed in working with China on its currency if it used a multilateral approach and coordinated with Japan and the EU in addressing China's alleged currency misalignment.

- **Fred Smith, Chief Executive Officer, Federal Express**, stated that Congress must renew TPA so that the United States could remain competitive in the global trade environment. He noted that failure to renew TPA would prevent the United States from "reaping the benefits of a comprehensive Doha agreement" and added that the United States also stands to lose trade benefits from future FTAs with Korea and Malaysia if TPA is not extended. Smith stated that the United States could also lose its role as a "leader in world trade" if Congress fails to renew TPA and added that such a move would signal to U.S. trading partners that the United States is not interested in the benefits of liberalized trade.
- **Robert Baugh, Executive Director, Industrial Union Council, American Federation of Labor and Congress of Industrial Organizations (AFL-CIO)**, remarked that "it is time for a fundamental change to U.S. trade policy." He stated that the United States needs global trade rules that link market access to strengthening protection for workers' fundamental human rights and opined that the United States must ensure that the International Labor Organization's core labor standards (*i.e.*, the freedom of association, the right to organize collectively, the right to bargain, and prohibitions on child labor and forced labor) are enforceable requirements under U.S. trade agreements. Baugh added that international environment commitments must be reaffirmed and protected in trade rules as well.
- **Craig Lang, President, Iowa Farm Bureau Federation**, expressed hope that Congress would quickly approve FTAs with Peru, Colombia, and Panama because passage of these agreements would provide benefits to U.S. agricultural producers. Lang stated that Congress must also renew TPA so that U.S. trading partners understand that the United States "is serious about global trade and the Doha Round." He noted that efforts to establish new FTAs would come to a halt without a renewed TPA which in turn would deny U.S. agricultural producers increased global market access for their products.

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Outlook

The March 8th hearing did not provide any groundbreaking news. As evidenced by the witnesses' testimony, the U.S. business community continues to urge Congress to renew TPA and approve the Peru, Colombia, and Panama FTAs. The question is whether this push by U.S. businesses is strong enough to persuade Congress. However, as Chairman Baucus noted in his opening address, legislators may not get around to drafting TPA renewal legislation in time before TPA expires. The threat could prove to be a bluff by the Senator to push USTR to act on Democrats' demands to insert labor provisions in the completed Peru and Panama FTAs. Given the limited amount of time between now and the June 30 expiry of TPA, however, there may indeed be no new TPA legislation, given the numerous other issues – such as Iraq funding resolutions and domestic oversight – that Congress faces between now and end-June. The U.S. business community is likely to increase its TPA-renewal efforts over the next several months in order to get Congress to consider the issue before TPA expires.

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ITC Holds First of Three Hearings on U.S.-China Trade and Investment

Summary

On March 8, 2007, the U.S. International Trade Commission (ITC) held an investigative hearing on U.S.-China trade and investment and the causes of the United States' growing trade deficit with China. The hearing focused on trade and investment trends in Asia and their effect on the bilateral economic relationship. The ITC heard **on-the-record** testimony from a number of witnesses including economists and representatives from U.S. business, industry, and labor groups. The hearing marks the beginning of a six-month investigation the ITC will conduct on Asian trade and investment trends and will conclude with a report to the House Ways and Means Committee in October 2007. The request is part of growing Congressional sentiment that the Administration has been reluctant to take action to address the U.S. trade deficit with China and China's alleged unfair trade practices such as currency manipulation and industrial subsidization.

Analysis

On March 8, 2007, the ITC held a hearing on U.S.-China Trade: Implications of U.S.-Asia Pacific Trade and Investment Trends. The hearing is part of a Section 332⁶ investigation the Commission is conducting at the request of the House Ways and Means Committee to examine causes for the recent growth in U.S.-China trade. In an October 2, 2006, letter to the ITC, the Committee asked that the ITC prepare three reports on various aspects of the U.S.-China trade relationship, including: (i) U.S. trade and investment patterns with the Asia Pacific region; (ii) the driving factors behind the growth U.S.-China trade; and (iii) China's integration with the global economy. The ITC plans to present the first report, "U.S.-Asia-Pacific Trade and Investment Trends and Implications for the U.S.-China Trade Relationship" to the Committee on October 2 and will initiate investigations for the second and third reports in April and October, respectively.

At the March 8 hearing, the ITC heard **on-the-record** testimony from a number of witnesses including economists and representatives from U.S. business, industry and labor groups.

We highlight below the key points of witness testimony.

⁶ Section 332 of the Tariff Act of 1930 mandates the ITC to conduct general fact-finding investigations on any matter involving tariffs or international trade, including conditions of competition between U.S. and foreign industries. Section 332 authorizes the President or the Chairman of either the Senate Finance Committee or the House Ways and Means Committee to request that the ITC conduct these general investigations.

- **John Frisbie, President, U.S.-China Business Council (USCBC)**, stated that the increase in the U.S.-China trade deficit resulted largely from economic integration within Asia. According to Frisbie, East Asian economies such as Hong Kong, Japan, South Korea, Taiwan, and Singapore, which used to supply the U.S. market directly, have shifted investment and production facilities to China. Thus, as U.S. imports of Chinese products (now produced by East Asian firms in China) have increased, imports of products formerly produced in East Asian countries have fallen. This has resulted in an increase in the U.S. trade deficit with China. Frisbie also stated that increased trade with China has benefited U.S. exporters. He noted that China and Hong Kong collectively constitute the United States' third largest export market after Canada and Mexico, and cited a 240 percent growth in U.S. exports to China from 2000 to 2006. He also noted an increase in U.S. investment in China, which has totaled \$4 billion annually since 2001. Frisbie stated that the majority of U.S. companies that invest in China do so to serve the domestic Chinese market, and that a 2006 USCBC membership survey found that only 18 percent of respondents invested in China to re-export products to the U.S. market.⁷
- **Gary Clyde Hufbauer, Senior Fellow, Institute for International Economics**, outlined areas in which he believed the ITC study could provide valuable information to U.S. policy makers. Hufbauer noted that foreign direct investment (FDI) data for countries other than the United States lack accuracy and suggested that the Commission consider compiling improved origin/destination figures for key countries. Given the difficulty of accessing the growing number of free trade agreements (FTAs) in Asia, he also suggested that the Commission consider the effect of regional and bilateral trade agreements on Asian trade and investment patterns. Hufbauer also noted that an examination of real exchange rates on U.S.-China and Asian trade and investment patterns at both aggregate and disaggregate levels (*i.e.*, at the HS 2 or 4 digit level) could also prove useful in the Commission's examination.
- **David Hartquist, Partner, Kelley Drye Collier Shannon, and Counsel to the China Currency Coalition (CCC)**, expressed CCC members' concern over China's deliberate undervaluing of its currency, the renminbi (RMB). Hartquist stated that China's currency policy has led to competitive devaluation among other Asian regional economies, undercutting and skewing free trade. Hartquist

⁷ According to the survey, 57 percent of respondents invested in China to access the domestic market, 22 percent to export to economies other than the United States and 18 percent to re-export to the U.S. market. The results of the survey are available on the USCBC website at:

<http://www.uschina.org/public/documents/2006/08/member-priorities-survey.pdf>

also stated that China's undervalued currency acts as a WTO-prohibited export subsidy that blocks U.S. products from entering the Chinese market. Hartquist criticized the Bush Administration's failure to take "legal action" against China, noting the Office of the United States Trade Representative's (USTR) rejection of three Section 301 petitions⁸ in 2004 and 2005, and the International Monetary Fund's (IMF) and U.S. Department of the Treasury's failure to label China a "currency manipulator." Hartquist expressed the CCC's hope that the ITC investigation would devote "considerable attention" to China's exchange rate misalignment.

- **Brett Gibson, Legislative Representative, AFL-CIO Industrial Union Council**, criticized the Bush Administration's emphasis on engagement with China through the Strategic Economic Dialogue (SED) as "too little, too late." He encouraged the Administration to use instead all available policy tools to address China's currency manipulation. Specifically, Gibson stated that the Administration should expand its economic agenda to include violations of workers' rights and should apply U.S. countervailing duty (CVD) law to non-market economies (NMEs) such as China. He added that Congressional passage of legislation (H.R. 782) sponsored on January 31, 2007, by Reps. Duncan Hunter (R-CA) and Tim Ryan (D-OH) would be a "crucial first step" given the Administration's unwillingness to act.
- **Joseph Fehsenfeld, President, Midwest Printed Circuit Services**, stated that China's undervaluing of its currency has been a major factor in the U.S. printed circuit board (PCB) industry's decline. Fehsenfeld noted that U.S. sales of PCBs have fallen to 10 percent of the global market despite continued growth in global demand. He also stated that the undervalued RMB has sparked competitive currency devaluations among other regional economies including Japan, Malaysia, and Taiwan, which have further hurt the U.S. PCB industry. Moreover, Fehsenfeld stated that many Korean and Taiwanese firms have shifted PCB production to take advantage of China's lax environmental laws. He argued that this constitutes a further unfair cost advantage to these firms.
- **Peter Morici, Professor, University of Maryland**, noted that China's economic growth has benefited from a combination of import substitution and export-led growth. Morici stated that China has exploited its comparative advantage in labor-intensive industries but has also used trade and investment barriers and industrial policy to rapidly develop industries in which it does not have a

⁸ Section 301 of the Trade Act of 1974 requires USTR to initiate retaliatory action against a country found to maintain an act, policy or practice that "violates, or is inconsistent with, the provisions of, or otherwise denies benefits to the United States under, any trade agreement, or is unjustifiable and burdens or restricts United States commerce."

comparative advantage, such as steel and automobiles. In particular, China has undervalued its currency to provide a subsidy to its exports that has increased the U.S. trade deficit with China. Moreover, Morici stated, China's undervaluation has prompted other Asian economies to adopt similar measures to remain competitive, further increasing the total U.S. trade deficit. These deficits shift U.S. jobs away from import-competing and export industries to non-tradable service industries that create less value-added per dollar and spend less research and development per dollar of value added, reducing U.S. economic growth. Morici dismissed arguments against revaluing the renminbi and advocated that the Chinese government allow the currency to appreciate to a level that balances external trade.

- **Barry Solarz, Senior Vice President, Trade and Economic Policy, American Iron and Steel Institute**, stated that China's activities threaten to undermine progress the global steel industry has made towards reducing global overcapacity in recent decades. Solarz noted that in 1980, state-owned enterprises comprised 40 percent of the global steel industry and resulted in excess capacity and a global steel glut. Solarz argued that these unprofitable state-owned industries required massive and costly capital infusions from their government owners and unfairly competed against privately-owned producers in the United States. As a result of governments' eventual privatization of these producers, by the late 1990s the global industry had begun to approach equilibrium and private investment had begun to return. Solarz stated that the Chinese government's involvement in China's domestic steel industry has allowed the industry to produce beyond domestic and global demand and prevents the expansion of U.S. and other steel producers. Solarz added that China's manipulation of its currency allows it to export excess steel cheaply, and that China's provision of subsidies to steel-users has encouraged auto parts and appliance manufacturers to relocate production to China, distorting global trade and investment flows.
- **Alan Price, Partner, Wiley, Rein & Fielding LLP, and Counsel to the Steel Manufacturers Association**, stated that China subsidizes its domestic steel industry and encourages foreign producers to relocate to China to take advantage of these subsidies. According to Price, China provides to steel manufacturers preferential loans from state-owned banks, assistance with energy, raw material and other input costs, and support from local and provincial governments. Chinese steel producers also benefit from lax environmental and labor standards, which constitute further subsidization of the industry. Price argued that these subsidies contribute to the rapid increase in Chinese domestic steel production, which rose from 15 to 35 percent of global production from 2000

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to 2006. Price added that this increase in production has led to an increase in Chinese steel exports to the United States, which has contributed to the growing U.S.-China trade deficit.

Outlook

The House Ways and Means Committee request to the ITC is part of a growing number of Congressional measures aimed at altering the United States' stance on China's economic policies, notably currency and subsidies. Members of the 110th Congress recently submitted two legislative proposals that would target China's alleged currency manipulation. On January 31, 2007, as mentioned above, Reps. Duncan Hunter (R-CA) and Tim Ryan (D-OH) introduced a bill (H.R. 782) that would amend U.S. trade law to allow application of countervailing duties to countries that misalign their currencies. On March 7, Sens. Debbie Stabenow (D-MI) and Jim Bunning (R-KY) introduced a Senate version of the bill (S. 796). Congress has been increasingly critical of what it views as the Administrations' unwillingness to move beyond dialogue in its relations with China. However, the Administration has moved slowly in this direction. On February 2, 2007, USTR requested consultations (DS358) with China at the World Trade Organization (WTO) over nine Chinese subsidy programs that the United States has identified as possibly violating WTO rules. Although China announced on March 8 that it would cancel one of these nine programs, it remains unclear whether the United States and China can resolve their disagreement over the remaining eight programs during the sixty-day consultation period that begins on March 20, or whether the United States will request a WTO panel to rule on the dispute. If the United States requests a panel, it would be the first time China has been involved in a WTO dispute settlement case since joining the organization in December 2001. Although the ITC's investigation could call attention to contentious aspects of the U.S.-China trade relationship, it is unlikely to result in any concrete Congressional action against China. It could, however, provide Members of Congress with justification for future legislation targeting Chinese currency or subsidy policies.

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Ways and Means Trade Subcommittee Holds Hearing on NME Trade Remedies Act of 2007

Summary

On March 15, 2007, the House of Representatives Ways and Means Trade Subcommittee held a hearing on proposed legislation (H.R. 1229) that would direct the Department of Commerce (DOC) to apply U.S. countervailing duty (CVD) law to non-market economies (NMEs) such as China. The bill would also require Congressional approval of any DOC decision to graduate an NME country to “market economy” status and would require the U.S. International Trade Commission (ITC) to prepare an annual report on Chinese government policies that support or influence China’s domestic manufacturing industry. This report highlights the key points of Subcommittee Members’ opening statements and testimony from witnesses including government and private sector representatives from the steel, legal and academic communities. Transcripts of full statements and testimony is available on the Subcommittee’s website.⁹

Analysis

On March 15, the Ways and Means Trade Subcommittee held a hearing on the “Non-market Economy Trade Remedy Act of 2007” (H.R. 1229). The bill, introduced on February 28, 2007 by Reps. Arthur Davis (D-AL) and Phil English (R-PA), would amend Title VII of the Tariff Act of 1930 to allow the application of U.S. countervailing duties laws to NME countries. Pursuant to a longstanding rule, DOC has not applied U.S. CVD law to NME countries since 1984, when it determined that: (i) it lacked statutory authority to do so; and (ii) it could not measure subsidies in NME countries. The bill would also require Congressional passage of a joint resolution to approve any change of a country’s status from “non-market economy” to “market economy.” Under current U.S. law, the Department of Commerce can designate a country as a market economy after conducting an investigation, including formal notice and comment procedures. Finally, the bill would require the ITC to conduct an annual study and prepare a report that would catalogue Chinese government practices and policies that “support and to attempt to influence decision making in China’s manufacturing enterprises and industries.”

During the hearing on the bill, the Subcommittee heard testimony from government and private sector representatives from U.S. steel, legal and academic communities. We summarize below the main points of Subcommittee members’ opening statements and witness testimony.

⁹ <http://waysandmeans.house.gov/hearings.asp?formmode=detail&hearing=537>

- **Subcommittee Chair Rep. Sander Levin (D-MI)** in his opening remarks characterized the U.S.-China bilateral trade relationship as unbalanced and unsustainable. He added that H.R. 1229 would be an important first step toward balancing relations and ensuring China's fulfillment of its World Trade Organization (WTO) accession commitments on eliminating "prohibited" subsidies and providing to WTO Members information about its domestic subsidies programs. Levin noted that because the Department of Commerce did not apply CVD law to NME countries, Congress should ensure its application to these countries "in every case." Levin also criticized the Administration for its failure to take action at the WTO to challenge China's "well-known and documented" subsidies programs. Levin dismissed critics' claims that the bill would constitute Congressional "micro-management" of the Administration and insisted that Congress' role under the bill would be modest.
- **Subcommittee Ranking Member Rep. Wally Herger (R-CA)** stated in his opening remarks that the proposed bill would increase pressure on all NME countries to end illegal subsidies to domestic industries. However, he cautioned fellow Members to consider the balance between the needs of import-sensitive U.S. industries and U.S. industries that rely on imported inputs to maintain their international competitiveness. Herger also cautioned that any U.S. response to NME country subsidies must conform with U.S. law and the United States' international obligations. Herger opined that the bill's lack of provisions to prevent "double counting"¹⁰ domestic subsidies and its requirement that the Department of Commerce use third-country data to determine subsidy levels within China¹¹ could violate U.S. law and international trading rules. Finally, Herger criticized as cumbersome the process by which the bill would require Congress to approve a decision to graduate an NME country to market economy status.
- **Rep. Davis, co-sponsor of H.R. 1229**, stated in his opening remarks that Congress should emphasize enforcement in the ongoing dialogue to build consensus on U.S. trade policy. Davis added that the same rules should apply to all countries. He also criticized China's alleged provision

¹⁰ This refers to a situation in which antidumping duty and countervailing duty cases are brought against China simultaneously, and both investigations include the same subsidies in their respective duty calculations and thereby impose two sets of separate duties for the same subsidy. The WTO Agreement on Subsidies and Countervailing Measures prohibits such "double counting."

¹¹ Section 2(b) of the bill would require the Department of Commerce upon determining that China is an NME country to "presume that special difficulties exist" in calculating the level of subsidies within China during an CVD investigation. The bill therefore requires the Department to "use terms and conditions prevailing outside of China" in calculating these subsidies.

of subsidies to its domestic steel and paper industries as protectionist and defended U.S. actions to ensure a level playing field for its own steel industry.

- **Rep. English, co-sponsor of H.R. 1229**, in his opening remarks urged Members to examine the bill objectively to determine why the bill's provisions constitute good trade policy and will help the overall performance of the U.S. economy. English opined that the bill would give domestic producers and the Administration the necessary tools to address trade practices that erode the global competitiveness of the U.S. manufacturing industry.
- **Rep. Pete Visclosky (D-IN), Chairman of the Congressional Steel Caucus**, criticized the Administration for its overemphasis on dialogue with China and failure to act against China's allegedly illegal domestic subsidies programs. According to Visclosky, these subsidies and the Administration's trade policy have resulted in the loss of three million U.S. jobs since 2000. Visclosky stated that the U.S. steel industry has been especially hard hit, losing 23 percent of its total employment since 2000 and losing 45 companies to bankruptcy since 1997. He opined that the bill would strengthen Congress' ability to influence trade policy and to limit China's ability to pressure the Administration to reclassify China as a market economy.
- **David Spooner, Assistant Secretary of Import Administration, DOC**, recognized that China's provision of subsidies to domestic industries harm U.S. producers and provide an unfair advantage to Chinese exporters to the United States. Spooner stated that the Administration takes a proactive stance in identifying and removing such barriers to U.S. trade with China, and noted the Office of the United States Trade Representative's (USTR) February 2, 2007 request for a WTO dispute settlement consultation (DS358) with China over what USTR claims to be nine cases of WTO-prohibited subsidies.¹² Spooner also reaffirmed the Commerce Department's commitment to "identifying and addressing trade-distortive and injurious subsidies from all countries." He added that the Administration would not hesitate to address illegal subsidies through the application of CVD laws to NME countries, provided that an appropriate set of facts is available and that the Department can formulate a methodology for doing so.

¹² On March 8, 2007, officials from the People's Bank of China, the State Administration of Foreign Exchange, the Ministry of Commerce and the State Administration of Taxation announced the termination of regulations implemented by China's central bank that allowed large exporters to take advantage of discounted loans not available to other companies. The "discounted loans" program was among nine subsidy programs that the United States identified as possibly violating WTO rules; it was also listed in the U.S. WTO request for consultations with China on the subsidy programs. Please refer to our March 21, 2007 alert on China's announcement to terminate one of the contested subsidy programs.

- **John Comrie, Director of Trade Policy and Communications, IPSCO**, stated that because China lacks natural advantages in producing steel, its domestic steel industry has relied on Government subsidization to grow and to unfairly undercut U.S. producers of competing products such as oil country tubular goods (OCTG). Comrie argued that the proposed bill would provide relief to U.S. industries such as steel by ensuring the uniform application of U.S. trade remedy laws to all prohibited subsidies irrespective of the country of origin. Comrie also opined that it would give appropriate weight to Congress' role in determining whether a NME country may be granted market economy status. Finally, Comrie praised the bill's requirement that the ITC prepare an annual catalogue of the Chinese government's use of "unfair and injurious subsidies."
- **David Phelps, Board Member of the Consuming Industries Trade Action Coalition (CITAC)**, noted CITAC's opposition to the proposed bill as it puts at risk U.S. consuming industries and is against the best interests of the U.S. economy. According to Phelps, the bill's lack of guidance to the Commerce Department on calculating subsidies in NME countries would impose an unfair burden on the Department and on consuming industries, which depend on competitively priced imported inputs. Phelps criticized the bill's failure to address or prohibit "double counting" and its requirement for Congressional approval of any change in an NME country's status. He added that the bill's required use of third-country data would not guarantee reliable subsidy calculations because there is no assurance that this data would be more accurate than Chinese data. Phelps also stated CITAC's belief that China's WTO Accession Protocol does not allow the United States to impose CVDs on China while classifying it as a NME country under antidumping rules. Moreover, Phelps argued that U.S. antidumping law provided adequate recourse for U.S. industries that claim injury as a result of Chinese imports.
- **Dr. Usha C. V. Haley, of the University of New Haven**, testified regarding China's "on-the-book" and "off-the-book" subsidies that Haley claims violate China's WTO commitments. According to Haley, China's April 2006 subsidies notification to the WTO remains incomplete and ignores: (i) subsidies to reduce local producers' operation and production costs; (ii) subsidies to the People's Liberation Army; and (iii) subsidies such as commercial bank lending policies and other special financial treatment for domestic producers. Haley stated that these subsidies are difficult to monitor due to the opaqueness and unreliability of official Chinese economic and financial data. She predicted a continuation of illegal subsidies under the "Eleventh Five Year Plan" for 2006 to 2010 and added that because the plan lacks specific numerical targets, these subsidies will remain difficult to identify and monitor. Haley argued that although CVDs under the proposed bill would only address

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some of these subsidies, they are preferable to the trade remedies available to U.S. companies under the U.S. antidumping law.

- **Daniel Porter of Vinson & Elkins, LLP**, argued that Congress lacks the authority to pass legislation that would allow the application of U.S. CVD law to NME countries. He stated that Congressional approval of the Commerce Department's determination of a country's market economy status oversteps Congress' bounds for involvement in routine application of trade remedy law. He added that the bill's requirement to use third-country data violates China's WTO Accession Protocol and contradicts evidence that certain sectors of the Chinese economy operate under market principals and can therefore provide appropriate data for use in subsidy calculation. Porter also criticized the bill's failure to prohibit "double counting" and urged Members to revise the bill's language to prevent its occurrence. Finally, Porter stated that the bill's retroactive application to CVD petitions filed on or after October 1, 2006 was unfair and encouraged Members to revise the bill's language to apply to petitions filed 30 days following legislation's enactment as law.
- **James Hecht of Skadden, Arps, Slate, Meagher & Flom, LLP**, argued that the proposed bill would improve, clarify and expand upon existing U.S. trade remedy laws and dismissed a number of arguments against the application of U.S. CVD law to NME countries. He cited China's April 2006 subsidies notification to the WTO and USTR's February 2007 request for WTO dispute consultations with China as evidence that subsidies in NME countries can be specifically isolated and identified. Hecht dismissed concerns over "double counting" on the grounds that there is no basis to conclude that U.S. antidumping methodology for NME countries remedies domestic subsidies. He also argued in favor of the bill's requirement for Congressional approval of an NME country's reclassification as a market economy. According to Hecht, such oversight would help address Congress' concern regarding a decision that can significantly impact U.S. producers and workers as well as U.S. trade policy.

Outlook

The hearing and proposed legislation underscore a growing impatience among some in Congress for the United States to take a more aggressive position towards China. Members of Congress, including Rep. Levin have become increasingly vocal in their criticism of what they allege is the Bush Administration's unwillingness to move beyond dialogue with China on bilateral economic issues. In particular, Congressional critics have targeted China's alleged currency manipulation and alleged use of WTO-illegal subsidies to domestic industries. Members of both the 109th and 110th Sessions have introduced bills

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that would impose punitive measures such as tariffs on China unless it revalues its currency, the renminbi (RMB). In January 2007, Reps. Duncan Hunter (R-CA) and Tim Ryan (D-OH) introduced a bill (H.R. 782) that would allow the Department of Commerce to apply U.S. countervailing duties to countries that manipulate their currencies, and in March, Sens. Debbie Stabenow (D-MI) and Jim Bunning (R-KY) introduced a Senate version of the bill (S. 796).

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GAO Issues Report on WTO Doha Negotiations: Key Decisions in Congress Likely to Affect Outcome

Summary

On March 5, 2007, the Government Accountability Office (GAO) issued a report on the status of World Trade Organization (WTO) Doha Round negotiations. GAO's study assesses the current status of negotiations and developments since the talks' July 2006 breakdown, the divisive issues among WTO Members, and the possible consequences of another collapse to the Doha Round. According to the report, agriculture and development are the main issues of contention among WTO Members, specifically regarding agricultural tariffs and subsidies and market liberalization. The report states that with these issues at the forefront of the negotiations, the U.S. Congress has the ability to "make or break" negotiations with its decisions on Presidential Trade Promotion Authority (TPA) and the U.S. Farm Bill, both set to expire in 2007. The report concludes that because the United States is a major player in the global trade arena, Congress's policy implementations are likely to determine Doha's fate. Although WTO Members debate the impact of a possible failure in the Doha Round, some argue that it could have serious implications for the WTO and the future of global trade.

The full GAO report is available at <http://www.gao.gov/cgi-bin/getrpt?GAO-07-379>.

Analysis

I. Background

In November 2001, the Doha Round of WTO trade negotiations began with the specific purpose of addressing the needs of developing nations in the global trade sphere. The Doha Development Agenda included discussion of the highly controversial topics of agriculture and economic development—issues that roused intense debate but resulted in little consensus among WTO Members. At the 2005 WTO Hong Kong Ministerial Conference, Members could only agree on specific, narrowly focused deadlines and initiatives but made some, albeit marginal, progress. Members agreed to eliminate all agricultural subsidies by 2013, to extend duty-free and quota-free access to developed countries from least-developed countries, to reach a set of benchmarks and deadlines for subsidy decreases, and to end the round in 2006. Consequently, the most contentious issues were left to be resolved in 2006. A subsequent impasse in agricultural negotiations, however, caused WTO Director-General Pascal Lamy to suspend talks indefinitely on July 24, 2006. During the next several months, WTO members conducted

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informal meetings and submitted public statements of commitment to Doha, eventually convincing Lamy to resume negotiations in February 2007.

II. Disagreement on Agriculture and Development

According to the GAO study, the United States, the EU, and developing countries disagree on how trade should influence agriculture. The EU and developing countries have asked that the United States cut its government support of agriculture. When the United States proposed a plan to decrease domestic agricultural aid in October 2005, these WTO Members argued that the United States made insufficient cuts and that they provided opportunity for future U.S. increases in aid. On the other hand, the United States, the world's largest exporter of agricultural products, requests that the EU and developing countries open their markets further to compensate for the domestic support reductions they demand.

The GAO study states that the EU and the United States continue to disagree on appropriate agricultural tariff cuts. Although all Members have agreed to cut tariffs in tiers (the higher tiers take higher percentage cuts), they disagree on tier thresholds, percentages to cut, and exemptions. The United States advocates drastic cuts of 55-90 percent, whereas the EU advocates more modest cuts of 35 to 60 percent. The United States also advocates little or no exemptions from tariff reductions for "special" or "sensitive" products, whereas the EU and developing countries propose that certain tariff lines be exempt from cuts.

The GAO report also notes that WTO Members have differing opinions and expectations regarding economic development. According to the study, the intent of the Doha "development round" is to ensure that developing countries benefit from trade, but Members have varied philosophies concerning how to achieve this goal. According to the report, the United States strongly advocates trade liberalization across the board, but many developing countries are wary of open markets and the threats that they might pose to domestic economies.

Though developing countries have assorted economic interests, they have acted together during the Doha negotiations as a collective voice representing the majority of WTO Member countries and a growing force in the global market. Among their shared beliefs are: (i) that agriculture be the first topic of negotiation; (ii) that trade-limiting subsidies be decreased; and (iii) that the least-developed countries (LDCs) receive "duty-free, quota free access" to markets. Several countries see significant potential economic gains from a Doha agreement, yet many LDCs, including a number of Sub-Saharan African countries, could lose. More-developed developing countries like India and Brazil, which have large

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projected economic gains from Doha, have acted as advocates for these LDCs to ensure that their voices are not overshadowed by developed countries in the discussion.

III. Implications of Doha's Impasse

The report states that opinions vary as to what the implications of Doha's impasse will be. Some trade analysts argue that Doha will have limited impact because economic gains would be limited anyway. Others argue that failure would cause lost economic opportunities and would be detrimental to the WTO's position in the global market. Although Members could achieve some of Doha's economic gains on the bilateral or regional level, this result would require extensive legislation and could complicate global trade.

Many Members emphasize the importance of Doha as a venue for eliminating the remaining barriers to trade. As there have been significant steps to reduce barriers in agriculture, proponents of Doha argue that further discussion could have the same effect in other industries. Some argue, however, that the United States' July offer was a "bad deal" and that "accepting an agreement simply for the sake of agreeing" could have negative impacts on the world economy. Instead, these participants advocate further negotiation to ensure the best possible economic outcomes for all parties involved. Although several countries wait for an agreement they deem acceptable, Doha enthusiasts warn that added delay could undermine the WTO's role in trade development, causing Member countries lose faith in multilateral negotiation.

IV. Congress's Role in the Doha Round

According to the GAO study, in the first half of 2007, Congress will address the impending expiry of TPA and the Farm Bill. The GAO study states that these two policies have serious implications for the United States and the entire global trade network. TPA grants the Administration with the authority to negotiate trade agreements that are then subject only to an up-or-down vote in Congress. This expedited negotiation process facilitates agreement and is therefore vital for a Doha conclusion. The GAO study concludes that if Congress does not renew TPA this year, it will essentially halt U.S. and multilateral trade developments indefinitely.

The report also notes that many countries consider movement on the U.S. Farm Bill decision as an indicator of Doha's future viability. The Farm Bill outlines U.S. domestic agricultural assistance and could face extensive modification if it is renewed. Proponents of the Farm Bill's modification argue that the United States must decrease subsidies in order to comply with current and potential WTO restrictions. The report states that this would also serve as a symbol of U.S. commitment to the WTO that could very well influence a Doha agreement. Those who are in favor of renewing the bill without modifications argue

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that the current Farm Bill has benefited farmers and the domestic agriculture industry and that the bill's revision is useless without knowing future WTO restrictions. The report notes that because government agricultural support remains a primary issue of contention among WTO members, the fate of the Farm Bill could resolve the Doha debate.

Outlook

The GAO report concludes that the future of Doha is tenuous for political and practical reasons. Agricultural trade remains a sensitive issue as worldwide changes to the industry would have domestic political and cultural implications for each WTO Member. In many developed countries, agribusiness has tremendous political clout and popular support. Developed countries have also constructed complex systems of support, restrictions, and subsidies that have kept their agricultural sector competitive. Most of these countries are hesitant to concede their country's place in the global market to foreign competition. Developing countries, however, have a greater influence at the WTO than ever before and thus have the negotiating power to push for an agreement on their terms. Unlike previous multilateral agreements, the Doha round requires *all* countries, developed and undeveloped, to evaluate the risk of liberalizing their economies and losing market-share. If countries cannot reach consensus, the Doha round will fail. If there is no Doha agreement, future trade negotiation will most likely occur on a regional or bilateral level. Since the suspension of talks in 2006, an influx of bilateral and regional agreements has already occurred. This trend will most likely continue as multilateral agreement becomes less likely.

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United States Highlights

U.S. Legislators Introduce Several China-Related Bills

Lawmakers introduced two bills the week of February 26, 2007, concerning trade with China. One bill (H.R. 782) is a retaliatory effort to stem currency manipulation in China and other countries. The other bill, the Nonmarket Economy Trade Remedy Act of 2007 (H.R. 1229), would make U.S. countervailing duty law applicable to all non-market economies (NMEs), including China. On March 7, 2007, Senators Jim Bunning (R-KY) and Debbie Stabenow (D-MI) introduced S. 796, the Senate version of H.R. 782.

On February 28, 2007, Representatives Tim Ryan (D-OH) and Duncan Hunter (R-CA) reintroduced a revised version of their bill (H.R. 782) regarding China's currency manipulation. This legislation provides that any country misaligning its currency is subject to countervailing duties under U.S. trade law because it is granting an "illegal export subsidy." Under current U.S. law, imports from China and other NMEs are not subject to countervailing duties. The bill also amends and clarifies existing legislation regarding international monetary and fiscal policy. One amendment, modifying the Bilateral Agreement section of the Exchange Rates and Economic Policy Coordination Act of 1988, provides that the Secretary of the Treasury shall, in conjunction with the International Monetary Fund, analyze foreign exchange rates annually for exchange rate manipulation. If there is reason to believe a country is manipulating its exchange rate, the Secretary of the Treasury shall start negotiations unless it is a threat to the U.S. economy or security. On March 7, 2007, Sens. Bunning and Stabenow introduced S. 796, the Senate version of H.R. 782. S. 796 contains the same provisions as H.R. 782 and its co-sponsors include Sens. Evan Bayh (D-IN), Olympia Snowe (R-ME), Carl Levin (D-MI), and Robert Casey (D-PA).

On March 1, 2007, Representatives Artur Davis (D-AL) and Phil English (R-PA) introduced a bill that would require the Department of Commerce (DOC) to conduct countervailing duty investigations against NMEs and to use World Trade Organization-approved "alternate methodologies" to calculate countervailing duties. The bill also provides that the DOC would need Congressional approval to graduate a country from NME status to market economy status. Regarding China, the bill requires the U.S. International Trade Commission (ITC) to conduct a study on and publish a report of the Chinese government's intervention in investment, employment, and export activities. The ITC would update the House Ways and Means Committee and the Senate Finance Committee on its findings, and the report would be available to the public.

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The new wave of trade legislation demonstrates a bipartisan effort in Congress to assuage the negative domestic impacts of increased trade with China. Members of Congress are likely to continue their focus on China, given the United States' move away from "quiet diplomacy" and towards direct confrontation, evident in the recent China subsidies case the United States launched at the World Trade Organization. These bills indicate the willingness of some legislators to engage in this confrontation. The Bush Administration's numerous attempts to convince China to adopt a flexible exchange rate have produced few results, and Secretary of the Treasury Henry Paulson is currently in China for talks on this topic for the third time in less than a year. These bills are examples of the increasing pressure that the Administration is under to negotiate an end to China's alleged currency controls.

WITA Hosts Briefing on 2007 Trade Prospects with Under Secretary of Commerce Frank Lavin

On February 28, 2007, the Washington International Trade Association (WITA) held a discussion with Under Secretary of Commerce for International Trade Franklin Lavin. Under Secretary Lavin provided his analysis of the Bush Administration's 2007 trade agenda and stated that the Administration's 2007 trade agenda is an "aggressive yet realistic agenda" that would focus on five key areas: (i) Free Trade Agreements (FTAs); (ii) the World Trade Organization's (WTO) Doha Round; (iii) Presidential Trade Promotion Authority (TPA); (iv) trade enforcement; and (v) increased market access.

- **FTAs.** Under Secretary Lavin stated that bilateral trade agreements offer the United States enhanced economic opportunities. He noted that the Administration is urging Congress to approve the completed Peru and Colombia FTAs and opined that Congress would likely focus on those two agreements before considering the Panama FTA. He stated that consideration of these FTAs will serve as a test for the Administration: can the Bush Administration reach out to a new Congress and work with Democratic leadership in a bipartisan manner to approve these agreements? He added, however, the FTA consideration would also test Congress' Democratic leadership and its ability to collaborate with the Administration on economically significant agreements.
- **WTO Doha Round.** Under Secretary Lavin stated that the economic benefits stemming from a comprehensive Doha agreement are significantly greater than economic benefits stemming from individual FTAs. He opined, however, that WTO Members would experience a "slow grind" in reaching a comprehensive conclusion to the round and in attempting to work through contentious issues in agriculture and non-agricultural market access (NAMA). Under Secretary Lavin indicated

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that WTO Members are “engaged in a more constructive dialogue now” than they were several months ago but added that Members still have a lot of work ahead of them.

- **TPA.** Under Secretary Lavin noted that the Administration has already asked Congress to renew TPA for the President. He opined that TPA is necessary in order for the United States to “maintain its ambitious trade agenda and keep growth on track.”
- **Trade Enforcement.** Under Secretary Lavin noted that the Department of Commerce (DOC) would continue to strengthen and enhance its trade enforcement throughout 2007. He noted that the results of the case involving the application of countervailing duty law to imports of coated free-sheet paper from China would “be interesting for the U.S.-China trade relationship.”
- **Market Access.** Under Secretary Lavin noted that DOC would also continue its work in increasing market access in several different economies, notably in India, Brazil, the EU, and China. He stated that DOC would also focus on intellectual property rights enforcement and monitoring in 2007 as well as the elimination of trade barriers and the facilitation of customs procedures with U.S. trading partners.

Under Secretary Lavin's discussion of the Administration's trade agenda mirrors the briefing United States Trade Representative Susan Schwab provided to members of Congress during several hearings in February. Lavin's comments made it clear that the Administration is intent on seeing Congress approve the FTAs with Peru, Colombia, and Panama as soon as possible. There will likely be increased activity on these three agreements – as well as the Doha Round – over the next several months. It remains to be seen, however, whether Congress' Democratic leadership will share the Administration's enthusiasm for the Peru and Colombia FTAs and TPA renewal. Democrats have called for improvements to the labor and environmental provisions of the Peru and Colombia agreements as well as for TPA, thus making it unclear if, when, and how Congress will consider these FTAs and TPA renewal.

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Free Trade Agreements

U.S. and Korean Negotiators Make Some Progress in Eighth Round; Key Issues Remain Unresolved as March Deadline Approaches

Summary

On March 8-12, 2007, U.S. and Korean negotiators held the eighth and final round of formal negotiations on the U.S.-Korea (KORUS) Free Trade Agreement (FTA). The talks achieved agreements for three of the FTA's chapters and neared agreement on seven other chapters. However, the negotiators' failure to resolve long-standing differences on agriculture, automobiles, trade remedies and other contentious issues prevented them from reaching a comprehensive agreement on all chapters. Despite setbacks in talks on these issues, however, both sides remain optimistic that they can complete the FTA by the end of March, when the Office of the United States Trade Representative (USTR) has indicated that it must submit the agreement's text to Congress. Negotiators are addressing the outstanding issues in last-minute, high-level talks that began on March 19 in Washington and Seoul. Neither side has ruled out the possibility of a second round of high-level talks before March 31. With less than two weeks remaining before the deadline, failure to resolve these issues in the talks would likely result in the agreement's collapse.

Outlook

Political will on the part of negotiators and both countries' governments remains high. Both AUSTR Cutler and Choi Seok Young, Minister for Economic Affairs Trade and the Korean Embassy in Washington recently expressed their belief that a final agreement was possible by the end of March 2007. For both parties then, the key to concluding a successful agreement will be to craft during the late-March talks a compromise on the remaining sensitive issues—notably automobiles and agriculture—that both countries' legislatures can accept. Although an impasse remains over trade remedies, it does not appear that failure to reach agreement on this issue will result in a failure to achieve the KORUS FTA. On the U.S. side, many Members of Congress remain concerned that the agreement will not grant what they consider adequate market access to U.S. automobile and beef exports. During a March 20 House Ways and Means Trade Subcommittee Hearing, Subcommittee Chair Sander Levin (D-MI) and a number of other Subcommittee members cautioned Deputy USTR Karan Bhatia that they would not lend their support to any agreement that did not adequately address these sectors. USTR's failure to assuage these concerns will make the agreement's passage in Congress difficult. On the Korean side, rice is

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unquestionably the most sensitive issue, and any agreement that includes rice is unlikely to pass Korea's legislature, the National Assembly. Thus, despite negotiators' public confirmation that an agreement is still possible, it is uncertain whether they can balance one another's demands with domestic political interests. However, given continued strong support from both countries' business communities and the agreement's likely economic gains to both parties, should they conclude an agreement before USTR's March 31 deadline, domestic political opposition is unlikely enough to stop the FTA's passage and eventual implementation.

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Ways and Means Trade Subcommittee Holds Hearing on KORUS FTA

Summary

On March 20, 2007, the House of Representatives Ways and Means Subcommittee on Trade held a hearing on the Korea-U.S. (KORUS) Free Trade Agreement (FTA) negotiations. The hearing examined the status of the ongoing negotiations as the completion deadline approaches. The Office of the United State Trade Representative (USTR) has stated that it must submit a completed agreement to Congress for review by March 31 to comply with Presidential Trade Promotion Authority (TPA). U.S. and Korean negotiators concluded an eighth and final round of formal negotiations on March 12 but completed only three of the FTA's chapters. Both parties agreed to address unresolved issues in two rounds of high-level talks during the weeks of March 19 and 26. This report highlights the key points of Subcommittee Members' statements and testimony from witnesses including government officials and private sector representatives from the automotive, agricultural, pharmaceutical and services industries. A full list of witnesses and transcripts of full statements and testimony is available on the Subcommittee's website.¹³

Analysis

On March 20, the House Ways and Means Trade Subcommittee convened a hearing on the KORUS FTA. Subcommittee Chairman Sander Levin (D-MI) called for the hearing on March 13 to examine the status of trade negotiations between the United States and Korea as the agreement's completion deadline approaches. USTR has stated that it must submit a completed agreement to Congress for review by March 31 to comply with TPA. U.S. and Korean negotiators completed the eighth and final formal round of negotiations on March 12 but were unable to conclude all of the FTA's chapters. Following the round's conclusion, both parties agreed to elevate the talks to a higher level to discuss remaining issues including agriculture, automobiles, textiles and trade remedies. The United States and Korea held a first round of high-level talks concurrently in Washington and Seoul from March 19 to 23 but were unable to conclude any additional chapters. Negotiators scheduled a second round of high-level talks in Seoul the week of March 26, during which they hope to produce a final text on the agreement's remaining chapters.

In his opening remarks at the March 20 hearing, **Rep. Levin (D-MI)** labeled the FTA with Korea a "key test of the approach [the United States] takes to trade policy." Levin called on USTR to shift to a "active approach" in its negotiations with Korea to address Korea's non-tariff barriers on industrial products and

¹³ <http://waysandmeans.house.gov/hearings.asp?formmode=detail&hearing=542>

especially on automobiles. **Subcommittee Ranking Member Wally Herger (R-CA)** stated that although rice must remain on the negotiating table and Korea must reopen its market to U.S. beef, USTR should reject any trade-off between these two issues. Herger also called on USTR to ensure that the FTA includes a dispute settlement mechanism on investment and “takes the right approach” to securing access to and ensuring transparency in Korea’s domestic automobile market.

The Subcommittee heard testimony from **Deputy USTR Karan K. Bhatia**. Bhatia provided the Subcommittee with an overview of the KORUS FTA’s benefits and importance to the United States and updated Members on the negotiation’s status. Bhatia stated that the agreement would allow the two countries to increase their bilateral trade, which currently totals \$78 billion. He noted that several studies estimate potential income gains for the United States as a result of the FTA to range from \$17 to \$43 billion. Bhatia underscored the agreement’s importance by noting that it would provide a “unique preferential advantage” to U.S. firms to secure access to the Korean market at a time when U.S. competitors are seeking to do the same.

Regarding the status of negotiations, Bhatia stated that the eighth round made good progress and highlighted negotiators’ completion of chapters on competition, customs and government procurement. He acknowledged that a number of “significant issues” remain unresolved but expressed hope that USTR would be able to close these issues by the end of March in order to notify Congress of its intent to sign the FTA according to TPA’s 90-day timeframe. He stated that a successful agreement would include “strong enforceable commitments,” strong market access packages for agricultural and industrial goods, and strong chapters on investment, labor and the environment and services.

Following Bhatia’s remarks, Rep. Levin opined that USTR should make Congress an “active, meaningful partner” in trade negotiations and warned Bhatia that any agreement that did not meet Congress’ concerns would risk failure. Rep. Herger emphasized that the FTA must include “provisions on rice” but did not offer further details regarding the issue. **Rep. John B. Larson (D-CT)** asked Bhatia if the agreement would include at a minimum the provisions included in Congress’ March 1 bipartisan proposal to President Bush on opening Korea’s automobile market.¹⁴ Bhatia responded that USTR had “reflected carefully” on the proposal and would push hard to include certain elements of the proposal such as the elimination of non-tariff barriers. However, Bhatia questioned whether other conditions of the proposal

¹⁴ The Proposal would phase out the 2.5 percent U.S. tariff on automobile imports over a minimum of 15 years and would threaten sudden reapplication of the full tariff if the United States determines a “significant” increase in Korea automobile imports. The Proposal would also require Korea to agree to the elimination of specified NTBs and would allow the United States to take “immediate, unilateral compensatory action to counter any future barrier.”

were the most effective means of addressing market access restrictions. In response to questions from **Reps. Bill Pascrell Jr. (D-NJ)** and **Kendrick Meek (D-FL)**, Bhatia assured Subcommittee members that USTR considered pharmaceuticals and telecommunications high priority issues.

The Subcommittee also heard testimony from three representatives of the U.S. automotive industry, all of whom expressed their organizations' support for free trade but underscored the need to ensure that the Korea FTA achieve market access gains for U.S. and other foreign automobile producers. **Stephen E. Biegun, Ford Motor Company's Vice President of International Governmental Affairs**, stated that although Korea's tax and tariff structure limit imports of foreign automobiles to Korea, the country's system of non-tariff barriers (NTBs) was the main barrier to imports. Biegun urged the Subcommittee to consider the recent bipartisan proposal to President Bush that would provide market access for U.S. automobiles and urged Members not to approve any agreement that could not guarantee such access. **Stephen J. Collins, Automotive Trade Policy Council President**, also described a number of tariff, tax and non-tariff barriers that restrict U.S. and other foreign automobile producers' access to the Korean market. Collins opined that because two past bilateral agreements on automobiles¹⁵ had failed to address Korea's use of these such measures, an FTA with Korea must recognize this failure to ensure that Korea meets any obligations it makes under the FTA. **Alan Reuther, Legislative Director for the United Automobile, Aerospace and Agricultural Implement Workers of America (UAW)** noted that the U.S. automotive trade deficit with Korea reached \$11.6 billion in 2006 and cited Korea's maintenance of tariff and non-tariff barriers as the primary cause of the deficit. Reuther urged Congress to establish concrete market access benchmarks that Korea must meet before the United States grants further market access through the FTA. He noted UAW's disappointment with USTR's rejection of the bipartisan proposal to open Korea's market and encouraged Congress to reject any FTA that did not meet the proposal's minimum requirements.

On agriculture, **Bob Stallman, American Farm Bureau President**, stated that although Korea remained an important export market for U.S. agricultural products, U.S. market share in Korea has fallen in recent years¹⁶ due to competition from Australia, China and other regional agricultural exporters. He identified Korea's high tariffs, internal supports, tariff rate quotas (TRQs) and sanitary and phytosanitary (SPS)

¹⁵ The United States and Korea signed two Memoranda of Understanding (MOU) in 1995 and 1998, respectively. Under these MOUs, the Korean government agreed to implement a number of measures to improve market access for U.S. and other foreign automobile imports.

¹⁶ According to Stallman, the United States exported to Korea an annual average of \$2.6 billion in agricultural products from 2000 to 2004, however, U.S. market share fell from 45 percent in 1996 to 30 percent in 2004

issues as concerns of the U.S. agricultural community, but ultimately emphasized the Farm Bureau's support for the FTA. Stallman noted, however, that the organization would not support the FTA's passage without resolution of Korea's market closure to U.S. beef. **J. Patrick Boyle, President and CEO of the American Meat Institute (AMI)**, noted that prior to Korea's 2003 ban on U.S. beef imports, Korea had been the third largest global market for the U.S. beef industry. He also noted that the World Organization for Animal Health's (OIE) recent preliminary designation of the United States as a "controlled risk" country and criticized South Korea's continued ban on U.S. beef imports despite "overwhelming" scientific evidence suggesting that U.S. beef is safe. Boyle urged Congress to secure a resumption of beef exports to Korea prior to concluding the FTA and added that AMI would fully support such an agreement.

On pharmaceuticals, **Geralyn S. Ritter, Senior Vice President for International Affairs for the Pharmaceutical Research and Manufacturers of America (PhRMA)**, stated that although the FTA could provide substantial benefits to both the U.S. pharmaceutical industry and Korean patients, PhRMA remains concerned with certain aspects of the FTA's chapters on Pharmaceuticals and Intellectual Property. She cited the lack of transparency and an appeals mechanism in Korea's December 2006 revised pharmaceutical reimbursement system and the FTA's provisions on data exclusivity and patent linkage as specific concerns. Ritter stated her organization's hope that the FTA address these long-standing concerns in a "commercially meaningful way"

On services, **Bob Vastine, President of the Coalition of Services Industries (CSI)**, noted that U.S. cross border services exports to Korea in 2005 totaled \$10.2 billion, and sales of services by U.S. affiliates in Korea totaled \$4.3 billion in 2004. He welcomed the "substantial" progress negotiators had made in the FTA's services provisions including those for financial services and insurance. However, Vastine also highlighted restrictions that remain in other services sectors including audio visual services, electronic commerce, express delivery services and telecommunications.

The Subcommittee also heard testimony from **Tami Overby, President and CEO of the American Chamber of Commerce in Korea**. Overby noted that the Chamber's member organizations strongly support a comprehensive and WTO-consistent FTA with Korea. She urged Congress and USTR to ensure that the FTA eliminates tariff and non-tariff barriers "as rapidly as possible" and expressed hope that such an agreement could serve as a model for future U.S. FTAs. Overby also identified a number of the negotiations' outstanding priority issues such as beef and automobile market access, Korea's pharmaceutical reimbursement system, and investment issues such as investment protection, investor-state dispute settlement procedures and investment caps. She warned that failure to conclude the FTA

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with Korea could lead to a loss in U.S. businesses' share of the Korean market as Korea signs additional FTAs with other countries.

Outlook

Given that the hearing followed closely the start of last minute, high-level talks between U.S. and South Korean negotiators in Washington, the hearing's outcome will likely prove more symbolic than substantive. The hearing allowed Congress to send a message to negotiators that it would not accept an agreement that is non-comprehensive and does not address Congressional concern on sensitive issues such as agriculture, automobiles, pharmaceuticals and services. It also allowed Members of Congress to demonstrate publicly their seriousness in standing up for issues of importance to their constituents. However, the hearing is unlikely to affect the outcome of negotiations, which negotiators must complete by March 31. There simply is not enough time for it to do so. Moreover, despite Subcommittee Members' warnings and witnesses' insistence that the agreement address all issues of concern or risk failure, Congress would not likely reject an agreement should negotiators be able to conclude negotiations before the March 31 deadline even if the agreement does not meet Congressional expectations. Assistant USTR Wendy Cutler has already indicated that compromise in some areas will likely be necessary to reach a final agreement, and that the agreement therefore could disappoint some domestic groups from both countries. However, given the U.S. business community's continued overall support for the FTA, Congress will likely pass a completed agreement.

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Free Trade Agreements Highlights

House Democrats Unveil Trade Compromise on Labor, Environmental Provisions in Pending FTAs

On March 27, 2007, House Democrats, led by House Ways and Means Committee Chairman Charles Rangel (D-NY), unveiled a new trade policy agenda that they believe could serve as the basis for a final compromise on labor and environmental provisions in pending Free Trade Agreements (FTAs) with Peru, Colombia and Panama. Congressional sources also opine that the new trade agenda could provide for a possible extension of Presidential Trade Promotion Authority (TPA), set to expire on June 30, 2007. Chairman Rangel presented the plan to the House Democratic Caucus on March 27; the Caucus endorsed the plan and gave Rangel the authority to negotiate with the Administration new language on TPA and four outstanding FTAs: the U.S.-Peru FTA, U.S.-Colombia FTA, U.S.-Panama FTA and the U.S.-South Korea (KORUS) FTA. (The KORUS FTA must be completed by March 31, 2007.) House Democrats have not yet made the plan public.

According to Congressional sources, the plan focuses on labor and environmental provisions, pharmaceuticals, investment, port operations, WTO dispute settlement, and the Andean Trade and Drug Eradication Act (ATPDEA):

- **Labor.** Core International Labor Organization (ILO) standards should be included in FTAs, and violations of these standards should be enforceable. According to House Ways and Means Trade Subcommittee Chairman Sander Levin (D-MI), the Peru and Colombia FTAs would have to be amended in order to incorporate these new provisions. The Bush Administration has expressed a desire to incorporate Democrats' suggestions to the labor provisions to the FTAs through side-letters as opposed to re-opening the agreements.
- **Environment.** The Democratic plan calls on U.S. FTA partners to implement and enforce common multilateral environmental agreements and, in the case of Peru, adopt and enforce laws on logging mahogany.
- **Pharmaceuticals.** The plan encourages pharmaceutical innovation in developing countries.
- **Investment.** The plan states that FTAs should give foreign investors "no greater rights" than are available to U.S. investors in the United States.
- **Port Operations.** The proposal also includes steps to protect port operations at U.S. ports.

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- **WTO Dispute Settlement.** The plan calls for the creation of a new U.S. trade enforcement office that would prepare World Trade Organization (WTO) cases.
- **ATPDEA.** The Democratic plan calls for the renewal of the ATPDEA, set to expire on June 30.

Chairman Rangel opined that House Democrats could reach a final agreement on the plan with House Republicans and the Administration by the end of the week. TPA dictates that the Administration must complete all pending FTA negotiations and notify to Congress its intent to sign these agreement by March 31. House Democrats, however, have stated that they might allow the Administration to make the final notifications on that day even if the FTAs' final language is not ready.

Response to the plan has been positive. United States Trade Representative Susan Schwab stated that the Democratic plan was "another step in what has been a good faith effort in a continuing dialogue by all sides." Senate Finance Committee Chairman Max Baucus (D-MT) commended Chairman Rangel for his work and opined that the proposed framework "forms a basis on which [the Administration and Congress] can all agree." House Ways and Means Ranking Member Jim McCrery (R-LA) opined that the Democratic proposal was "positive [and] credible" and Trade Subcommittee Ranking Member Wally Herger (R-CA) stated that the plan "goes a long way towards reaching a shared goal." House Republicans also believe that a compromise on the FTAs could pave the way for TPA extension, but House Democrats were quick to temper any positive forecasts. Rep. Levin stated that legislators "need to get the trade policy right before we can talk about TPA."

The Democratic plan comes after weeks of stop-and-go negotiations on labor provisions in pending FTAs between Congressional Democrats and the Administration. At the start of the 110th Congress in January 2007, Democrats noted that they would closely scrutinize U.S. FTAs, with a focus on labor and environmental provisions. The completed Peru, Colombia and Panama FTAs were the first bilateral agreements to face this added scrutiny. House Democrats have assured the Administration that the plan is not a "make-or-break" deal, but given the Democratic majority in Congress, the Administration will likely have to accept the plan's key principals and implement at least some suggested changes quickly if it wants to ensure passage of pending FTAs and TPA renewal.

U.S.-UAE FTA Negotiations Remain Stalled on Several Key Issues

On March 11, 2007, U.S. Commerce Under Secretary for International Trade Franklin Lavin announced that free trade agreement (FTA) negotiations between the United States and the United Arab Emirates (UAE) are stalled and that both sides will continue informal discussions to reach a comprehensive

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bilateral agreement in the future. Officials from both sides had been working to complete the FTA before March 31, 2007, so that Congress could consider the FTA under Presidential Trade Promotion Authority (TPA). Under TPA, the Administration must complete any pending FTA negotiations by March 31 so that Congress can provide a simple “up-or-down” vote on the agreement. TPA is scheduled to expire on June 30, 2007, and Congress has begun exploring possibly renewing the “fast-track” authority.

Lavin stated that there is “a pause in negotiations” and that negotiators from both sides are using the pause as “a stock-taking moment.” He added that the FTA discussions will continue on an informal basis but that there is no formal negotiating round planned for the moment. The last formal negotiating round occurred in mid-February in London; Lavin noted that in that round, the two sides could not progress past several contentious issues, including U.S. demands for UAE labor market reforms and opening of the services sector. According to Lavin, the United States is also pressing the UAE to change its Companies Law to allow 100 percent foreign ownership across the whole country.

The Office of the United States Trade Representative (USTR) has not yet announced that the FTA negotiations with the UAE have been suspended. Given the number of contentious issues remaining on the negotiating table, however, it seems unlikely that the two sides can complete a comprehensive agreement by March 31. Analysts had earlier predicted that the U.S.-UAE FTA would be one of the agreements the United States would complete before TPA expiry, given that the UAE is a smaller economy than other pending trade partners – namely South Korea and Malaysia – and given that USTR would use the recently-completed Bahrain and Oman FTAs as a template for the UAE agreement. The United States and the UAE postponed FTA negotiations in March 2006 due to the U.S. Congress’ opposition to the sale of U.S. port operation rights to Dubai Ports World – a UAE-owned port management company.

The United States views trade with the UAE as an important component of the Bush Administration’s U.S.-Middle Eastern Free Trade Area initiative, which it hopes to establish by 2013. That was one reason the United States returned to the negotiating table in 2006. In addition, the UAE’s role in the Middle East as a financial and services hub also likely motivated the United States to return to the negotiating table. These factors, however, may not have been enough to complete negotiations by March 31.

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House Members Urge USTR to Re-Assess Pharmaceutical IP Provisions in FTAs

In a March 12, 2007 letter to United States Trade Representative (USTR) Susan Schwab, a group of Democratic House Members urged USTR to reexamine the pharmaceutical and intellectual property (IP) provisions of the completed Peru, Colombia, and Panama Free Trade Agreements (FTAs) and in pending agreements with Thailand, Malaysia and others. The legislators – led by Reps. Henry Waxman (CA) and Jim McDermott (WA) – state that recent U.S. FTAs appear to undermine U.S. commitments to the World Trade Organization's (WTO) Trade-Related Aspects of Intellectual Property (TRIPs) Agreement, and that the bilateral agreements also “upset an important balance between innovation and access by elevating intellectual property at the expense of public health,” thus resulting in a restriction for poor countries to affordable and necessary generic medicines.

The Members note that the majority of people killed by treatable infectious diseases live in the developing world and lack access to essential medicines that fight these diseases. Thus, it is necessary to expand access to affordable drugs in the developing world. The Members also note that the United States is a signatory to the 2001 “Doha Declaration” on TRIPs and public health - a declaration that reaffirms the rights of WTO Members to use the TRIPs Agreement's provisions to protect public health. The Representatives believe that recent completed and pending FTAs undermine this commitment in several areas:

- **Data exclusivity.** The letter notes that under WTO rules, pharmaceutical innovations receive 20 years of patent protection, and that recent U.S. FTAs have added a period of “data exclusivity” that begins when the patented drug is approved. The Members believe that this “data exclusivity” period delays the availability of generic versions of the patented drug because regulators cannot use the patented drug's clinical test data during this period when considering market approval for generic versions. The Members also note that recent FTAs lack a cap on data exclusivity periods, and that U.S. negotiators can use this to urge developing countries to adopt longer data exclusivity periods which in turn delays the creation of a generic version of the patented drug. The Members believe that data exclusivity periods inhibit the developing country citizens' access to affordable generic drugs.
- **Patent extensions.** The Members note that U.S. law grants patent extensions where delays exist in patent reviews or in the market approval of a drug. According to the letter, the United States requires its FTA partners to provide such extensions without any limitation to their number or duration. The

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Members believe that patent extension could also delay the creation and approval of an affordable generic version of the patented drug.

- **Compulsory licensing.** The letter states the Doha Declaration affirmed the TRIPs principle that each WTO Member has the freedom to determine the grounds upon which compulsory licenses are granted. According to the Members, however, the United States has included provisions in recent FTAs that “narrow these grounds.” The Members also state that USTR has refused to reference the right to compulsory licensing in FTA text and instead relies “upon the use of vaguely worded side-letters that are subordinate to the agreements and non-binding on the parties.”
- **Absence of consumer safeguards.** According to the letter, recent FTAs have omitted key elements of U.S. law designed to protect consumer access to pharmaceutical products, including: (i) the “Bolar provision” which allows for the early registration of generics so they can enter the market more quickly when a patent expires; (ii) a requirement that patent applicants describe the “best mode” to reproduce an invention; and (iii) protections to address attempts to gain repeated and unjustified patents on a product. The letter states that the absence of these safeguards threatens access to affordable drugs in developing countries

The Members urge USTR to pursue a trade agenda that re-asserts the U.S. commitment to the Doha Declaration and to revise recent FTAs based on this commitment. The Members believe that IP protection in FTAs is important but that the current pharmaceutical provisions in FTAs “extend pharmaceutical monopolies without sufficient regard to consumer access and public health.” Their letter serves as a counterpoint to the views of many in Congress that the United States should pursue in its international agreements strict IPR rules and standards for pharmaceuticals.

Other signatories to the letter include Reps. Tom Allen (ME), Lloyd Doggett (TX), Janice Schakowsky (IL), Pete Stark (CA), Diana DeGette (CO), Chris Van Hollen (MD), Barbara Lee (CA), Earl Blumenauer (OR), John Lewis (GA), and Rahm Emanuel (IL).

USTR Announces DR-CAFTA Entry Into Force for the Dominican Republic

On March 1, 2007, United States Trade Representative (USTR) Susan Schwab announced that the Dominican Republic-Central America Free Trade Agreement (DR-CAFTA) would enter into force for the Dominican Republic on March 1. The Dominican Republic is the fifth country to implement fully the agreement. DR-CAFTA entered into force for El Salvador on March 1, 2006, for Honduras and Nicaragua

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on April 1, 2006, and for Guatemala on July 1, 2006. Costa Rica remains the only signatory that has not approved the agreement. USTR Schwab stated that DR-CAFTA implementation has been positive and that U.S. exports to El Salvador, Guatemala, Honduras, and Nicaragua grew by over 18 percent in 2006. DR-CAFTA implementation for the Dominican Republic was held up while Dominican lawmakers revised intellectual property laws governing the pharmaceutical industry and handled disagreements over fuel transportation rights.

Press sources indicate that the Costa Rican Congress intends to vote on the agreement in the coming weeks and that Costa Rican legislators are awaiting a court ruling to clear procedural issues before voting on the agreement. Although there is stiff opposition to the agreement, analysts forecast that the Costa Rican Congress will likely approve the agreement. The United States will continue to implement DR-CAFTA on a rolling basis with regard to Costa Rica as it makes sufficient progress to ratify 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." Thus, DR-CAFTA implementation for Costa Rica will likely occur either in April or May if the Costa Rican Congress ratifies the trade agreement in the coming weeks.

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Multilateral

Multilateral Highlights

China Terminates Subsidy Program; US Welcomes Announcement But Continues Pressing China on Other Subsidies

On March 8, 2007, officials from the People's Bank of China, the State Administration of Foreign Exchange, the Ministry of Commerce and the State Administration of Taxation announced the termination of regulations implemented by China's central bank that allowed large exporters to take advantage of discounted loans not available to other companies. The "discounted loans" program was among nine subsidy programs that the United States identified as possibly violating World Trade Organization (WTO) rules; it was also listed in the U.S. WTO request for consultations with China on the subsidy programs. United States Trade Representative (USTR) Susan Schwab welcomed China's announcement and was encouraged that "the calls for reform from the United States and other trading partners appear to have prompted Chinese officials to announce the end of a policy that created an unfair advantage for companies exporting into the international market place from China." She expressed hope that the termination of the discounted loans programs is a signal of China's willingness to withdraw other subsidy programs.

On February 2, 2007, the United States requested WTO dispute settlement consultations with China regarding alleged Chinese subsidies to domestic and foreign companies. The U.S. request alleges that these subsidies violate China's WTO obligations because they distort trade conditions for U.S. manufacturers and can inhibit U.S. exports to China, as well as provide an unfair advantage to China's exports in the United States and around the world. Under WTO rules, the United States and China will have a mandatory 60-day consultation period. If the parties cannot reach a mutually agreeable solution at the end of the consultation period, the United States can then request the WTO Dispute Settlement Body (DSB) to create a panel to rule on the issue. Australia, the EU, Japan, and Mexico all have requested to participate as third parties in the US. consultations.

The U.S. complaint targets nine Chinese measures that allegedly benefit Chinese companies and foreign corporate investors in China, including export subsidies and import-substitution subsidies (*i.e.*, financial incentives that encourage firms in a country to purchase domestic goods instead of foreign goods) that are prohibited by WTO rules. China committed to eliminate these prohibited subsidies by the time it

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joined the WTO in December 2001, but USTR claims that China has failed to do so; thus, the United States seeks the elimination of these prohibited subsidies.

China's termination of one of the listed subsidy programs is unlikely to stop the United States and other WTO Members from continuing their WTO dispute over the other eight subsidy programs still in place. USTR tempered its response to the Chinese government's termination announcement with assurances that it would continue its dialogue with China on the other subsidy programs. The dispute represents the third WTO complaint that the United States has issued against China. The United States' first complaint centered on semiconductors. In March 2004, the United States requested consultations with China concerning China's preferential VAT for domestically produced or designed integrated circuits. However, in October 2005, China and the United States informed the WTO that they had reached a mutually satisfactory solution during consultations. The second WTO complaint against China (DS340) came in March 2006 and involved China's use of a tax system that blocked imports of U.S. and other foreign-made auto parts into China. That dispute has progressed to the Panel phase, and the Panel is compiling data and examining the complaint in detail. The recent WTO disputes represent a policy change for USTR regarding U.S. bilateral economic relations with China. Over the last several years, the United States has pursued "quiet diplomacy" with China but recently has taken a more direct and aggressive approach – including WTO dispute settlement.

U.S. Will Comply with AB Ruling on Zeroing But Believes DSB Findings are Without Legal Basis

On February 20, 2007, U.S. Deputy Permanent Representative to the World Trade Organization (WTO) David Shark delivered a statement to the WTO's Dispute Settlement Body (DSB) in which he stated that the United States would comply with a January 9 WTO Appellate Body (AB) ruling, which upheld a Japanese complaint against the U.S. use of its "zeroing" methodology in antidumping investigations. Shark noted, however, that the United States believes the DSB's findings regarding zeroing are without legal basis.

On January 9, 2007, the WTO AB released its decision in *United States – Measures Relating to Zeroing and Sunset Reviews* (DS322) and found that the practice of zeroing violates U.S. obligations under the WTO Anti-Dumping Agreement. In Fall 2006, a WTO Panel had decided that certain types of zeroing – including zeroing during administrative reviews – were permitted under the Agreement. The AB reversed these findings by the Panel, ruling that all of the types of U.S. zeroing challenged by Japan were WTO-inconsistent. Analysts opine that this was the most definitive AB decision to date on the WTO-

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inconsistency of zeroing because the ruling went beyond previous WTO decisions against zeroing by declaring the practice illegal, whether used in the original investigation, in periodic reviews, in new shipper reviews, or in sunset reviews. The AB also ruled that zeroing is illegal whether an average-to-average or transaction-to-transaction comparison is used.

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

The U.S. Department of Commerce (DOC) has already addressed its use of average-to-average zeroing in antidumping investigations. In response to an earlier adverse WTO ruling, on January 23, 2007, DOC announced that it would institute a change to its zeroing methodology beginning February 22, 2007. The change was necessary to implement the recommendations and rulings of the WTO DSB in connection with the U.S.-EU dispute *US – Zeroing (EC)* (DS294). According to DOC, when calculating the weighted-average dumping margin in antidumping investigations, effective February 22, 2007, the Department will no longer disregard negative dumping margins (i.e., zero) in antidumping investigations where it uses weighted average to weighted average comparisons.

Shark stated that "the United States considers that the Appellate Body's findings relating to zeroing outside the context of average-to-average comparisons in investigations are devoid of legal merit" and noted that the AB's findings "suggest forms of implementation that simply make no sense from a policy perspective." He also stated that the WTO's Anti-Dumping Agreement does not contain a specific provision on zeroing. In making the U.S. announcement, Shark stated that the United States would need a "reasonable period" to make further changes to its zeroing methodology in order to comply with the AB ruling. He also noted that the United States will continue to urge WTO Members to change WTO antidumping rules so as to allow for the use of zeroing, as part of the Doha Round negotiations.

U.S. compliance with the AB's ruling in the Japan case sounds the death knell for DOC's use of zeroing. The adverse rulings in the Japan case, the EC case, and a January 30 DSB decision that the United States violated its obligations under the Anti-Dumping Agreement when it used "zeroing" in an

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antidumping investigation of shrimp from Ecuador (DS335) have spurred DOC to make further changes to its zeroing practice. The U.S. push to amend WTO rules to allow for zeroing, however, will likely result in very little. All WTO Members would have to accept such a change and given the recent adverse rulings from several major WTO Members, it seems unlikely that the WTO will agree as a whole to allow the United States to zero in antidumping investigations.

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