III. Bilateral and Regional Negotiations

A. Free Trade Agreements

1. Chile

Chile has been a recognized leader of economic reform and trade liberalization in Latin America and currently is the only South American country with an investment grade credit rating. Real GDP growth averaged 8 percent for the decade prior to Chile's economic slowdown in 1998-99. Chile's real GDP grew at about a 2 percent rate in 2002 and at a 3.5 percent rate in 2003.

Two-way trade in goods (exports plus imports) between the United States and Chile totaled $6.4 billion in 2002, with the United States in deficit by $1.2 billion. Two-way trade in services in 2001 (latest year available) amounted to $2.2 billion, with the United States in surplus by $472 million. Since 1994, U.S. goods trade with Chile has expanded by 39 percent (to 2002) and services trade by 37 percent (to 2001).

The United States and Chile concluded negotiations on an historic Free Trade Agreement (FTA) on December 11, 2002. The agreement, signed on June 6, 2003 by U.S. Trade Representative Robert B. Zoellick and Chilean Foreign Minister Soledad Alvear, is the first comprehensive FTA between the United States and a South American country. The U.S.-Chile FTA, along with the U.S.-Singapore FTA, entered into force on January 1, 2004. The U.S. Congress implemented the agreement with strong bipartisan majorities in the House and Senate.

The U.S.-Chile FTA eliminates tariffs and opens markets, reduces barriers for services, protects leading-edge intellectual property, keeps pace with new technologies, ensures regulatory transparency, and provides explicit guarantees for electronic commerce and digital products and effective labor and environmental enforcement. American workers, consumers, investors, manufacturers and farmers will enjoy access to one of the region's most stable and fastest growing economies, enabling products and services to flow between the two economies with no tariffs and streamlined customs procedures.

Under the agreement, more than 85 percent of bilateral trade in consumer and industrial goods became tariff-free immediately. In less than four years, 75 percent of farm production will also be freely traded. After just ten years, all trade in non-agricultural goods will take place without tariffs or quotas; for agriculture, the phase out will take just 12 years. Key U.S. export sectors benefit, such as agricultural and construction equipment, autos and auto parts, computers and other information technology products, medical equipment, and paper products. U.S. farmers' access to Chilean markets will be as good or better than the European Union or Canada. Farmers will gain duty-free treatment within four years for important U.S. products such as pork and pork products, beef and beef products, soybeans and soybean meal, durum wheat, feed grains, potatoes, and processed food products such as french fries, pasta, distilled spirits and breakfast cereals.

This agreement offers new access to a fast-growing Chilean services market for U.S. banks, insurance companies, telecommunications companies, security firms, express delivery companies, and professionals. U.S. firms may offer financial services to participants in Chile's highly successful privatized pension system. The agreement offers state of the art and non-discriminatory protections for digital products such as U.S. software, music, text, and videos. Protection for U.S. patents, trademarks, and trade secrets exceeds past agreements in the region.

The agreement establishes a secure, predictable legal framework for U.S. investors, and provides for ground-breaking anti-corruption measures in government contracting. U.S. firms are guaranteed a fair and transparent process to sell goods and services to a wide range of Chilean government entities, including airports and seaports.

With respect to labor and the environment, both governments commit to effectively enforce their domestic labor and environmental laws. An innovative enforcement mechanism includes monetary assessments to enforce commercial, labor and environmental obligations of the trade agreement. In addition, it establishes a framework for cooperative environmental projects that will help protect wildlife, reduce hazards and promote internationally recognized labor laws.

The negotiations on the U.S.-Chile FTA were conducted in a transparent manner to ensure that businesses, labor organizations, non-governmental organizations, state and local governments, and the public were kept informed and had ample opportunity to provide input on the negotiations. The Administration briefed Congress on the status of negotiations through periodic meetings with the House Committee on Ways and Means and the Senate Committee on Finance, as well as other committees with interests in the negotiations and individual Members' staffs.

2. Singapore

President Bush and Prime Minister Goh signed the U.S.-Singapore FTA on May 6, 2003. H.R. 2739, the U.S.-Singapore FTA Implementation Act, was passed by the House of Representatives on July 24, and by the Senate on July 31 with strong bipartisan support, and was signed by President Bush on September 3. The FTA entered into force on January 1, 2004.

This FTA is the first comprehensive U.S. FTA with any Asia-Pacific nation. Singapore is our 12th largest trading partner, with two-way trade of goods and services exceeding $38 billion. The provisions of the U.S.-Singapore FTA build on the WTO and NAFTA and make important advances in many key areas. Most tariffs will be eliminated immediately upon entry into force of the Agreement, with the remaining tariffs phased out over a 3 to 10-year period.

The FTA chapters cover goods, rules of origin, customs administration, technical barriers to trade, services, telecommunications, financial services, temporary entry, competition policy, government procurement, investment, intellectual property, electronic commerce, customs cooperation, transparency, labor and environment, and dispute settlement.

The FTA will provide strong disciplines in the most competitive U.S. sectors. U.S. firms will enjoy barrier-free market access, a transparent regulatory environment and non-discriminatory treatment across a wide range of services, including: financial services (banking, insurance, securities and related services), computer and related services, direct selling, telecommunications services, audiovisual services, construction and engineering, tourism, advertising, express delivery, professional services (architects, engineers, accountants, etc.), distribution services (such as wholesaling, retailing and franchising), adult education and training services, environmental services, and energy services.

The FTA has other important features. For example, this FTA will provide: a secure legal environment for U.S. investors operating in Singapore; explicit guarantees for electronic commerce and digital products; enhanced, state-of-the art protection for intellectual property; specific commitments regarding the conduct of Singapore's government enterprises; reinforced commitments to strong and transparent disciplines on government procurement procedures; strong, simple, and transparent rules of origin; firm commitments to combat illegal transhipments of all traded goods and prevent circumvention for textiles and apparel; mobility for highly-trained personnel; and requirements to ensure effective enforcement of domestic labor and environmental laws. An innovative enforcement mechanism includes monetary assessments to enforce commercial, labor, and environmental obligations of the trade agreement.

The FTA with Singapore will foster economic growth and create higher paying jobs in the United States by reducing and eliminating barriers to trade and investment. The agreement will not only improve market opportunities for U.S. goods and services exports, but it may also serve as a model for the Asia-Pacific region, encouraging trade liberalization, regulatory reform, and transparency, including under the Enterprise for ASEAN Initiative, which President Bush announced at the Summit of Leaders' of the Asia-Pacific Economic Cooperation forum in October 2002. The FTA will offer important benefits to U.S. workers, ranchers, farmers, and businesses while reinforcing important American values in the region.

These negotiations, which began in December 2000, recognized Singapore's importance as a trading partner and strategic role in the Asia Pacific region. The negotiations on the U.S.-Singapore FTA were conducted in a transparent manner to ensure that businesses, labor organizations, non-governmental organizations, state and local governments, and the public were kept informed and had ample opportunity to provide input on the negotiations. The Administration briefed Congress on the status of negotiations through periodic meetings with the House Committee on Ways and Means and the Senate Committee on Finance, as well as other committees with interests in the negotiations and individual Members' staffs.

3. Jordan

The United States and Jordan continued their efforts in 2003 to help take advantage of the opportunities afforded by the U.S.-Jordan Free Trade Agreement (FTA) which went into effect in December 2001. These efforts included meetings in June between senior USTR officials and the Jordanian Minister of Trade, as well as with the Jordanian-American Business Association. At year's end the United States and Jordan were engaged in planning for the second U.S.-Jordan Joint Committee meeting to be held under the FTA. The FTA established the Joint Committee to bring together senior U.S. and Jordanian officials to discuss and act on ways to further boost bilateral trade and investment.

The FTA will eliminate nearly all tariffs on industrial goods and farm products within 10 years, as well as commercial barriers to bilateral trade in goods and services originating in the United States and Jordan. The FTA includes, for the first time ever in the text of a trade agreement, substantive provisions on electronic commerce. Other provisions address intellectual property rights protection, balance of payments, rules of origin, safeguards, labor, environment, and procedural matters such as consultations and dispute settlement. Because the United States already has an up-to-date Bilateral Investment Treaty with Jordan, the FTA does not include an investment chapter.

While the FTA is a key part of the U.S.-Jordan economic relationship, it is just one component of an extensive U.S.-Jordanian collaboration in economic relations. Close economic cooperation between the two countries began in earnest with joint efforts on Jordan's accession to the World Trade Organization (WTO) in 2000. The United States and Jordan continue to work together closely in the WTO, particularly on issues of special concern to developing nations. The United States' efforts to support Jordan's rapid and successful WTO accession were followed on the bilateral front by the conclusion of the U.S.-Jordan Trade and Investment Framework Agreement and a Bilateral Investment Treaty. Qualifying Industrial Zones (QIZs) are another important example of successful U.S.-Jordanian efforts to boost Jordan's economic growth and promote peace in the Middle East.

These measures have played a significant role in boosting U.S.-Jordanian economic ties. In 2002 U.S. goods imports were $412 million, an 80 percent increase ($183 million) from 2001. In

2002 U.S. goods exports to Jordan were $404 million, up 19 percent ($65 million) from 2001.

4. Israel

The United States and Israel held two formal rounds of negotiations in 2003 on a new bilateral agreement on trade in agricultural products, in addition to extensive informal discussions. This new agreement would succeed the 1996 Agriculture Agreement which expired at the end of 2001. The United States and Israel extended the benefits provided by the Agriculture Agreement through 2002 and 2003. At the time this report went to press, the two sides were in the final stages of concluding a new agreement, which would provide duty free treatment of over 90 percent of bilateral agricultural trade. The United States and Israel have undertaken negotiations on agricultural trade to address problems arising from the two sides' disagreement as to whether or not the 1985 U.S.-Israel Free Trade Agreement permits either party to apply restrictions on bilateral trade in this area.

5. U.S.-Central American Free Trade Agreement (CAFTA) Negotiations

The five countries of the Central American Common Market (CACM), as a whole, comprise one of the largest trading partners in the Hemisphere for the United States, with bilateral trade expected to total about $25 billion in 2003. From 1996 to 2002, U.S. exports to the region increased 54 percent. To consolidate and strengthen this relationship, in January 2003 the United States launched negotiations for a free trade agreement with the CACM member countries—Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua. Negotiators for the U.S.- Central America Free Trade Agreement (CAFTA) held nine rounds of negotiations throughout 2003, resulting in an agreement among the United States, El Salvador, Guatemala, Honduras, and Nicaragua in mid-December in Washington, DC. Talks with Costa Rica continued into January 2004 resulting in that country being added to the FTA at the end of January. This historic Free Trade Agreement is the first between the United States and a group of countries with small, developing economies. The FTA will eliminate most barriers and facilitate trade and investment among the countries, as well as help further CACM's integration efforts. When the United States and the Dominican Republic conclude market access negotiations, to be held January through March 2004, the Dominican Republic will be integrated into CAFTA, which will stand to become the United States' second largest market in Latin America after Mexico. Bilateral trade between the United States and the Dominican Republic totaled over $8.4 billion in 2002.

To date, the United States has only six FTA partners: Canada, Mexico, Israel, Jordan, Chile, and Singapore, the last two of which entered into force in January 2004. Like the U.S.-Chile FTA, CAFTA is expected to spur progress on negotiations of the Free Trade Area of the Americas as well as ongoing global trade negotiations.

CAFTA will eliminate tariffs and open markets, reduce barriers for services, protect leading-edge intellectual property, keep pace with new technologies, ensure regulatory transparency, and provide explicit guarantees for electronic commerce and digital products and effective labor and environmental enforcement. American workers, consumers, investors, manufacturers and farmers will enjoy access to one of the hemisphere's most dynamic economic regions, enabling products and services to flow between the two economies with no tariffs and streamlined customs procedures.

Throughout the negotiation process, U.S. negotiators consulted closely with Congress, industry representatives, and labor and environmental groups to ensure the FTA advanced U.S. interests and, in its final provisions, reflected the goals contained in Trade Promotion Authority. Under the Trade Act of 2002, the Administration must notify Congress at least 90 days before signing an FTA. President Bush notified Congress of his intent to enter into an FTA with Central America in early 2004. During the 90-day period, both the

United States and the countries of Central America will undertake legal reviews of the texts and continue to consult with their respective legislatures and other interested groups regarding the provisions negotiated. Also during this period, the Dominican Republic, which will accede to the overall obligations agreed between the United States and Central America, will negotiate with the United States specific bilateral market access issues.

Under the agreement, more than 80 percent of U.S. commercial and industrial goods will enjoy tariff-free access to Central America immediately upon entry into force, and 85 percent will be duty free within 5 years. Virtually 100 percent of Central American nonagricultural goods will receive immediate duty-free access to the U.S. market. Most remaining tariffs will be eliminated in five years and all tariffs will be eliminated in 10 years for nonagricultural goods. Key U.S. exports, such as information technology products, agricultural and construction equipment, paper products, chemicals, and medical and scientific equipment will gain immediate duty-free access to Central America. More than half of current U.S. farm exports to Central America will become duty-free immediately, including high quality cuts of beef, cotton, wheat, soybeans, key fruits and vegetables, processed food products, and wine, among others. Tariffs on most U.S. farm products will be phased out within 15 years. U.S. farm products that will benefit from improved market access include pork, beef, poultry, rice, fruits and vegetables, corn, processed products and dairy products.

Under the Agreement, the Central American countries will accord substantial market access across their entire services regime, subject to very few exceptions. U.S. financial service suppliers will have full rights to establish subsidiaries, joint ventures or branches for banks and insurance companies. The agreement offers state of the art protections for digital products such as software, music, text and video. Protection for patents and trade secrets meets or exceeds past trade agreements.

The Agreement establishes a secure, predictable legal framework for U.S. investors, sets strong anti-corruption rules in government contracting, and guarantees U.S. firms transparent procurement procedures to sell goods and services to Central American government entities.

With respect to labor and the environment, both parties commit to effectively enforce their domestic labor and environment laws. An innovative enforcement mechanism includes monetary assessments to enforce commercial, labor and environmental obligations of the trade agreement. In addition, it establishes a framework for cooperative environmental projects and promotes internationally recognized labor standards. CAFTA includes unprecedented provisions that commit member countries to provide workers with improved access to procedures that protect their rights. CAFTA goes beyond Chile and Singapore FTAs through a 3-part cooperative approach to improve working conditions by: ensuring effective enforcement of existing labor laws, working with ILO to improve existing labor laws and enforcement, and building local capacity to improve worker rights.

6. Australia FTA Negotiations

The United States and Australia held five rounds of FTA negotiations in 2003, and concluded the Agreement February 8, 2004. The FTA will further boost trade in both goods and services, enhancing employment opportunities in both countries. Two-way annual trade already is more than $25 billion, and Australia purchases more goods from the United States than from any other country. The FTA will provide U.S. firms free access in all goods. More than 99 percent of U.S. exports of manufactured goods to Australia will become duty-free immediately upon entry into force and all U.S. agricultural exports to Australia, totaling more than $400 million, will receive immediate duty-free access. The FTA also accords substantial access to virtually all U.S. services suppliers and will encourage additional foreign investment flows between the United States and Australia, adding to the many jobs that the already significant investment flows between the two countries currently support. The comprehensive FTA strengthens intellectual property protection, has provisions on electronic commerce reflecting the principle of avoiding barriers that impeded the use of e-commerce, and includes transparency and other commitments on market access issues related to pharmaceuticals. Moreover, the FTA will bolster the WTO partnership between the United States and Australia, deepen the broader ties between the two countries, and strengthen the foundation of our security relationship.

7. Morocco FTA Negotiations

In April of 2002 President Bush and King Mohammed VI agreed to pursue a Free Trade Agreement (FTA) between the United States and Morocco. On October 1, 2002, USTR Zoellick notified Congress and trade negotiations were initiated with the Moroccans in January of 2003. The FTA with Morocco will be comprehensive and is part of the Administration's effort to promote more open and prosperous Middle Eastern societies. The FTA will support the significant economic and political reforms underway in Morocco, and create improved commercial and market opportunities for U.S. exports to Morocco by reducing and eliminating trade barriers. Negotiations have continued through 2003 and are expected to conclude in 2004, which would make it the first FTA to be completed under the President's Middle East Free Trade Area initiative.

8. Southern Africa FTA Negotiations

On November 4, 2002, U.S. Trade Representative Robert B. Zoellick notified Congress of President Bush's decision to negotiate a free trade agreement (FTA) with the five member countries of the Southern African Customs Union (SACU). These nations—Botswana, Lesotho, Namibia, South Africa and Swaziland—comprise the largest U.S. export market in sub-Saharan Africa, with $2.5 billion in U.S. exports in 2002. The negotiations began in Pretoria, South Africa in June 2003 and subsequent rounds were held in August and October 2003. The target completion date is December 2004. This FTA—the first ever with any sub-Saharan African country—offers an opportunity to craft a groundbreaking agreement that will serve as a model for similar efforts in the developing world. The SACU countries are strong economic reformers and leading AGOA beneficiaries. They have seen the positive role that trade can play in promoting economic growth and development and, through the FTA negotiations, are taking an important step toward deeper economic engagement with the United States. Through an FTA with SACU, U.S. businesses will gain preferential access to their largest export market in sub-Saharan Africa. Other exporters such as the European Union already receive preferential access to the South African market. By building on the success of AGOA, the SACU countries would secure the kind of guaranteed access to the American market that supports long-term investment and economic prosperity. The FTA would also reinforce ongoing regional economic reforms and lower the perceived risk of doing business in Southern Africa.

B. Regional Initiatives

1. Free Trade Area of the Americas

2003 was the first full year of negotiations with the U.S. and Brazil as Co-Chairs of the process. The 34 governments participating in the process initiated market access negotiations and continued to make progress on the draft text of the Agreement. In addition, they made progress on implementation of the Hemispheric Cooperation Program, which is designed to assist countries to participate in the negotiations, prepare to implement the FTAA obligations and adjust to hemispheric integration.

The U.S. participated actively in meetings of the nine negotiating groups (market access, agriculture, intellectual property rights, services, investment, government procurement, competition policy, dispute settlement, and subsidies/antidumping/countervailing duties) and the three committees and non-negotiating groups (the Technical Committee on Institutional Issues (TCI), the Consultative Group on Smaller

Economies (SME), and the Committee of Government Representatives on the Participation of Civil Society (SOC)). The negotiating groups and the TCI focused on eliminating brackets in the existing text, while delegations to the market access, agriculture, services, investment and government procurement negotiating groups met to negotiate market access commitments. Most delegations exchanged initial offers and requests for improvement to those initial offers in most of the market access areas. Some delegations also exchanged improved offers. In addition, the U.S. participated actively in the Ad Hoc Group on Rules of Origin, and an ad hoc group within the Market Access Negotiating Group, which are negotiating rules of origin for the FTAA. The Ministers have instructed negotiators to continue at a pace that will lead to conclusion of market access negotiations by September 30, 2004.

The U.S. proposed additions to the TCI text, similar to that in the Chile and Singapore FTAs, on labor and environment. Under the proposal, countries would reaffirm their obligations as members of the International Labor Organization (ILO) and pledge to strive to ensure that core labor standards in the ILO Declaration of Fundamental Principles and Rights at Work are fully protected in domestic labor laws. Countries would be obligated not to fail to effectively enforce domestic labor laws through a sustained or recurring course of action or inaction, in a manner affecting trade. This obligation would be subject to dispute settlement and could result in a monetary assessment if a country was found not to be meeting this obligation and failed to remedy the situation. Failure to pay the assessment could lead to suspension of trade benefits sufficient to collect the assessment. Several countries believe there is no mandate to include labor in the FTAA and have blocked discussion of the U.S. proposal.

Recognizing the role trade plays in promoting economic development in America and in other countries and reducing poverty and that smaller and less developed economies require financial support to assist in adjusting to hemispheric integration, the U.S. has worked with CARICOM and other smaller economies to implement the Hemispheric Cooperation Program. The Inter-American Development Bank (IDB) hosted a meeting in October in Washington, D.C. with relevant donor institutions and FTAA countries to discuss preparation of trade capacity building (TCB) strategies by governments seeking assistance. These strategies are critical to identifying effective programs and appropriate funding sources. They are the first steps in enhancing the capacity of countries seeking assistance to complete negotiation of the FTAA Agreement, prepare to implement its obligations, enhance their capacity to trade and successfully adjust to hemispheric integration.

Despite this progress, negotiations were marked by disagreement about the FTAA's ultimate scope and ambition. Since 1994, the negotiations have been guided by principles and objectives approved by the leaders of the 34 democratically-elected FTAA countries. One of the most important principles is that the FTAA should improve upon World Trade Organization (WTO) rules and disciplines wherever possible and appropriate. Objectives include: progressive elimination of tariffs and non-tariff barriers, as well as other measures with equivalent effects; elimination of agricultural export subsidies in the hemisphere; liberalization of trade in services under conditions of certainty and transparency; adequate and effective protection of intellectual property rights, taking into account changes in technology; establishment of a fair and transparent legal framework for investment and related capital flows; integration of trade and environmental policies and observance and promotion of internationally-recognized core labor standards. Some delegations questioned these principles and objectives, proposing that the FTAA negotiations focus exclusively on market access, leaving additional rules and disciplines for discussion in the WTO.

At the Miami Ministerial meeting in November, the Trade Ministers considered the progress of the negotiations in the past year. In light of the WTO Cancun Ministerial, where global trade liberalization (including agricultural trade reform) was set back and in view of the increase in political and economic uncertainty in the region, Ministers agreed that the FTAA negotiations would move forward with the flexibility necessary to handle differences in the economic and political situations of countries in the hemisphere. The FTAA will be comprehensive and include a common and balanced set of rights and obligations, in each of the nine negotiating disciplines, that will be applicable to all countries. Those countries that wish to may agree to additional obligations and benefits. This will allow countries to go beyond the common rights and obligations in areas were there has not been a consensus to do so on a hemisphere-wide basis. The Ministers directed Vice-Ministers to define the comprehensive set of common rights and obligations as well as procedures for negotiating additional provisions. Negotiation of these additional provisions is very important to the U.S., which hopes that all countries will eventually agree to them. Ministers reaffirmed that negotiations should be completed by January 2005. In addition, several delegations supported establishment of a consultative group on labor and environment within the FTAA process. This may provide a forum for discussion of the U.S. proposals on labor and environmental standards.

The Ministers also continued efforts to improve transparency in the FTAA process and build broader public understanding of and support for the FTAA. Ministers met with representatives of the eighth Americas Business Forum (ABF) and the Americas Trade and Sustainable Development Forum, organized with broad representation from civil society and received detailed recommendations from workshops covering all areas of the negotiations. The Ministers agreed to make public the third draft consolidated texts of the FTAA agreement, which is available on the USTR website (http://www.ustr.gov) and the official FTAA website (http://www.ftaa-alca.org). They also recognized the efforts of the FTAA Committee of Government Representatives on the Participation of Civil Society (SOC) to improve two-way communication with civil society by holding open meetings that focus on issues under discussion in the negotiations. In 2003 two such meetings were held, one in Sao Paulo, Brazil on agriculture and the other in Santiago, Chile on services. Two more are scheduled for 2004: one in the Dominican Republic on intellectual property rights, the other in the U.S. on market access, with special focus on small businesses.

In Miami, Ministers also received two reports from the SOC: the Report on Best Practices and Illustrative Examples of Consultations with Civil Society at the National/Regional Level that highlights best practices for disseminating information to civil society and increasing its participation in the FTAA process and the Fourth Report of the SOC that describes SOC activities as well as the contributions received in response to the Open and On-Going Invitation for comment on all aspects of the FTAA negotiations. Ministers instructed the SOC to continue to forward such contributions to the relevant FTAA entities. Both reports are available on the official FTAA website. Finally, Ministers directed the SOC to coordinate with the TCI to prepare recommendations for the TNC on the possibility of creating a civil society consultative committee within the institutional framework of the FTAA upon entry into force. The TNC will review these recommendations and make a proposal to the Ministers.

Ministers agreed that their next meeting would be hosted by Brazil in 2004.

2. Enterprise for ASEAN Initiative

President Bush announced a major new initiative, the Enterprise for ASEAN Initiative (EAI), in October 2002 to strengthen U.S. trade and investment ties with ASEAN both as a region and bilaterally. With two-way trade of nearly $120 billion annually, the ten-member ASEAN group already is the United States' fifth largest trading partner collectively. The initiative is intended to further enhance the already close U.S. relationship with this strategic and commercially important region. With the ASEAN countries anticipating solid future economic growth and with their population of 500 million, the United States anticipates significant opportunities for U.S. companies, particularly agricultural exporters. For ASEAN, this initiative will help boost trade and redirect investment back to the ASEAN region.

Under the EAI, the United States offered the prospect of bilateral free trade agreements with ASEAN countries that are committed to the economic reforms and openness inherent in an FTA with the United States. Any potential FTA partner must be a WTO member and have a TIFA with the United States. The United States now has TIFAs with Indonesia, Philippines, Thailand, and Brunei Darussalam and is near conclusion of one with Malaysia. The U.S. Government sees progress in addressing bilateral issues under these TIFAs as important to laying the groundwork for entering FTA negotiations with the confidence that they can be concluded successfully. The U.S. goal is to create a network of bilateral FTAs with ASEAN countries.

Under the EAI, the United States also committed to support the efforts of ASEAN members that do not yet belong to the WTO to complete their accessions successfully. With U.S. government support, Cambodia successfully acceded to the WTO in September 2003.

U.S. and ASEAN officials met in August 2003 to discuss progress under the EAI. The two sides will work to advance the U.S.-ASEAN work program established in 2002, including efforts on intellectual property rights, customs and trade facilitation, biotechnology, standards, agriculture, human resource development and capacity building, small and medium enterprises, and information and communications technology.

3. North American Free Trade Agreement

Overview

Ten years ago, on January 1, 1994, the North American Free Trade Agreement between the United States, Canada and Mexico entered into force. NAFTA created the world's largest free trade area, which now links 427 million people producing more than $11 trillion worth of goods and services. The dismantling of trade barriers and the opening of markets has led to economic growth and rising prosperity in all three countries. NAFTA also includes significant labor and environmental cooperation agreements. The NAFTA has dramatically improved our trade and economic relations with our neighbors. The net result of these efforts is more economic opportunity and growth, greater fairness in our trade relations, and a coordinated effort to better protect worker rights and the environment in North America.

The magnitude of our trade relations in North America is impressive: U.S. two-way trade with Canada and Mexico exceeds U.S. trade with the European Union and Japan combined. U.S. goods exports to NAFTA partners nearly doubled between 1993 and 2002, from $142 billion to $258 billion, significantly higher than export growth of 49 percent for the rest of the world over the same period.

NAFTA's record is clear: By lowering trade barriers, the agreement has expanded trade in all three countries. This has led to better jobs, more choices for consumers at competitive prices, and rising prosperity. From 1993 (the year preceding the start of NAFTA implementation) to 2002, trade among the NAFTA nations climbed 109 percent, from $297 billion to $621 billion. Each day the NAFTA parties conduct nearly $1.7 billion in trilateral trade. Thanks in part to NAFTA, North America is one of the most competitive, prosperous and economically integrated regions in the world.

Elements of NAFTA

A. Operation of the Agreement

The NAFTA's central oversight body is the NAFTA Free Trade Commission, chaired jointly by the U.S. Trade Representative, the Canadian Minister for International Trade, and the Mexican Secretary of Economy. The NAFTA

Commission is responsible for overseeing implementation and elaboration of the NAFTA and for dispute settlement. The Commission held its most recent meeting annual meeting in October 2003, in Montreal, Canada. Ministers launched an initiative to study the Parties' most-favored-nation tariffs, in order to determine whether harmonizing these tariffs could further promote trade by reducing export-related transaction costs. The FTC also agreed to pursue further liberalization of the NAFTA rules of origin. Since nearly all tariffs between the Parties have been eliminated, reducing the costs associated with trade, such as those associated with compliance with the rules of origin, will generate additional benefits for traders.

B. Investment

As part of the ongoing commitment to make the NAFTA more responsive to the needs of the public, the Commission at its October 2003 meeting produced two statements to enhance the transparency and efficiency of NAFTA's investor-state arbitration (Chapter 11 of the NAFTA Agreement):

- an affirmation of the authority of investor-state tribunals to accept written submissions (*amicus curiae* briefs) by non-disputing parties, coupled with recommended procedures for tribunals on the handling of such submissions; and
- endorsement of a standard form for the Notices of Intent to initiate arbitration that disputing investors are required to submit under Article 1119 of the NAFTA.

These procedures will enhance the transparency and efficiency of the investment chapter's investor-state dispute settlement process.

C. Dispute Settlement Mechanisms

NAFTA has several mechanisms available to avoid and resolve disputes. Over the last year, only those provisions related to investor-state (see below) and reviews under Chapter 19 of antidumping and countervailing duty determinations were used. In ten years of experience under Chapter 19, the United States has generally done well, and all three countries have demonstrated the process functions as intended. Since the NAFTA's inception on January 1, 1994, panels have been requested to review nearly ninety AD and CVD determinations by the countries' various trade agencies; nearly sixty of these requests concerned the United States. Completed decisions have been issued in over thirty cases, thirteen of which concern the United States, while another twenty-eight cases remain active, most of which concern the United States. Most notably, in the past several months, three panels have reviewed and issued in timely fashion unanimous decisions concerning the United States' antidumping and countervailing duty orders on softwood lumber from Canada. While remands are ongoing in all three of those cases—two concerning Commerce and one involving the U.S. International Trade Commission—the ability of the Chapter 19 system to handle such massive litigation has been noteworthy. Chapter 19 also provides for an extraordinary challenge procedure. Following a panel decision, either of the countries involved may request the establishment of a three-person extraordinary challenge committee ("ECC"), comprised of judges or former judges from those countries. If the ECC determines that one of the grounds for the extraordinary challenge has been met (such as a violation of the standard of review which materially affects the panel's decision and threatens the integrity of the panel process), it will vacate the original panel decision. Under the ten-year history of the NAFTA, only two ECCs have been requested: one concerning the Commerce Department's review of the U.S. antidumping order on Mexican cement and, just recently, a second concerning Commerce's sunset review of the antidumping order on pure magnesium from Canada. The cement ECC affirmed the decision of the lower panel, which affects the fifth annual administrative review.

D. NAFTA and Labor

The North American Agreement on Labor Cooperation (NAALC), a supplemental agreement to the NAFTA, promotes effective enforcement of domestic labor laws and fosters transparency in their administration. Each NAFTA Party also has established a National Administrative Office (NAO) within its Labor Ministry to serve as a contact point for information, to examine labor concerns, and to coordinate the expansive cooperative work programs. In addition, the Agreement created a trinational Commission for Labor Cooperation, comprised of a Ministerial Council and an administrative Secretariat.

The Ministerial Council held its most recent meeting in Washington in November 2003. Ministers discussed labor issues facing the three countries, including the opportunities and challenges involved in developing the skills needed for the 21st century workforce, the social and labor components of hemispheric integration, and migrant worker rights. The Council agreed to continue its second review of the operation and effectiveness of the NAALC. Regarding this ongoing review, each country will solicit public views on the process and efficiency of the labor agreement. The countries will also share their findings with each other. A final report will be made available to the public in 2004.

In addition, the Council announced the release of the second edition of its major report on North American labor markets, "North American Labor Markets: Main Changes Since NAFTA." The study provides data on labor market issues such as unemployment, productivity, hours of work and classes of employment. In 2003, the Trilateral Working Group on Occupational Safety and Health, established by the U.S., Mexico and Canada, agreed to host a seminar on ergonomic best practices in the automotive sector; undertake additional training by the U.S. for Mexican labor inspectors; and pursue strategies for involving Hispanic workers in the development of safety and health management systems.

E. NAFTA and the Environment

A further supplemental accord, the North American Agreement on Environmental Cooperation (NAAEC), ensures that trade liberalization and efforts to protect the environment are mutually supportive. The NAAEC created the Commission for Environmental Cooperation (CEC), which is comprised of: a) the Council made up of the environmental ministers from the United States, Canada, and Mexico; b) the Joint Public Advisory Committee made up of five private citizens from each of the NAFTA countries; and c) the Secretariat made up of professional staff, located in Montreal, Canada. Specific information on the CEC's activities can be found in Section V.

In November 1993, Mexico and the United States agreed on arrangements to help border communities with environmental infrastructure projects, in furtherance of the goals of the NAFTA and the NAAEC. The Border Environment Cooperation Commission (BECC) and the North American Development Bank (NADB) are working with communities throughout the U.S.-Mexico border region to address their environmental infrastructure needs. Since their creation, the institutions have been instrumental in the development of over 65 projects, now complete or under construction, with an aggregate cost of approximately $2.1 billion. These projects, when complete, will serve about 9 million residents of the United States and Mexico, with new projects being developed continually.

4. MEFTA

The United States Middle East Free Trade Area initiative (MEFTA), announced by President Bush in May 2003, seeks to promote trade expansion and economic reforms in North Africa and the Middle East leading to a Middle East Free Trade Area within a decade. To re-ignite economic growth and expand opportunity in the Middle East, the U.S. will build on free trade agreements (FTAs) with Israel and Jordan and will take a series of graduated steps with countries in the region tailored to the level of development of individual countries. These steps include helping reforming countries with WTO Accession, enhancing access to the Generalized System of Preferences (GSP) program for eligible countries, negotiating Trade and Investment Framework

Agreements, negotiating Bilateral Investment Treaties, negotiating comprehensive Free Trade Agreements, melding sub-regional FTAs into MEFTA, and helping with Technical Assistance.

5. Asia Pacific Economic Cooperation

Overview

For the past decade the Asia Pacific Economic Cooperation (APEC) forum has been instrumental in advancing regional and global trade and investment liberalization. APEC, which was founded in 1989, was largely a consultative body until the United States invited Leaders from 18 Asia Pacific economies to Blake Island, Washington in 1993. This event marked the first ever meeting of Pacific Rim leaders, and was precipitated by the realization that Asia Pacific economies accounted for more than half of U.S. exports to the world, and had steadily increased in importance in recent years. APEC Leaders have met annually since.

The growth in U.S. good exports to APEC clearly demonstrates the benefits of open markets and trade liberalization. Since 1994, U.S. exports to APEC increased nearly 43 percent. In 2003, two-way trade with APEC members totaled $1.3 trillion, an increase of 5 percent from 2002 (2003 based on annualized 11 monthsí data).

2003 Activities

1. Leadership in the Multilateral Trading System

APEC Leaders and Ministers meeting in Bangkok in October committed to move the DDA forward. They regretted the missed opportunity to advance negotiations at the September WTO Cancun Ministerial, but agreed that the WTO offers the potential for real benefits for all APEC members. To achieve further progress, they pledged to build on Chairman Derbezís text in Cancun, calling for flexibility and political will from all parties.

Leaders discussed and agreed to work to abolish all forms of agricultural export subsidies, unjustifiable export prohibitions and restrictions, committed to working in the negotiating group on rules in accordance with the Doha mandate. Ministers noted that progress had been made in some areas of the WTO negotiations, and they welcomed the decision on TRIPS and access to essential medicines. There was consensus that increased focus should be applied to areas that dominated discussions in Cancun, such as agriculture, industrial market access and the Singapore Issues (trade facilitation, transparency in government procurement, competition and investment), noting that APEC's valuable work on trade facilitation would be helpful in the context of the WTO negotiations.

APEC Ministers and Leaders also emphasized the importance of continuing to build confidence in the WTO through APEC's Strategic Plan for WTO Capacity Building, created in 2000 to help developing APEC economies implement their WTO obligations. In June APEC Trade Ministers welcomed APEC's capacity building workshops on Trade and Environment, Geographical Indications, and Investment. At their October meeting, Ministers instructed senior officials to review the lessons of Cancun and utilize APECís experience in this area to help reinvigorate the DDA negotiations. Furthering this work will help developing economies participate fully in the DDA negotiations and enjoy the benefits of WTO membership.

2. Advancement of APEC's Work on Trade and Investment Liberalization and Facilitation

APEC Leaders and Ministers reviewed APEC's trade policies and measures that contribute to trade and investment expansion and economic growth in the Asia-Pacific region. They agreed to new commitments in key areas under the Shanghai Accord, a U.S.-led blueprint for APEC's trade agenda agreed by APEC Leaders in 2001. These commitments include:

- an agreement on Transparency Standards in specific areas (Services, Investment, Competition Law and Policy and Regulatory

Reform, Standards and Conformance, Intellectual Property, Customs procedures, Market Access, and Business Mobility. Officials were also directed to complete work on standards on government procurement by the 2004 Trade Ministers meeting);

- an agreement to fight corruption;
- an agreement to carry forward APEC's "Pathfinder Statement to Implement APEC Policies on Trade and the Digital Economy" by, e.g., working to combat optical disc piracy and ensuring best enforcement practices, ensuring technology choice for business, and identifying additional information technology products on which tariffs could be eliminated;
- the identification by individual economies of trade facilitation reforms they intend to implement to achieve a significant reduction in business transaction costs by 2006 (by endeavoring to reduce them by 5 percent); and
- an agreement to accelerate structural reform.

In 2003, APEC made progress on a number of APEC "Pathfinder Initiatives"—cooperative arrangements which enable a group of countries to pilot initiatives, even though not all APEC Members can initially participate. In addition to the Statement on Trade and the Digital Economy, Leaders and Ministers welcomed the launch of the APEC Sectoral Food Mutual Recognition Arrangement (MRA) to promote trade in food/agricultural products. Ministers also noted that progress had been made on other Pathfinder Initiatives, including: Implementation of Unilateral Advance Passenger Information Systems; Adoption of the revised Kyoto Convention of the Simplification and Harmonization of Customs Procedures; Electronic Sanitary and Phytosanitary (SPS) Certificates; Electronic Certificates of Origin; Mutual Recognition Arrangement of Conformity Assessment on Electrical and Electronic Equipment Part II and Part III; and Corporate Governance.

APEC Members report annually on their actions to achieve free trade and investment by preparing Individual Action Plans (IAPs). The Shanghai Accord called for, and APEC Senior Officials developed, a more meaningful process for reviewing IAPs. The first of these enhanced reviews were of Japan and Mexico in 2002. In 2003 APEC Members reviewed the trade regimes of Canada, Hong Kong, Japan, Korea, Mexico, New Zealand and Thailand. During each session the economies being reviewed provided opening statements, while officials from other economies, as well as outside experts, submitted oral and written questions. The participants engaged in a productive exchange, bringing increased focus to trade and investment liberalization in APEC. The economies scheduled to be reviewed in 2004 include the United States, Chile, China, Peru, Singapore, and Chinese Taipei. In Bangkok Ministers reaffirmed their commitment to complete all twenty-one IAP peer reviews by the first APEC Senior Officials Meeting in early 2005, and to conduct a mid-term review of progress toward meeting the Bogor Goals by the Ministerial Meeting in 2005. Reports of the IAP Peer Review Meetings can be found on the APEC website (www.apecsec.org.sg).

APEC's work on trade and investment liberalization and facilitation is overseen by the *Committee on Trade and Investment* (CTI) and its sub-fora. The CTI and its sub-fora have well-developed, specific work programs in the sixteen substantive issue areas first defined in the 1995 Osaka Action Agenda (OAA). These areas are: tariffs, non-tariff measures, services, investment, government procurement, standards and conformance, customs, competition policy, deregulation, intellectual property rights, dispute mediation, mobility of business people, rules of origin, information gathering/analysis, and implementation of WTO obligations (including rules of origin), and Strengthening Economic Legal Infrastructure. The CTI's 2003 Annual Report to Ministers details all of the work on trade and investment undertaken in 2003 by the CTI and its sub-fora. This

Report and additional information can be found on the APEC website (www.apecsec.org.sg).

3. Free Trade Agreements

Another important issue for APEC in 2003 was the growing number of Regional Trade Agreements (RTAs) and Free Trade Agreements (FTAs) in the region. APEC held its first policy dialogue on regional and bilateral trade agreements in May 2003, and agreed to convene a second in 2004. Ministers agreed that such agreements can contribute to multilateral trade liberalization, and reiterated Leaders' emphasis that RTAs and FTAs must be consistent with both the WTOís rules and disciplines and APEC's goals and principles. They agreed that if RTAs and FTAs are comprehensive they can promote competitive liberalization in the region and help to build momentum for global trade liberalization.

4. Private Sector Involvement

APEC works closely with the private sector in many of its activities, and the United States has been a driving force in fostering this interaction.

Live Sciences Innovation Forum

In 2002, the United States led an initiative to establish the APEC Life Sciences Innovation Forum (LSIF), which held its initial meeting this year on August 14-15 in Phuket Thailand. Over 200 participants drawn from academia, government and industry discussed implementation of the APEC Leaders instructions to develop a strategic plan for Life Sciences innovation in the region. The LSIF recommended key elements in four areas—Research, Development, Manufacturing and Marketing, and Health Services—for inclusion in the framework for the Life Sciences Innovation strategic plan. In addition, the LSIF recommended an agreement in principle to harmonize quality standards for life sciences products and services according to international best practices; and recommended that assessments be undertaken of the strength of each APEC economy to identify those areas where contributions to life sciences innovation may be established quickly and effectively. In October, APEC Ministers endorsed the LSIF recommendations, took note of the progress in developing the draft *"Strategic Plan for Promoting Life Sciences Innovation"* and requested that the LSIF finalize the plan for endorsement in 2004. APEC Leaders endorsed the Ministerial conclusions.

Automotive and Chemical Dialogues

The *Automotive Dialogu*e and the *Chemical Dialogue* are public-private sector dialogues recognized as important for improving the mutual understanding of key imperatives for the development of future policy and for enhancing the competitiveness of each sector.

The *Automotive Dialogue* is organized into six working groups—customs, technical regulatory harmonization, environment, information technology, economic and technical cooperation and market access. This year, the Dialogue, attended by over 150 participants from industry and government, recommended that APEC Ministers reaffirm that they will endeavor to refrain from using measures having the effect of increasing levels of protection in the automotive sector. APEC Ministers did reaffirm this undertaking at their meeting in October. The Dialogue approved a second letter expressing interest in the work of the WTO Non-Agricultural Market Access (NAMA) Negotiating Group, and offering its resources to support this work. In this regard, the Dialogue endorsed efforts to identify areas of interest to the automotive sector that might be useful in the context of the DDA to promote greater awareness of opportunities for economies to support the reduction or elimination of existing barriers to automotive trade and investment.

The *Chemical Dialogue* was attended by approximately 50 participants from industry and government this year. The Dialogue considered a broad agenda, including continuing to express strong concern over the EU's chemical legislation, building capacity for individual economies to implement the Globally Harmonized System (GHS) of hazard classification and labeling of chemicals, and identifying goals for the chemical sector in the WTO negotiations. APEC Ministers noted the continuing concern of APEC economies over the European Commissioniś proposed regulatory framework for chemicals and downstream products. Ministers observed that many APEC economies had submitted detailed comments on the proposed system, and urged the European Commission to carefully consider the trade effects and trade policy implications of the proposed legislation. Chinese Taipei hosted a capacity-building workshop on the benefits of adopting the GHS and mechanisms for doing so. The chemical industry is working to identify priority non-tariff barriers that could be addressed in APEC as part of a contribution to the WTO Doha negotiations.

C. The Americas

1. Canada

Canada is the largest trading partner of the United States with over $1 billion of two-way trade crossing our border daily. The United States and Canada share one of the world's largest bilateral direct investment relationships. In 2002, the stock of U.S. foreign direct investment in Canada was $152 billion, an increase of 7.6 percent from 2001. In 2002, the stock of Canadian direct foreign investment in the United States was $92.0 billion, a decrease of 9.9 percent.[1] The United States' trade deficit with Canada was $54.5 billion in 2003, an increase of $6.3 billion from $48.2 billion in 2002. U.S. goods exports in 2003 were $168.8 billion, up 4.7 percent from the previous year. Corresponding U.S. imports from Canada were $223.3 billion, up 6.8 percent. Canada is currently the largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Canada were $24.3 billion in 2002 (latest data available), and U.S. imports were $18.4 billion. Sales of services in Canada by majority U.S.-owned affiliates were $51.2 billion in 2001 (latest data available), while sales of services in the United States by majority Canada-owned firms were $47.9 billion.

a. Softwood Lumber

Following the expiration of the 1996 U.S.-Canada Softwood Lumber Agreement in 2001 [and the filing of petitions on behalf of the U.S. softwood lumber industry], the Commerce Department announced amended final antidumping rates ranging from 2.18 percent to 12.44 percent and an amended final countervailing duty rate of 18.79 percent, effective May, 2002.

Negotiations to find a durable solution as an alternative to litigation have been ongoing. The United States remains prepared to offer Canadian lumber producers the market access they seek in exchange for Canadian provinces implementing market-based pricing for sales of timber from public lands. The Department of Commerce, industry, non-governmental organizations, the Government of Canada and Canadian provinces have been engaged since early 2003 in the drafting of a Policy Bulletin which provides a blueprint for provincial forestry reforms. In the process, the provinces have offered commitments to ensure that competitive timber markets would operate in Canada. The Department of Commerce has indicated its willingness to consider petitions from individual provinces for a review of provincial market reforms, with the potential for province-specific revocation of the countervailing duty order. Negotiations on an interim agreement and the Policy Bulletin have been closely linked. In the absence of an agreement on basic reforms, the United States will effectively enforce U.S. trade laws to address the U.S. industry's concerns about subsidies to, and dumping of, Canadian softwood lumber.

Canada is challenging the underlying Commerce Department and ITC investigations in the WTO and NAFTA. On November 1, 2002 the WTO

1 2003 estimates are annualized based on 11 months data.

Dispute Settlement Body officially adopted a panel report which addressed the Canadian challenge of the Commerce Department's preliminary countervailing duty determination. The report is a victory for the U.S. on two key issues in the ongoing dispute: Canadian provinces' sale of timber from public lands can constitute a subsidy under the WTO Subsidies Agreement; and U.S. laws governing reviews of countervailing duty orders are consistent with the WTO Subsidies Agreement. The ITC filed its injury remand to the NAFTA panel on December 15, 2003.

On January 12, 2004, the Department filed a remand determination in response to a NAFTA Panel's decision on the final determination in the CVD investigation. In its decision, the Panel upheld the Department's key findings—that the provincial governments' sale of timber from public lands constitutes a "financial contribution" by the government that can give rise to a "specific" subsidy, which can be subject to countervailing duties. In addition, however, the Panel remanded the benefit calculation methodology for further consideration by the Department. In the DOC's redetermination on remand, a CVD rate of 13.23 percent (lower than the 18.53 percent rate calculated in the investigation) was calculated. If this rate becomes final, the average combined AD/CV duties would be 21.66 percent. We expect a decision regarding whether the remand redetermination is acceptable to the Panel in April, 2004.

With regard to the AD investigation, the Department of Commerce filed a redetermination with the NAFTA panel last October. The dumping margin declined only slightly (from 8.43 percent to 8.07 percent). The Panel's decision on that redetermination is expected in early 2004.

b. Agriculture

Canada is the United States' second largest market for food and agricultural exports. For fiscal year 2003 (October 2002-September 2003), U.S. agricultural exports to Canada grew by 6.1 percent to $9.1 billion. As a result of the 1998 U.S.-Canada Record of Understanding on Agricultural Matters (ROU), the U.S.-Canada Consultative Committee (CCA) and the Province/State Advisory Group (PSAG) were formed to provide fora to strengthen bilateral agricultural trade relations and to facilitate discussion and cooperation on matters related to agriculture. In 2003, the CCA and PSAG met twice on issues including livestock, processed food, plant, seed, fortified breakfast cereals and horticultural trade, as well as pesticide and animal drug regulations.

Wheat

USTR announced a four-prong approach to level the playing field for American farmers that included dispute settlement proceedings against the Canadian Wheat Board and the Government of Canada in the WTO, identification of impediments to U.S. wheat entering Canada, pursuing reforms to state trading enterprises (STE) as part of the WTO agricultural negotiations and countervailing and antidumping investigations in response to petitions filed by the North Dakota Wheat Commission.

During the past year, the Department of Commerce announced August 29 it had determined Canada subsidizes and dumps durum and hard red spring wheat. An ITC panel on October 3, 2003 made a negative determination on imports of durum wheat from Canada. ITC ruled in October, 2003 that US wheat farmers are injured by Canadian Wheat Board practices opening the door for duties of 14.6 percent to be imposed on imports of hard spring wheat from Canada. In November 2003, the Canadian Wheat Board working with the Government of Canada, Manitoba and Saskatchewan filed a NAFTA appeal. NAFTA has 13-16 months to review the matter and issues its findings. The U.S. Government maintains that Canada provides the Canadian Wheat Board with exclusive and special privileges, including monopoly rights. The U.S. allegation is being pursued under art. XVII & III:4 of GATT and a final panel report is due in February, 2004.

Dairy

In April 1999, the United States and New Zealand successfully challenged Canada's subsidized dairy industry under WTO dispute settlement procedures. Canada committed to bring its export regime into compliance with its WTO export subsidy commitments on butter, skimmed milk powder and an array of other dairy products by January 31, 2001. However, the United States believed that Canada instituted new measures that largely duplicated the withdrawn subsidies and continued to challenge Canada in the WTO. After a series of panel reviews, in December 2002 the Appellate Body affirmed that Canada was not in compliance. The WTO's Dispute Settlement Body formally adopted the Appellate Body's report on January 17, 2003. On May 9, 2003, USTR and the U.S. Department of Agriculture announced the settlement with Canada resulting in major revisions to Canada's subsidy programs for its dairy exports. As a result of the settlement, Canada agreed to eliminate its dairy subsidies and consequently, Canada will no longer export subsidized dairy products to the United States and will significantly limit subsidized dairy exports destined to third countries.

Fortified Cereals

Canadian regulations concerning breakfast cereals permit only the addition of niacin, vitamin B6, folic acid, pantothenic acid and magnesium to restore the amounts lost in processing, and of iron and thiamin as fortificants to address public health concerns identified for the Canadian population. Nutrient addition to breakfast cereals is optional, but the amounts that may be added are specified in the regulation. While a wide variety of cereals are marketed in Canada, the level of fortification of breakfast cereal is lower than in the United States for most nutrients, and fewer nutrients, i.e. only those listed above, are permitted to be added in Canada.

U.S. cereal manufacturers commonly fortify up to 15 vitamins and minerals in breakfast cereals. While there are no specific federal rules in the United States on the fortification of cereals, the U.S. Food and Drug Administration (FDA) does maintain guidelines on fortification.

USTR raised the matter of Canada's cereal fortification regulations in bilateral, NAFTA and CCA meetings in 2003. FDA and Health Canada are working in the NAFTA Committee on Food Labeling, Packaging and Standards to work towards a harmonized approach on nutrition-related policies, particularly as it relates to labeling and standards, including fortification. In addition, the U.S. Department of Agriculture and FDA are working cooperatively with Health Canada in sponsoring a study by the National Academy of Sciences to determine principles for discretionary fortification of nutrients to food products and the suitability of using reference values based on the Academy's Dietary Reference Intake values for discretionary nutrient additions. The final report from the Academy is due at the end of December 2003.

c. Intellectual Property Rights

Canada continues to make progress in improving its IPR regime. In December 2002, the Government of Canada (GOC) revised its Copyright Act (Bill C-11) so that Internet retransmission is, in effect, excluded from its compulsory licensing regime—that is, unless licensed by the Canadian Radio-television & Telecommunications Commission (CRTC) and the CRTC has determined not to so license Internet retransmissions. This follows amendments made to Canada's patent law in 2001 to provide 20 year patents that were filed before October 1, 1989. Despite these positive developments, several issues remain largely unresolved. Canada has not resolved the outstanding issue of national treatment of U.S. artists in the distribution of proceeds from Canada's private copying levy and its "neighboring rights" regime. In addition, Canada does not provide effective data exclusivity protections, and systematic inadequacies in Canadian administrative and judicial procedures allow entry of infringing generic versions of patented medicines into the marketplace. Further, Canada's border measures have been the target of severe criticism by IP owners, who consider Canada's border enforcement measures to be inconsistent with its TRIPS obligations.

2. Mexico

Mexico is our second largest single-country trading partner and has been among the fastest-growing major export markets for goods since 1993, with U.S. exports up 132 percent through 2003. The NAFTA has fostered this enormous relationship by virtue of the Agreement's comprehensive, market-opening rules. It is also creating a more equitable set of trade rules as Mexico's higher trade barriers are being reduced or eliminated.

a. Agriculture

North American agricultural trade has grown significantly since the NAFTA was implemented. Mexico is currently the United States' third-largest agricultural export market. For 2003, U.S. agricultural exports to Mexico increased 8.8 percent from 2002, to $7.9 billion (based on annualized 11 month data).

Current issues subject to negotiations include Mexico's limits on the importation and domestic consumption of high fructose corn syrup (HFCS). After the U.S. prevailed in the WTO, Mexico on May 20, 2002 removed antidumping duties it had put in place in 1998, but replaced this with a NAFTA-inconsistent tariff rate quota. In addition, on December 31, 2001, the Mexican Congress imposed a tax on soft drinks produced using HFCS. Although temporarily suspended by the Fox Administration, the tax was reimposed in July 2002, and remains in place. The tax effectively eliminated the use of HFCS in the Mexican beverage industry, reduced sales of HFCS by U.S. firms, lowered U.S. corn exports used to produce HFCS, and affected U.S. beverage exports. USTR continues to work to achieve a long-term solution.

The Administration has worked to address problems associated with Mexico's antidumping regime. The U.S. is concerned about the procedures applied in the investigation of U.S. exports of beef, rice, pork, and apples. Mexico imposed antidumping duties on U.S. exports of long grain white rice in June 2002. In December 2002, Mexico passed amendments to its antidumping and countervailing duties laws. The United States and Mexico held consultations in July 2003 on Mexico's antidumping investigations related to beef and rice. In November 2003, the WTO established a dispute settlement panel with regard to Mexico's antidumping order on white long grain rice. In December 2003, the United States formally requested that a WTO panel on beef be formed, and there are separate proceedings under the NAFTA.

Mexico conducted two safeguard reviews over the last year with significant potential impact on U.S. exports. An investigation on certain plywood concluded in December 2003 excluded all plywood from the United States from its scope. In the case of poultry, Mexico imposed a provisional safeguard measure on imports of U.S. chicken leg quarters in January 2003 and a final safeguard on July 24, 2003. Through an exchange of letters on July 24 and 25, Mexico agreed to provide compensation to the United States for Mexico's safeguard measure and the United States provided its consent to the application of the safeguard measure past December 31, 2003—the expiration of the phase-out period for Mexican tariffs on U.S. chicken leg quarters. In particular, Mexico committed not to impose any additional import restrictions on U.S. poultry products, to eliminate certain sanitary restrictions on U.S. poultry products, and to consult with the United States in advance regarding new sanitary measures. As a result, U.S. exporters will continue to receive unlimited duty-free access to the Mexican market for most poultry products, as well as assured access for a growing volume of chicken leg-quarters and the further assurance that U.S. exporters will not be subject to any unjustified import restrictions. U.S. exports of poultry meat to Mexico totaled $173.8 million in 2002.

b. Telecommunications

Market barriers in Mexico's telecommunications sector remain a serious source of concern. In particular, through a series of rules and other measures, Mexico does not permit effective competition and otherwise discriminates against U.S. suppliers of basic telecommunications services. As a result, wholesale telecommunications rates for U.S.-Mexico calls are still roughly four times their cost. These high rates cost U.S. companies and consumers hundreds of million of dollars in excess payments a year.

The United States initially requested WTO consultations with Mexico on telecommunications issues in August 2000 and first requested the establishment of a WTO panel in November 2000. At that time, Mexico took steps to address several important barriers to telecommunications trade. However, relevant Mexican agencies have not yet addressed trade barriers affecting international telecommunications services. A WTO panel was formed in April 2002 to specifically address this issue.

c. Tequila

In August 2003, the Mexican Secretariat of Economy, citing the need to ensure the quality of Mexican tequila, announced that the official standard for tequila will be amended to require that tequila be "bottled at the source" in order to be labeled as tequila. Currently, the Mexican standard requires that only "100 percent agave" tequila be bottled at the source. Ordinary tequila can be sold and exported in bulk form under the current official standard. If the draft standard is formally proposed and adopted, it will require that all tequila be bottled within the territory of the Mexican appellation of origin, and bulk exports will be prohibited. If implemented, the measure would have an adverse impact on U.S. companies that import bulk tequila from Mexico and bottle tequila in the United States.

The Secretariat of Economy originally intended to sign a formal proposal to amend the standard on August 18, 2003. Following a formal comment period, it was to have been adopted later in 2003 and then enter into effect on January 1, 2004, with a one-year grace period to allow for the establishment of new procedures and the unwinding of existing contracts. Following consultations with the U.S. Government, Mexico agreed to create a defined period of time to receive comments from interested stakeholders. The United States and Canada have held further meetings with Mexico in an ongoing effort to establish a framework for resolving this issue. The United States will continue to work to ensure that any action taken by Mexico is consistent with its international obligations.

d. Intellectual Property Rights

Piracy and counterfeiting of U.S. intellectual property as well as lax and ineffective enforcement of intellectual property rights in Mexico remain persistent problems. As a result, Mexico was placed on the 2003 Special 301 Watch List for the first time since 1999.

Progress was made in 2003 regarding concerns expressed by U.S. pharmaceutical and agricultural chemical companies about the lack of coordination between the Mexican Intellectual Property Institute (IMPI) and Mexican health officials with regard to the granting of marketing approval for their products. As part of the process to obtain approval to sell their products in Mexico, pharmaceutical and agricultural chemical companies must submit data on the safety and efficacy of their products. This data is very valuable and is the result of substantial investments in research by U.S. companies. In September 2003, the Mexican Health Ministry developed new regulations to require a determination from IMPI attesting that the drug in question does not already have a Mexican patent before the issuance of a health and safety certificate. The United States will continue to monitor the implementation of the new regulation.

3. Brazil and the Southern Cone

a. Mercosur (Argentina, Brazil, Paraguay and Uruguay)

The Common Market of the South, referred to as "Mercosur," from its Spanish acronym, is the largest trade bloc in Latin America. As a customs union, Mercosur is a free trade area (FTA) that applies a common external tariff (CET) to products of nonmembers. Its members, Argentina, Brazil, Paraguay, and Uruguay, make up over one-half of Latin America's gross domestic product. Bolivia, Chile, and Peru are associate members and participate in the Mercosur FTA, but not in the CET. Mercosur became operative on January 1, 1995, and covers some 85 percent of intra-Mercosur trade, with each member allowed to maintain a list of sensitive products outside the FTA regime. Members aim to converge their individual tariff schedules to the CET by January 1, 2006. The four Mercosur countries are acting as a group in the context of the FTAA negotiations.

Four Plus One: In September 2001, the United States and the four Mercosur countries resumed meeting under the auspices of the 1991 Rose Garden Agreement. This agreement created a framework, known as the Four Plus One, for the United States and the Mercosur countries to discuss means to deepen their trade relationship.

b. Argentina

U.S. goods exports to Argentina were $2.4 billion in 2003, up 52 percent from 2002. Overall bilateral trade was $5.6 billion, and the U.S. deficit of $1.6 billion in 2002 decreased to $0.8 billion in 2003. A key factor in the Argentine economy is its trade with Brazil, Argentina's number one trading partner.

On July 1, 2003 President Bush signed a Proclamation expanding the product coverage of the Generalized System of Preferences (GSP) program, under which 140 beneficiary developing countries and territories, including Argentina, import products duty-free into the United States. The President's Proclamation extends GSP benefits to approximately $900 million in imports from these countries through the addition of new products, the restoration of previously lost benefits, and the continuation of benefits that would otherwise expire. The Proclamation underscores the Administration's commitment to providing trade opportunities to developing countries as a way to encourage broad-based economic development. The President's action resulted in additional GSP benefits valued at more than $96 million for Argentina.

DUSTR Allgeier met with his Argentinian counterpart October 22-23, 2003 in a meeting of the U.S.-Argentina Bilateral Council on Trade and Investment (BCTI). Among the issues discussed were the problems of U.S. investors and Argentina's need to honor the commitments made in its Bilateral Investment Treaty (BIT).

Intellectual Property Rights (IPR): Argentina's intellectual property rights regime does not yet appear to meet TRIPS standards and fails to fulfill long-standing commitments to the United States. Failure to provide adequate protection for copyright and patents has led to Argentina's placement on the Special 301 Priority Watch List through 2003. In 1997, the United States withdrew 50 percent of Argentina's benefits under GSP over this same issue, and benefits will not be restored unless the concerns of the United States are addressed adequately. In May 1999, the United States initiated a WTO case against Argentina because of its failure to protect patents and test data. The United States added additional claims to this case in May 2000, due to the fact that the TRIPS Agreement became fully applicable for Argentina in the year 2000. The United States engaged in a series of consultations with Argentina in Geneva throughout 2001, however, the problem remained unresolved. The establishment of the BCTI gave the two countries a vehicle to address various bilateral trade issues.

As a result of the April 24, 2002 meeting of the BCTI, the U.S. and Argentina finalized the elements of a joint notification to the World Trade Organization (WTO) regarding the dispute on intellectual property matters. In the joint notification, Argentina clarified how certain aspects of its intellectual property system, such as those related to its import restriction regime, operate so as to conform with the TRIPS Agreement. In addition,

2 2003 estimates are annualized based on 11 months' data.

Argentina agreed to amend its patent law to provide protection for products obtained from a process patent and to ensure that preliminary injunctions are available in intellectual property court proceedings, among other amendments. Finally, on the remaining issues, including that of data protection, the United States retains its right to seek resolution under the WTO dispute settlement mechanism. Argentina and the United States notified a settlement of these issues to the WTO on May 31, 2002. Consultations continue on the unresolved issues.

c. Brazil

The United States exported goods valued at an estimated $10.9 billion to Brazil in 2003. Brazil's market accounts for 21 percent of U.S. annual exports to Latin America and the Caribbean excluding Mexico, and 77 percent of U.S. goods exports to Mercosur.[2]

Intellectual Property Rights (IPR): In 1997, Brazil enacted laws providing protection for computer software, copyrights, patents, and trademarks. The United States has identified certain problems with parts of this legislation, including a local working requirement and extensive exceptions in the patent law to a prohibition on parallel imports. U.S. industry has also voiced concerns about the high levels of piracy and counterfeiting in Brazil, the lack of effective enforcement of copyright (especially for sound recordings and video cassettes), and trademark legislation. In 2001, the International Intellectual Property Association (IIPA) filed a petition to remove Brazil's GSP benefits due to its failure to offer adequate protection to copyrighted materials, in particular sound recordings. There was a GSP hearing regarding Brazil's failure to protect copyrighted material in 2003. The GSP Committee will make recommendations regarding the petition to the USTR.

d. Paraguay

With a population of just over five million, Paraguay is one of the smaller markets in Latin America. In 2003, the United States exported an estimated $499 million worth of goods to Paraguay.[3] However, Paraguay is a major exporter of, and a transshipment point for, pirated and counterfeit products in the region, particularly to Brazil.

Intellectual Property Rights (IPR): In January 1998, the USTR identified Paraguay as a "Priority Foreign Country" (PFC) under the "Special 301" provisions of the Trade Act of 1974. As required under the Trade Act of 1974 as amended, the USTR initiated an investigation of Paraguay in February 1998.

During negotiations under Special 301, the Government of Paraguay indicated that it had undertaken a number of actions to improve IPR protection. In November 1998, in light of commitments made by the Government of Paraguay in a bilateral Memorandum of Understanding (MOU), USTR concluded its Special 301 investigation. In December 2003, the two governments revised and extended the term of the MOU.

U.S.-Paraguay Bilateral Council on Trade and Investments

On September 26, 2003, following his meeting with President Bush, Paraguayan President Duarte witnessed the signing of the Agreement on the U.S.-Paraguay Bilateral Council on Trade and Investments. AUSTR Vargo signed for the United States and Foreign Minister Rachid signed for Paraguay.

e. Uruguay

With the smallest population of Mercosur (just over three million people), Uruguay nonetheless imported an estimated $336 million of goods from the United States in 2003. The United States has been meeting with Uruguay under the auspices of the U.S.-Uruguay Joint Commission on Trade and Investment (JCTI) since AUSTR Regina Vargo and Uruguayan Vice Minister Valles signed the agreement in April 2002. The

3 2003 estimates are annualized based on 11 months' data.

JCTI has been a forum to discuss deepening trade relations as well as to work toward resolution of bilateral irritants.

The last meeting of the JCTI in 2003 was held on the occasion of a visit to Uruguay by DUSTR Allgeier in October. At that meeting DUSTR Allgeier discussed the possibility of negotiating a BIT as well as other sectoral bilateral agreements. During the November 2003 Miami FTAA Ministerial USTR Zoellick and Uruguayan Foreign Minister Opertti announced the decision to initiate negotiations of a BIT in early 2004.

f. Chile

U.S.-Chile bilateral trade relations in 2003 were dominated by the negotiation of an FTA as discussed at the beginning of this Chapter.

4. The Andean Community

a. The Andean Region

The U.S. goods trade deficit with the Andean region (comprising Bolivia, Colombia, Ecuador, Peru and Venezuela) increased from $13.6 billion in 2002 to an estimated $18.5 billion in 2003 (2003 based on annualized 11 month data). U.S. goods exports to the region were an estimated $9.6 billion in 2003, a decline of 15.8 percent from 2002.

i. U.S.-Andean Free Trade Agreement Negotiations

On November 18, 2003, U.S. Trade Representative Robert B. Zoellick formally notified Congress, on behalf of President Bush, of the Administration's intent to initiate negotiations for a free trade agreement with Colombia, Peru, Ecuador, and Bolivia. The Administration plans to structure the negotiations to begin in the second quarter of 2004, initially with Colombia and Peru. The United States is prepared to work intensively with Ecuador and Bolivia in order to include them in the agreement as well. As a destination for U.S. exports, the Andeans collectively represented a market of $7 billion in 2002, while the U.S. imported $9.8 billion from the region. The stock of U.S. foreign direct investment in the four countries was $4.5 billion in 2002.

ii. Andean Trade Preference Act

The U.S. trade relationship with the Andean countries is currently conducted in the framework of the unilateral trade preferences of the Andean Trade Preference Act (ATPA), as amended by the Andean Trade Promotion and Drug Eradication Act (ATPDEA). Congress enacted the ATPA in 1991 in recognition of the fact that regional economic development is necessary in order for Bolivia, Colombia, Ecuador and Peru to provide economic alternatives for the illegal drug trade, promote domestic development, and thereby solidify democratic institutions. The ATPDEA was signed into law on August 6, 2002 as part of the Trade Act of 2002. The program provides enhanced trade benefits for the four ATPA beneficiary countries.

The original ATPA expired in 2001. The ATPDEA retroactively restored the benefits of the ATPA, providing for retroactive reimbursement of duties paid during the lapse. In addition, the original ATPA included prohibitions on the extension of duty-free treatment in several sectors: for textiles, apparel, footwear, leather, tuna in airtight containers, and certain other items. The ATPDEA expanded the list of items eligible for duty-free treatment by about 700 products.

Apparel imports under ATPA accounted for nearly 13 percent of U.S. imports under ATPA in January-August 2003 and for 67 percent of all apparel imports from the region during the 2003 period. New products benefitting from the program include: tuna in pouches, leather products, footwear, petroleum and petroleum products, and watches and watch parts.

iii. ATPDEA Eligibility

The ATPA established a number of criteria that countries must meet in order to be designated as eligible for the program, and the ATPDEA added further eligibility criteria and provided for an annual review of the countries' eligibility. The new criteria relate to issues such as intellectual property rights, worker rights, government procurement procedures, and cooperation on countering narcotics and combating terrorism.

USTR initiated the 2003 ATPA Annual Review in a Federal Register notice dated August 14, 2003, and announced a deadline of September 15, 2003 for the filing of petitions. USTR received petitions to review certain practices in certain beneficiary developing countries to determine whether such countries were in compliance with the ATPA eligibility criteria. In a Federal Register notice dated November 13, 2003 a list was published of the September 2003 petitions that were filed. Ecuador, Peru, and Colombia had petitions filed against them for reasons such as worker rights, contract nullification, intellectual property rights, expropriation, and tax disputes. In December 2003 USTR indicated that it would announce the results of the preliminary review of the petitions by March 31, 2004.

5. Central America and the Caribbean

a. U.S.-Central America Free Trade Agreement (CAFTA)Negotiations

On January 8, 2003, the United States Trade Representative and Ministers from Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua announced the launch of negotiations on an agreement to eliminate tariffs and other barriers to trade in goods, agriculture, services, and investment between the United States and those Central American nations. Negotiations on the U.S.-Central American Free Trade Agreement, or CAFTA, began in San José, Costa Rica, on January 27. Negotiators have met in a total of nine rounds, once in each Central American capital, as well as in Cincinnati, New Orleans, Houston, and finally in Washington, DC, where the United States, El Salvador, Guatemala, Honduras and Nicaragua completed work on the FTA in mid-December 2003. Negotiations with Costa Rica continued into January 2004.

The United States and Central America enjoy an increasingly productive trade partnership. U.S. exports to the region have grown 54 percent since 1996 and totaled an estimated $9.8 billion in 2002. Imports totaled almost $11.9 billion. Bilateral trade in 2003 is on target to reach $25 billion.

USTR has continued to hold periodic trade and investment meetings with the Dominican Republic throughout 2003. On August 4, 2003, the President notified Congress of his intention to enter into negotiations for an FTA with the Dominican Republic. The intention of the Administration is to hold bilateral market access negotiations from January through March in order to integrate the Dominican Republic into the CAFTA agreement, which would be submitted to Congress as a single agreement among the United States and six partners. The CAFTA countries including the Dominican Republic have the potential to form the United States' second largest market in Latin America after Mexico.

b. Central America

CACM: The United States is Central America's principal trading partner. The Central American Common Market (CACM) consists of Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua, and provides duty-free trade for most products traded among the five countries. Panama, which has observer status, and Belize participate in CACM summits but not in regional trade integration efforts. The Central American countries continued during 2003 to pursue a range of bilateral and regional trade agreements. Negotiations between Canada and El Salvador, Guatemala, Honduras and Nicaragua made substantial progress and they intend to conclude an agreement with Canada soon after the completion of CAFTA. Negotiations for a Panama-CACM free trade agreement have resulted in agreement on common disciplines; negotiations of related market access provisions continued throughout 2003.

All of the countries are active participants in the FTAA negotiations.

The President announced on November 18 his intention to enter into negotiations with Panama for a bilateral free trade agreement in the second quarter of 2004. Throughout 2003, the United States continued to meet with Panama under our existing Trade and Investment Council (TIC) mechanism. In 2003, the countries continued to meet and maintain an ongoing work program that includes investment issues. These meetings have served to prepare the bilateral relationship for the launch of FTA negotiations by helping to resolve a range of outstanding bilateral issues.

In 2002, bilateral trade between the United States and Panama totaled $1.7 billion, of which U.S. exports accounted for $1.4 billion. January-October 2003 figures showed a remarkable 35 percent increase in U.S. exports to Panama over the same period in 2002, with projected 2003 exports totaling about $2 billion. Panama receives about fifty percent of its imports from the United States. In addition, the U.S. holds approximately $25 billion in foreign direct investment in Panama, with investments in sectors ranging from finance, to maritime, to energy.

Panama was active in the FTAA and worked closely with the United States. In 2003, Panama chaired the Negotiating Group on Investment.

c. Caribbean Basin Initiative

The trade programs collectively known as the Caribbean Basin Initiative (CBI) remain a vital element in the United States' economic relations with its neighbors in Central America and the Caribbean. CBI was initially launched in 1983 through the Caribbean Basin Economic Recovery Act (CBERA), and was substantially expanded in 2000 through the U.S.-Caribbean Basin Trade Partnership Act (CBTPA). The Trade Act of 2002 increased the type and quantity of textile and apparel articles eligible for the preferential tariff treatment accorded to designated beneficiary CBTPA countries. Among other actions, the Trade Act of 2002 extended duty-free treatment for clothing made in beneficiary countries from both U.S. and regional inputs, and increased the quantity of clothing made from regional inputs that regional producers can ship duty-free to the United States annually.

In 2003, the Administration continued to work with Congress, the private sector, CBI beneficiary countries, and other interested parties to ensure a faithful and effective implementation of this important expansion of trade benefits. Beginning in January 2003, USTR negotiated a free trade agreement with several CBI beneficiaries, as called for in the legislation. Negotiation of the U.S.-Central America Free Trade Agreement (CAFTA) concluded in mid-December 2003 with El Salvador, Guatemala, Honduras, and Nicaragua, while talks continued with Costa Rica into January 2004. Market access negotiations between the United States and the Dominican Republic from January through March 2004 are intended to lead to that country's integration into CAFTA. The agreement will lock in and expand the countries' CBI benefits while simultaneously opening member countries' markets to U.S. products. In the second quarter of 2004, USTR will launch FTA negotiations with Panama.

Since its inception, the CBERA program has helped beneficiaries diversify their exports. On a region-wide basis, this export diversification has led to a more balanced production and export base and has resulted in a reduction in the region's vulnerability to fluctuations in markets for traditional products. Since 1983, the year prior to the implementation of the CBI, total CBI country non-petroleum exports to the United States have more than tripled. Light manufactures, principally printed circuit assemblies and apparel, but also medical instruments and chemicals, account for an increasing share of U.S. imports from the region and constitute the fastest growing sectors for new investment in CBERA countries and territories.

Apparel remains one of the fastest growing categories of imports from the CBI countries and territories—growing from just 5.5 percent of total U.S. imports from the region in 1984, to nearly 45 percent in 2002, valued at over US$9.5 billion. (Apparel constituted almost 59 percent of all imports from the five Central American countries with which the United States negotiated the CAFTA agreement.) Apparel has ranked as the leading category of U.S. imports from the region since 1988. The CAFTA provisions for textiles and apparel were specifically crafted to encourage integration of the North and Central American industries to prepare for an increasingly competitive global market.

CBI currently provides 24 beneficiary countries and territories with duty-free access to the U.S. market. They are: Antigua and Barbuda, Aruba, The Bahamas, Barbados, Belize, British Virgin Islands, Costa Rica, Dominica, Dominican Republic, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Montserrat, Netherlands Antilles, Nicaragua, Panama, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, and Trinidad and Tobago. When CAFTA enters into force, Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, and Nicaragua will graduate from the CBI program, although the FTA will lock in their market access at better than its current levels.

d. The Caribbean

The Dominican Republic: The Dominican Republic is the United States' largest single trading partner in the CBI region, with bilateral trade exceeding $8.4 billion in 2002. Annualized projections from January through October 2003 figures show a projected 3.6 percent increase in bilateral trade versus 2002. Reflecting the importance of this trade relationship, the President announced on August 4, 2003, his intention to negotiate a free trade agreement with the Dominican Republic. The United States and the Dominican Republic had revitalized the Trade and Investment Council (TIC) mechanism and held productive meetings under the TIC during 2002, covering both bilateral issues and cooperation in the FTAA and WTO negotiations. The TIC continued to meet throughout 2003, which helped prepare both sides to begin FTA negotiations in January 2004.

The Dominican Republic continues to lead all countries in taking advantage of CBI, as they have done in virtually every year since the program became effective, accounting for 28 percent of U.S. imports under CBI provisions. The Dominican Republic does not belong to any regional trade association, but has negotiated trade agreements with its partners in Central America and CARICOM. After the Dominican Republic and the United States conclude market access negotiations in March 2004, the Dominican Republic will be integrated into CAFTA along with its Central American partners.

The Dominican Republic's relatively open trade and investment regime, augmented by recent fiscal reforms, has made it one of the world's fastest growing economies over the last decade and an economic engine in the Caribbean Basin. It maintains strong trade relations within the Caribbean, including with its neighbor, Puerto Rico, and with Central America, thus serving as an economic bridge within the region. Adding the Dominican Republic as an FTA partner will build on the progress we have made through our bilateral TIC meetings over the last year, where the Dominican Republic has made important efforts to resolve bilateral trade and investment issues. Through this process, the Dominican Republic has become a reliable trade partner in the region and also has worked closely with us to advance common objectives in the World Trade Organization (WTO) and FTAA negotiations. The Dominican Republic chaired the Negotiating Group on Intellectual Property and served as vice-chair for the Negotiating Group on Market Access.

CARICOM: Members of the Caribbean Community and Common Market (CARICOM) are: Antigua and Barbuda, The Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname, and Trinidad and Tobago. In theory, CARICOM is a customs union rather than a common market. However, progress towards a customs union remains limited.

CARICOM countries are active in the FTAA negotiations, which provide opportunity for frequent bilateral dialogue between U.S. and Caribbean officials. CARICOM serves as chair for the FTAA Negotiating Group on Services and the Consultative Group on Small Economies and as vice-chair on the Negotiating Group on

Competition Policy. In addition, the United States Trade Representative met with CARICOM trade ministers in Jamaica in July, 2003, to discuss ways to further enhance our trade relations both bilaterally and in multilateral trade negotiations.

D. Western Europe

Overview

The U.S. economic relationship (measured as trade plus investment) with Western Europe is the largest and most complex in the world. Due to the size and nature of the transatlantic economic relationship, serious trade issues inevitably arise on occasion. Sometimes small in dollar terms, especially compared with the overall value of transatlantic commerce, these issues can take on significance for their precedential impact on U.S. trade policies.

The United States' trade relations with Western Europe are dominated by its relations with the European Union (EU). From its origins in the 1950s, the EU has grown from six to fifteen Member States, with Austria, Finland, and Sweden becoming the newest EU member states on January 1, 1995. These fifteen countries together comprise a market of some 370 million consumers with a total gross domestic product of more than $8 trillion. U.S. goods exported to the EU totaled an estimated $143.5 billion in 2002. On May 1, 2004, the EU will expand again, to incorporate ten new member states from Central and Eastern Europe (Poland, Hungary, Czech Republic, Slovakia, Slovenia, Estonia, Latvia and Lithuania), as well as Cyprus and Malta. The combined EU of 25 will represent a market of more than 450 million consumers.

The other major trade group within Western Europe is the European Free Trade Association (EFTA), which includes Switzerland, Norway, Iceland, and Liechtenstein (Austria, Finland, and Sweden had also been members prior to their accession to the EU in 1995). Formed in 1960, EFTA provides for the elimination of tariffs on manufactured goods and selected agricultural products that originate in, and are traded among, the member countries. The EFTA countries are linked to the EU through a free trade agreement. Norway, Iceland, and Liechtenstein have further structured their economic relations with the EU through the Agreement on the European Economic Area (EEA), which permits the three countries to participate in the EU Single Market (Switzerland rejected the EEA in a referendum at the end of 1992). In practice, the EEA involves the adoption by non-EU signatories of approximately 70 percent of EU legislation.

2003 Activities

1. European Union

In 2003, the EU began to prepare in earnest for the historic step of integrating eight Central and Eastern European countries into the Union. The planned May 1, 2004, accession of these countries, plus Cyprus and Malta, will bring the EU a considerable distance closer to a single market encompassing the entire European continent. The EU has also committed to enter into accession negotiations with Romania and Bulgaria (Turkey remains an accession candidate, with no EU commitment to commence formal negotiations). Important EU institutional questions associated with enlargement still need to be resolved as the enlargement process proceeds.

In 2003, USTR continued to devote considerable resources to addressing issues of trade concern with the EU and its individual Member States, as well as to promoting efforts to enhance the transatlantic economic relationship.

a. Geographical Indications

The EU's system for the protection of geographical indications, namely Council Regulations 1493/99 for wines and spirits and 2081/92 for other agricultural products, is not available to other WTO Members on a national treatment basis. In order to receive protection, all non-EU WTO members are required instead to establish a GI registration system that the EU considers to be equivalent to its own system or negotiate a specific bilateral agreement with the EU. Under the terms of the WTO TRIPS Agreement as well as the GATT, the EU is obligated to make such special protection available to all WTO Members, without the requirement for concluding special agreements or establishing special systems. In addition, both EU regulations appear to deprive non-EU trademark owners of TRIPS-level ownership rights in the event of a conflict with later-in-time geographical indications. U.S. industry has been vocal in raising concerns about the impact of these EU regulations on U.S.-owned trademarks.

For these reasons, in 1999 the United States initiated formal WTO consultations with the EU on Regulation 2081/92. A number of subsequent bilateral discussions have taken place; however, to date the EU has not adequately addressed the United States' concerns. In August, 2003, after requests made by the United States and Australia, the WTO established a panel to hear the dispute. The panel is in the process of being composed.

b. Agricultural Biotechnology

The EU's five-year moratorium on the approval of new products of modern agricultural biotechnology continues to hinder U.S. exports of corn, and threatens exports of soya. Restarting the EU approvals process remains a high priority for the United States in order to restore these exports. Despite implementation of EU Directive 01/18 in October 2002 (which governs the approval of biotechnology products, including seeds and grains, for environmental release and commercialization), a number of EU Member States have continued to refuse lifting the approvals moratorium. In May 2003, the U.S. Government initiated a dispute settlement process in the WTO to underscore its concerns regarding the failure of the EU to have a functioning approval process.

Several Member States have insisted that new EU regulations governing traceability and labeling and biotechnology food and feed authorizations must first enter into force before they will consent to renewed approvals. The traceability/labeling and food/feed regulations are now scheduled to come into effect in April 2004. USTR is consulting with other agencies and the private sector regarding the likely trade impact of these regulations.

c. Transatlantic Economic Partnership/Positive Economic Agenda

At the May 1998 U.S.-EU Summit in London, the President and EU Leaders announced the Transatlantic Economic Partnership (TEP) initiative, designed to deepen and systematize cooperation in the trade field. Under the TEP, the two sides identified a number of broad areas in which they committed to work together in order to increase trade, avoid disputes, address disagreements, remove barriers, and achieve mutual interests. These areas included: technical barriers to trade, agriculture, intellectual property, government procurement, services, electronic commerce, environment and labor.

Building upon work begun under the TEP, U.S. and EU Leaders at the May 2002 U.S.-EU Summit in Washington agreed on a list of priority subject areas in which the United States and the EU committed to initiate, or give new impetus to existing, cooperative efforts. Labeled as the "Positive Economic Agenda," both sides have indicated their interest in using this list as a first step in an open-ended process of enhancing transatlantic cooperation, both for its own sake and as a means to put headline-grabbing trade disputes in their proper context. The agenda initially covers activities with respect to financial markets, regulatory cooperation, electronic procurement and customs, regulation of organic foods, and sanitary and phytosanitary measures. Work on these issues continued through 2003, leading in particular to a number of projects launched under the TEP Guidelines for Regulatory Cooperation and Transparency and completion of a bilateral mutual recognition agreement (MRA) covering marine safety. (See section on Regulatory Cooperation below.) In addition, the two sides made substantial progress toward resuming U.S. exports to the EU of poultry meat, suspended since 1997 due to EU sanitary and phytosanitary concerns. (See section on Poultry Meat below.)

d. Public Dialogues

Important companions to the official exchanges between governments in the United States and the EU are the various private dialogues among European and American businesses, labor organizations, and consumer groups. The first of these to be established, the Transatlantic Business Dialogue (TABD), is a forum in which American and European business leaders can meet to discuss ways to reduce barriers to U.S.-European trade and investment. Other dialogues—such as the Transatlantic Consumer Dialogue (TACD)—stem from a similar premise, i.e., that corresponding organizations on both sides of the Atlantic should share views and, where possible, present joint recommendations to governments in both the United States and the EU on how to improve transatlantic relations and to elevate the debate among countries in multilateral fora. In 2003, the TABD pursued a process of reconfiguration aimed at more sharply focusing the issues it discusses with governments. The TACD continued to engage in dialogue with governments on a number of trade and economic questions.

e. Regulatory Cooperation

As traditional barriers affecting transatlantic trade and investment have declined in recent years, specific trade obstacles arising from unnecessary divergences in U.S. and EU regulations and the lack of transparency in the EU rulemaking and standardization processes have loomed relatively larger in importance. During 2003, the United States continued efforts to enhance U.S.-EU regulatory cooperation and reduce unnecessary technical barriers to transatlantic trade.

In April 2002, under the auspices of the Transatlantic Economic Partnership (TEP) initiative, the United States and the European Commission concluded "Guidelines for Regulatory Cooperation and Transparency." The TEP Guidelines outline specific cooperative steps that U.S. and European regulators are encouraged to follow in bilateral dialogues, including early and regular consultations, extensive data and information exchanges, and sharing of contemplated regulatory approaches. The Guidelines also stress improved transparency and public participation as necessary elements to promote more effective regulatory cooperation, better quality regulation, and to help minimize possible regulatory-based trade disputes. During 2003, the United States and European Commission advanced regulatory cooperation projects under the Guidelines in such areas as cosmetics, auto safety, food additives, nutritional labeling and metrology—including the conclusion of formal arrangements for extensive information exchanges on pharmaceuticals and auto safety.

In 2003, the United States and the EU finalized a new, precedent-setting mutual recognition agreement (MRA) on marine equipment, under which designated U.S. equipment which meets all U.S. requirements can be marketed in the EU without additional testing. This agreement is to enter into force during 2004. The United States also continues to pursue implementation of the 1998 U.S.-EU Mutual Recognition Agreement (MRA), which includes sectoral annexes on telecommunications equipment; electromagnetic compatibility (EMC) for electrical products; electrical safety for electrical and electronic products; good manufacturing practices (GMP) for pharmaceutical products; product evaluation for certain medical devices; and safety of recreational craft. The annexes on telecommunications equipment, EMC, and recreational craft are fully operational. We are working to bring the medical device annex into operation during 2004.

f. Foreign Sales Corporation Tax Rules

Potentially the most damaging of the trade disputes currently involving the United States and the EU is the EU's complaint to the WTO that the U.S. Foreign Sales Corporation (FSC) tax rules are an illegal export subsidy. The United States lost this case on February 24, 2000, repealed the FSC law, and enacted new legislation (the Extraterritorial Income Exclusion Act—ETI) in November 2000 to correct the shortcomings identified in the dispute. On January 14, 2002, the WTO review of the new legislation was completed, resulting in a finding that the ETI act is also WTO-inconsistent. Subsequently, a WTO arbitration process determined that the EU was within its rights to retaliate against up to $4.043 billion of U.S. products if the United States fails to bring its law into conformity with the WTO ruling. In 2003, legislation was introduced in both houses of Congress that would, *inter alia*, repeal the November 2000 law. In December 2003 the European Council approved a regulation providing for EU retaliation against U.S. exports beginning March 1, 2004 if the United States fails to comply with the WTO ruling. The Administration will be working with the Congress in 2004 as Congress considers a legislative solution that would bring the United States into compliance with its WTO obligations in this area. (For more information on this dispute, see Chapter II.)

g. Chemicals

The EU is developing a comprehensive new regulatory regime for chemicals which will impose extensive new testing and reporting requirements on over 30,000 chemicals, and extend data requirements to downstream users of chemicals. The proposal could affect the majority of U.S. goods exported to the EU ($143 billion in 2002).

During 2003, while supportive of the EU's objectives to protect human health and the environment, the United States stressed that this draft regulation appears to adopt a particularly costly, burdensome, and complex approach, which could prove unworkable in its implementation, adversely impact innovation and disrupt global trade. The proposal also departs from ongoing international regulatory cooperation efforts. We will continue to monitor closely revisions to this draft regulation, and remain engaged constructively with the European Union to ensure that U.S. interests are protected.

h. Ban on Growth Promoting Hormones in Meat Production

The EU continues to ban the import of U.S. beef obtained from cattle treated with growth-promoting hormones. In 1996 the United States challenged the EU ban on imports of U.S. beef in the WTO. In June 1997, a WTO panel found in favor of the United States on the basis that the EU's ban was inconsistent with the EU's obligations under the WTO Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement) because the EU failed to provide an adequate scientific risk assessment. In January 1998, the WTO Appellate Body upheld the panel's finding that, absent a risk assessment, the EU's ban on imported meat from animals treated with certain growth-promoting hormones is inconsistent with obligations under the WTO SPS Agreement. In 1999, the WTO authorized U.S. trade retaliation because the EU failed to comply with the WTO rulings by the May 13, 1999 deadline. Subsequent to receiving WTO authorization, in July 1999 the United States applied 100 percent duties on $116.8 million of U.S. imports from the EU.

In October 2003, the EU amended its original hormone directive based on what it claimed were new studies that support the EU claim that growth hormones in beef production are unsafe. Later, during a WTO Dispute Settlement Body meeting, the EU announced that it was now in compliance with the earlier WTO ruling based on its new directive. The United States, supported by other member states, rejected the EU's assertion and maintains its retaliation on EU products as a result of the earlier WTO ruling.

The United States remains open to exploring possible ways to resolve this dispute.

i. Poultry Meat

The EU continues to maintain its 1997 ban on imports of U.S. poultry because many U.S. producers use washes of low-concentration chlorine as an antimicrobial treatment (AMT) to reduce the level of pathogens in poultry meat production, a practice not permitted by the EU's sanitary regime. During 2003, the United States gained EU approval for the use of alternative AMTs and approval of its residue program and water standards. The U.S. continues to provide the EU with information regarding U.S. food safety rules for poultry to address outstanding EU concerns with a view to reestablishing poultry exports to the EU. The issue remains a key one in the Positive Economic Agenda. (See section on Positive Economic Agenda above).

j. Wine

U.S.-EU negotiations on a bilateral wine agreement were launched in 1999 and accelerated in 2003. Key U.S. industry concerns are EU recognition and acceptance of U.S. wine making practices, removal of EU import certification requirements and reductions in the EU's export subsidies and subsidies to its grape growers and wine producers. A major EU concern is restriction of the use of semi-generic wine names exclusively to wines of EU origin. Other U.S. issues include tariffs and trade restrictive requirements under the April 29, 2002 EU wine labeling regulation (Commission Regulation No. 753/2002). The United States will continue to press the EU to provide U.S. wine makers equitable access to the EU market.

k. Margin of Preference

In mid-2003, the European Commission (EC) notified the United States of its intentions to withdraw from market access concessions on rice made during the Uruguay Round. These concessions, known as the Margin of Preference (MOP), were meant to replace the EU's pre-1995 variable levy system for rice, so as to ensure maintenance of market access opportunities for rice imports into the EU. The EC proposes replacing the MOP with global Tariff-Rate Quotas (TRQs) for rice imports.

The United States is one of the leading suppliers of rice to the EU market. Since the MOP scheme went into effect, EU duties on rice have decreased by half and will decline significantly more under the MOP, as a result of recent EU reforms to its Common Agriculture Policy (CAP). Consequently, although under GATT Article XXVIII the EU has the right to modify its rice regime, the United States will continue to oppose any action that would impair market access for U.S. rice.

In 2002, the EC attempted to negotiate similar changes to MOP concessions for grains. In the end, the United States and the EC reached an agreement that maintained these concessions for almost all wheat and feed grain imports.

2. EFTA

Although USTR activity in 2003 with the EFTA countries as a group was modest, the United States made substantial progress on negotiation of a mutual recognition agreement (MRA) with the EFTA EEA countries (i.e., Norway, Iceland, and Liechtenstein) which will cover telecommunications equipment, electro-magnetic compatibility (EMC), and recreational craft. We aim to conclude this MRA in early 2004. We are also looking to increase U.S. engagement with the EFTA countries and explore ways to foster closer U.S.-EFTA trade and economic relations.

3. Turkey

General: As a result of its 1996 customs union with the European Union, Turkey applies the EU's common external customs tariff for third country (including U.S.) imports and imposes no duty on non-agricultural imports from EU and EFTA countries. Turkey's harmonization of its trade and customs regulations with those of the EU, coupled with a decline in most of its MFN tariff rates, benefits third country exporters as well. Nevertheless, Turkey continues to maintain high tariff rates on many agricultural and food products to protect domestic producers. The Turkish Government also levies high duties, as well as excise taxes and other domestic charges, on imported alcoholic beverages that increase wholesale prices by more than 200 percent. Turkey does not permit any meat imports.

Investment: While Turkey's legal regime for foreign investment is liberal, private sector investment is often hindered, regardless of nationality, by: excessive bureaucracy; political and macroeconomic uncertainty; weaknesses in the judicial system; high tax rates; a weak framework for corporate governance; and frequent, sometimes unclear changes in the legal and regulatory environment.

The Turkish government is considering legal and other changes to reduce red tape and dismantle other barriers to investment.

Intellectual Property: While maintaining that it is in full compliance with its obligations under the WTO TRIPS agreement, Turkey provides neither patent protection nor adequate data exclusivity for pharmaceutical products, both of which are required under TRIPS. Turkey has passed a patent law, but it will only protect drugs coming on the market in another 3-4 years. Local producers still rely on data submitted by drug inventors in registering their generic copies. The U.S. Government continues to urge Turkey to adopt data exclusivity retroactive to January 2000, when Turkey's TRIPS obligations came into effect.

Qualifying Industrial Zones (QIZs): Legislation introduced in both the Senate and the House of Representatives to make Turkey eligible for the Qualifying Industrial Zone (QIZ) program was not enacted by Congress prior to adjournment. The Administration had submitted draft legislation to the Congress in 2002 to amend current QIZ legislation to permit Turkish participation in the program.

E. Central, Eastern and Southeast Europe

Overview

The United States has developed strong trade and investment links and actively supported political and economic reforms in the countries of Central and Eastern Europe (Poland, Hungary, Slovenia, the Czech Republic, Slovakia, Estonia, Latvia and Lithuania) and Southeast Europe (Romania, Bulgaria Croatia, Albania, Bosnia-Herzegovina, the Former Yugoslav Republic of Macedonia, and Serbia and Montenegro). On April 4, 2003, the Former Yugoslav Republic of Macedonia joined most of the countries in this region in becoming a formal member of the WTO. Other WTO members include: Poland, Hungary, the Czech Republic, Slovakia, Romania, Albania, Slovenia, Croatia, Latvia, Lithuania, and Estonia.

During 2003, the United States also restored a trade agreement to extend Normal Trade Relations (formerly referred to as most-favored nation or MFN) to Serbia and Montenegro and maintained Generalized System of Preferences (GSP) benefits to eligible countries in the region.

With a strong trade framework in place, USTR and its interagency colleagues worked during 2003 to ensure that Central and Eastern Europe and Southeast European countries satisfy their bilateral and multilateral trade obligations and comply with U.S. trade laws and regulations, such as those governing eligibility for participation in the GSP program.

2003 Activities

1. EU Accession

A key emerging area of activity in 2003 was working with the countries slated to enter the European Union in May 2004 (Estonia, Latvia, Lithuania, Poland, Slovakia, Czech Republic, Hungary and Slovenia, as well as Cyprus and Malta) to ensure that the accession process does not adversely affect U.S. commercial interests in the region. USTR and other U.S. agencies engaged these countries on a wide range of trade policy issues related to EU accession, including: their adoption of the EU's standards, regulations and conformity assessment procedures, including sanitary and phytosanitary requirements, testing, certification, and labeling requirements; and their eventual entry into multilateral and bilateral agreements to which the European Union and/or individual EU member states are parties.

USTR and other U.S. agencies also concluded discussions with these countries and the European Commission to amend several bilateral investment treaties (BITs) to ensure that countries entering the European Union retained guarantees related to compensation for expropriation, transfers in convertible currency, and the use of appropriate dispute settlement procedures. The United States also is working with several accession countries to preserve protections and rights negotiated as part of our Bilateral Trade Agreements with them.

2. Tariff Differentials

The United States has been strongly supportive of the integration of the Central and East European countries into the European Union. Ten Central European countries (Poland, Hungary, Slovenia, the Czech Republic, Slovakia, Romania, Bulgaria, Estonia, Latvia, and Lithuania) have concluded Europe Agreements with the EU that set the stage for their EU membership. These agreements provide for the reduction to zero of virtually all tariff rates on industrial goods and preferential rates and quotas for many agricultural goods traded between the EU and these countries. Later agricultural agreements (the "Zero-Zero Agreements") further reduced tariffs on the majority of agriculture goods. U.S. goods continue to face generally higher MFN rates in these countries, creating a tariff differential vis a vis EU goods.

Upon their entry into the European Union, these countries will adopt the EU's common external tariff rate (CXT), which will reduce some of these differentials, but raise tariffs in other areas. The United States has been consulting with several key countries to minimize the tariff differential problem in the interim before accession. In September 2002, Poland lowered tariffs on key U.S. exports to Poland. In April 2002, Hungary implemented a similar agreement. From 2001 to 2003, the Czech Republic and Slovakia agreed to waive tariffs on large civil aircraft and key parts. As a result, the United States continued its support for these countries' participation in the Generalized System of Preferences program until their accession to the EU in May 2004. In October 2003, USTR and other U.S. agencies launched similar negotiations with Bulgaria and continued tariff reduction talks with Romania, which were launched in October 2002.

3. Generalized System of Preferences

Most of the countries in this region participate in the Generalized System of Preferences program (except Serbia and Montenegro and Slovenia; the latter graduated in 2003 because of its increased income levels). As required by the GSP statute, countries entering the EU in 2004 will no longer receive GSP benefits after accession to the European Union.

The GSP statute provides that a country may not receive GSP benefits if it affords preferential treatment to the products of a developed country, other than the United States, that has a significant adverse effect on U.S. commerce. As noted above, the U.S. Government has consulted with several countries concerning those countries' granting, pursuant to their Europe Agreements with the EU, of preferential tariffs to EU exporters vis-a-vis U.S. exporters.

4. Intellectual Property Rights

The United States has concluded bilateral agreements covering intellectual property rights (IPR) protection with many of the countries in Central and Eastern and Southeast Europe. USTR's focus in the region is to closely monitor WTO Members' compliance with the TRIPS Agreement, improve enforcement of IPR legislation, and counter trends such as copyright and trademark piracy. The U.S. Government has provided technical assistance to the countries in the region to help improve the level of IPR protection.

a. Poland—Piracy

In 2003, USTR placed Poland on the Special 301 Priority Watch List because of strong concerns about an open air market inside the Government-owned Warsaw Stadium, which is awash in pirated optical media products and counterfeit goods. In addition, optical disc piracy is on the rise. There are concerns that pirated products may be produced in Poland itself as well as entering via its porous borders. Finally, despite a new pharmaceutical law that came into effect in October 2002, there are still significant shortcomings with the protection of confidential test data submitted for marketing approval.

b. Croatia and Romania: Data Exclusivity

Protecting the confidential data submitted by pharmaceutical firms to health authorities in order to obtain marketing approval remained a top USTR priority in 2003. On January 1, 2003, Hungary put into effect a ministerial decree providing for data exclusivity protection. The decree, however, remains problematic because it links protection to the existence of a patent and provides an inappropriate starting point for the period of protection. During 2003, USTR and other U.S. agencies pressed Croatia to provide adequate protections for confidential test data, ratify a 1998 Memorandum of Understanding Concerning Intellectual Property Rights, and provide sufficient enforcement of its IPR laws, especially those regarding copyrights and patents.

c. Latvia, Lithuania, Romania: Copyright Piracy

USTR retained Latvia, Lithuania, and Romania on the Special 301 Watch List in 2003. Latvia has improved its intellectual property rights regime to meet its TRIPs obligations, but important enforcement concerns remain. Large volumes of pirated products, including pirate optical media products are transshipped through Latvia from Russia and Ukraine. Lithuania faces similar IPR enforcement challenges and appears to remain a major transshipment country, as well. In 2003, the U.S. government urged the Romanian Government to strengthen its efforts against piracy by encouraging more anti-piracy raids with clear basis for civil ex parte searches, more piracy cases launched by prosecutors, and increased border enforcement.

5. Bilateral Trade Agreements and Bilateral Investment Treaties

The United States has some form of bilateral trade agreement with all of the Central European countries. In addition to these general trade agreements, the United States has concluded a variety of trade agreements concerning specific product areas with various Central European countries, such as those regarding textiles with Romania and Macedonia, customs valuation with Romania, and poultry with Poland.

The United States has Bilateral Investment Treaties (BITs) in force with Albania, Bulgaria, the Czech Republic, Estonia, Latvia, Lithuania, Poland, Romania, Slovakia, and Croatia.

F. Russia and the Newly Independent States

Overview

Over the past decade, the United States has been actively supporting political and economic reforms in the Newly Independent States (NIS) (Russia, Ukraine, Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan, and Uzbekistan). The U.S. Government has been striving to construct a framework for the development of strong trade and investment links between the United States and this region. This approach has been pressed on both bilateral and multilateral fronts. Bilaterally, the United States has negotiated trade agreements to extend Normal Trade Relations (formerly referred to as "most-favored nation" or "MFN") tariff treatment to these countries and to enhance intellectual property rights (IPR) protection. The United States also has extended Generalized System of Preferences (GSP) benefits to eligible developing countries and has negotiated bilateral investment treaties (BITs) to guarantee compensation for expropriation, transfers in convertible currency, and the use of appropriate dispute settlement procedures. Multilaterally, the United States has encouraged accession to the WTO as an important method of supporting economic reform. Now that much of this framework is in place, USTR and its interagency colleagues are working to ensure that the NIS satisfy their bilateral and multilateral trade obligations, as well as comply with U.S. trade laws and regulations.

2003 Activities

1. Normal Trade Relations Status

Russia, Ukraine, and seven of the other NIS republics within the region receive conditional NTR tariff treatment pursuant to the provisions of Title IV of the Trade Act of 1974, also known as the Jackson-Vanik amendment. Under the Jackson-Vanik amendment, the President is required to deny NTR tariff treatment to any non-market economy that was not eligible for such treatment in 1974 and that the President determines or seriously restricts or burdens its citizens' right to emigrate. This provision is subject to waiver, if the President determines that such a waiver will substantially promote the legislation's objectives. Alternatively, the President can determine that an affected country complies fully with the legislation's emigration requirements and report on this status semi-annually. Affected countries must also have a trade agreement with the United States, including certain specified elements, in order to obtain conditional NTR status.

The President has determined that Russia, Ukraine and all of the other NIS republics, with the exception of Belarus and Turkmenistan, are in full compliance with Title IV's emigration requirements. Belarus and Turkmenistan receive NTR tariff treatment under an annual waiver, as Congress must enact a law to terminate application of Title IV to a country. Turkmenistan became subject to an annual waiver in 2003, following the reimposition of an exit visa requirement.

In 2000, pursuant to specific legislation, the President terminated application of Title IV to Kyrgyzstan, Albania and Georgia. These countries now receive full NTR treatment. The Administration is currently consulting with the Congress and interested stakeholders with regard to removing Russia and other NIS republics from the coverage of Title IV provisions.

If a country is still subject to Jackson-Vanik at the time of its accession to the WTO, the United States has invoked the "non-application" provisions of the WTO. In such cases, the United States and the other country in effect have no "WTO relations." This situation, among other things, prevents the United States from bringing a WTO dispute based on a country's violation of the WTO or of commitments the country undertook as part of its WTO accession package. (See Chapter II for further information.)

2. Intellectual Property Rights

Since the United States has concluded bilateral agreements covering IPR protection throughout the NIS, USTR concentrates principally on ensuring compliance by these countries with their IPR obligations. In 2000, the transitional period granted developing countries and formerly centrally planned economies for compliance with the WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement) expired. Accordingly, USTR has conducted a close examination of compliance of WTO Members in the region with the TRIPS Agreement. The U.S. Government has cooperated with and provided technical assistance to the countries in the region to help improve the level of IPR protection. Much of USTR's focus in the region is on improving enforcement of existing IPR legislation. Copyright and trademark piracy has been a widespread and serious problem throughout much of the NIS. Customs and law enforcement authorities in the region are making slow progress in upgrading these countries' enforcement efforts, but continued close monitoring and technical assistance are still warranted.

Two IPR issues in the region merit special mention:

a. The Russian Federation—Widespread Optical Media Piracy

Piracy of U.S. films, videos, sound recordings, and computer software is a growing problem in Russia. In April 2003, Russia was again placed on the Special 301 "Priority Watch List" because of deficiencies in both the protection and enforcement of IPR. In 2003, USTR conducted hearings on a review of country eligibility for GSP including a review of Russia's continued eligibility to receive GSP benefits due to deficiencies in Russia's IPR regime resulting from a petition filed by the U.S. copyright industry. While Russia has revised several IPR laws, including those on the protection of trademarks, patents, integrated circuits and plant varieties, amendments to other IPR laws, including the copyright law, remain under consideration in the Duma. Notably, enforcement of IPR remains a pervasive problem. The prosecution and adjudication of intellectual property cases remains weak and sporadic; there is a lack of transparency and a failure to impose deterrent penalties. Russia's customs administration also needs significant strengthening. In October 2002, as a result of U.S. efforts to work with the Government of Russia to address the growing optical media piracy problem, the Government of Russia established an inter-ministerial task force, headed by Russian Prime Minister Kasyanov, to combat optical media piracy. Since the creation of the inter-ministerial commission, the Russian government has taken some steps to remedy the optical media piracy problem, including raids on several of the illegal plants in operation, but piracy remains rampant and the number of plants illegally producing optical media continues to grow. Immediate adoption of effective enforcement measures to address optical media piracy are necessary, including vigorous implementation of a concrete plan to close illegal optical media plants and the adoption of an optical media law.

b. Ukraine—Optical Media Piracy

In 1999, U.S. industry estimated that Ukrainian pirates exported over 35 million pirated compact discs (CDs) to Europe and elsewhere, which represented over $200 million in lost revenues. In June 2000, Ukrainian President Kuchma committed to a plan of action to stop the unauthorized production of CDs and to enact legislation to outlaw such piracy by November 1, 2000. However, due to Ukraine's failure to pass an adequate optical disc licensing law, USTR designated Ukraine a Priority Foreign Country in March 2000 and initiated a Special 301 investigation. In August 2001, USTR withdrew GSP beneficiary status from Ukraine. On December 11, 2001, USTR announced that the U.S. Government would impose 100 percent duties on a list of 23 Ukrainian products with an annual trade value of approximately $75 million contingent upon the outcome of a vote on an optical media licensing law in the Ukrainian Parliament scheduled for December 13, 2001. When Ukraine failed to adopt the optical media licensing law, USTR announced on December 20, 2001 that the sanctions would take effect January 23, 2002. Ukraine has subsequently adopted an optical media licensing law, but due to flaws in the legislation, the sanctions currently remain in effect pending amendment to the optical medial licensing law to make it effective and further enforcement efforts on the part of the Ukrainian Government.

3. Generalized System of Preferences

Most of the NIS (Armenia, Georgia, Moldova, Kazakhstan, Kyrgyzstan, Russia and Uzbekistan) participate in the GSP program. Azerbaijan, Tajikistan and Turkmenistan have not applied to be designated as eligible to receive the benefits of the GSP program. Belarus's GSP benefits were suspended in 2000 due to worker rights violations.

During annual GSP product reviews, the U.S. Government has reviewed several petitions requesting changes in the products imported from the NIS which are eligible for GSP benefits. In 2003, the U.S. Government reviewed the continued GSP eligibility of wrought titanium, which has been included in the GSP program since 1997. This review remains ongoing (68 FR 40012).

USTR has also conducted annual reviews of country practices, in response to petitions from the U.S. copyright industry, to determine several countries' eligibility to receive GSP benefits. In late 2000, based on significant improvement in Moldova's IPR regime, the U.S. copyright industry withdrew its GSP petition with respect to Moldova. In August 2001, USTR withdrew GSP beneficiary status from Ukraine (see subsection on Ukraine—Optical Media Piracy above). In 2003, due to improvements made to Armenia's IPR regime, the U.S. Government terminated review of the industry's petition with respect to Armenia. The reviews of Kazakhstan, Russia and Uzbekistan remain ongoing (see subsection on the Russian Federation—Widespread Optical Media Piracy above).

4. WTO Accession

Prior to the end of 2003, four NIS countries (Kyrgyzstan, Georgia, Moldova and Armenia) had become members of the WTO. WTO accession working parties have been established for an additional seven NIS countries (the Russian Federation, Ukraine, Azerbaijan, Belarus, Kazakhstan, Tajikistan and Uzbekistan). Turkmenistan has not yet applied for observer status or membership in the WTO.

The United States supports accession to the WTO on commercial terms and on the basis of a new Member's implementation of WTO provisions immediately upon accession. The United States has provided technical assistance, in the form of short- and long-term advisors, to many of the countries in the region in support of the WTO accession process. (See Chapter II for further information on accessions.)

Russia's WTO accession was particularly active in 2003. Russia indicated an interest in accelerating the negotiations and has taken steps to put in place new and amended laws and regulations to bring it into conformity with WTO provisions. Since Russia applied for membership, the United States has strongly supported Russia's efforts to join the GATT 1947 and then the WTO, through active participation in the WTO Working Party established to conduct the negotiations and through technical assistance on how to move Russia's trade regime into conformity with WTO rules. In a series of Working Party meetings through December 2003, Russia continued to describe its trade regime, with WTO delegations noting specific aspects of the trade regime that require further legislative action to become compatible with the WTO. The United States and Russia also continued bilateral discussions on Russia's offers on goods and services market access throughout 2003.

WTO-based reforms to Russia's trade regime will strengthen its ongoing efforts for broader-based market-oriented economic reform and can help Russia integrate more smoothly into the global economy. Adopting WTO provisions will give Russia a world-class framework for IPR protection, customs duties and procedures, and application of other requirements to imports that will encourage increased investment and economic growth. Completion of the accession negotiations will depend on how rapidly Russia implements WTO rules and moves to conclude negotiations on goods and services with current WTO members.

5. Bilateral Trade Agreements and Bilateral Investment Treaties

The United States has some form of bilateral trade agreement with all of the NIS countries. In addition to these general trade agreements, the United States has concluded a variety of trade agreements concerning specific product areas with various NIS countries, such as those regarding firearms and poultry with Russia.

The United States currently has BITs in force with seven NIS countries (Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan, Moldova, and Ukraine) and has signed BITs with three others (Russia, Belarus, and Uzbekistan) for which the formal process of ratification has not been completed.

6. Country Specific Issues

The United States continued to encounter a number of country specific trade issues in the region, which were not described above. The major items are discussed below.

a. Russia—Market Access for Poultry, Pork and Beef

The United States was actively engaged with the Russian government throughout 2003 to ensure that U.S. producers of poultry, pork and beef continue to maintain access to the Russian market. Following intense discussions, in September 2003 the United States signed an agreement in principle with the Russian government that establishes market access parameters for U.S. exports of poultry, pork and beef. This agreement will be finalized through an exchange of letters with the Russian Government. Technical discussions also continue to resolve issues concerning poultry plant certification.

b. Russia—Product Standards, Testing, Labeling and Certification

U.S. companies still cite product certification requirements as a principal obstacle to U.S. trade and investment in Russia. In the context of Russia's WTO accession negotiations, we continue to urge Russia to bring its product regulations and certification requirements into compliance with international practice. The Russian government is now attempting to put in place the necessary legal and administrative framework to establish transparent procedures for developing and applying standards, technical regulations and conformity assessment procedures in Russia in order to better align with WTO rules.

There has been some movement to eliminate duplication among regulatory agencies and to clarify categories of products subject to certification. However, businesses are still experiencing difficulties in getting product approvals in key sectors. Certification is a particularly costly and prolonged procedure in the case of pharmaceuticals, alcoholic beverages, and telecommunications equipment. In many sectors, type certification or self-certification by manufacturers is currently not possible. Veterinary certification is often arbitrary and needs to be more transparent and based on science. Russian phytosanitary import requirements for certain planting seeds (notably corn, soybeans and sunflowers) appear to lack scientific basis and have blocked imports from the United States. Discussions to ease or eliminate burdensome Russian requirements are ongoing.

c. Russia—Aircraft Market Access

The United States and Russia concluded a joint Memorandum of Understanding (MOU) in 1996 which was designed to address U.S. concerns about access to the Russian civil aircraft market and the application of international trade rules to the Russian aircraft sector. Under the MOU, the Russian Federation confirmed that it intends to become a signatory to the WTO Agreement on Trade in Civil Aircraft at some point in the future. The MOU also commits the Russian Federation to provide fair and reasonable access for foreign aircraft to its market. Russia agreed to take specific steps, such as the granting of tariff waivers and the reduction of tariffs, to enable its airlines to meet their needs for U.S. and other non-Russian aircraft on a non-discriminatory basis. New tariff waivers have not been provided in recent years to keep up with demand for foreign aircraft, adversely affecting market access to Russia.

G. Mediterranean/Middle East

Overview

U.S. trade relations with the countries of Northern Africa and the Middle East have considerable potential value in terms of both U.S. commercial and foreign policy interests. The events of September 11, 2001 highlighted the importance of supporting peace and stability in the region by fostering economic development. The U.S.-Jordan Free Trade Agreement (FTA), the U.S.-Israel Free Trade Agreement, the U.S.-Morocco Free Trade Agreement, and the U.S. commitment to negotiate a Free Trade Agreement with Bahrain, together with the Trade and Investment Framework Agreements (TIFAs) established with several countries in the region, provide the context for our bilateral trade policy discussions with these countries, which are aimed at increasing U.S. exports to the region and assisting in the development of intra-regional trade.

2003 Activities

1. Morocco Free Trade Agreement

The FTA with Morocco, which is discussed earlier in this chapter in the Free Trade Agreements (section A), will support support the significant economic and political reforms underway in Morocco, and create improved commercial and market opportunities for U.S. exports.

2. Egypt

In 2003 the United States and Egypt continued efforts to expand bilateral trade and investment ties and to strengthen Egypt's economic reform program. In recognition of Egypt's 2002 passage of a comprehensive new law on intellectual property rights (IPR), an effort in which the United States provided extensive technical assistance, Egypt was moved from the Priority Watch List to the Watch List in the 2003 Special 301 Review. Four video conferences were held by the working groups formed in 2002 under the U.S.-Egypt Trade and Investment Framework Agreement (TIFA) to facilitate progress in the areas of Customs Administration and Reform and Sanitary and Phytosanitary Issues Related to Agricultural Trade, achieving modest movement in addressing barriers to some U.S. agricultural exports. The U.S. and Egypt also sought to expand cooperation in the multilateral sphere on issues related to the Doha Development Agenda. Resolution of problems affecting U.S. firms and investors in Egypt continued to be a key focus of U.S. efforts in the TIFA process in such areas as corporate taxation, barriers to U.S. apparel exports, and IPR enforcement. To assure fair access for U.S. textile and apparel producers to Egypt's market, the United States in December initiated a request for WTO consultations with Egypt on Egyptian apparel tariffs which the United States views as far in excess of Egypt's WTO tariff bindings. At year's end Egypt's IPR enforcement is a point of renewed concern, as the Egyptian Government departed from its recent positive IPR efforts by approving unauthorized copies of U.S. pharmaceuticals based on confidential test data provided by U.S. firms, contrary to Egypt's WTO commitments.

3. Israel

U.S. negotiations with Israel on a new bilateral agreement on trade in agricultural products is discussed earlier in this chapter in the Free Trade Agreements section.

4. Jordan

Qualifying Industrial Zones

Qualifying Industrial Zones (QIZs) continue to be a bright spot in Jordanian economic performance. Eleven Qualifying Industrial Zones (QIZ) have been established in Jordan since 1998. They played an important role in helping to boost Jordan's exports to the United States from $16 million in 1998 to $412 million in 2002. Jordan estimates that QIZs have created up to 30,000 jobs. Peak QIZ employment is forecast at 40,000 to 45,000. Investment in the establishment of QIZs is approximately $85 million to $100 million, which is expected to grow to $180 to $200 million when all projects are completed.

In 2001, USTR designated the eleventh QIZ in Jordan, the Zarqa Industrial Zone. Five QIZs were designated in 2000: The Investors and Eastern Arab for Industrial and Real Estate Investments Company Ltd. (Mushatta International Complex), El Zay Ready Wear Manufacturing Company Duty-Free Area, Al Qastal Industrial Zone, Aqaba Industrial Estate, and Industry and Information Technology Park Company (Jordan CyberCity Company). Four QIZs were designated in 1999, Al-Tajamouat Industrial City, Ad-Dulayl Industrial Park, Al-Kerak Industrial Estate, and Gateway Projects Industrial Zone. The first QIZ in Jordan, Irbid, opened in 1998.

QIZs are established pursuant to legislation passed by the Congress in October 1996, authorizing the President to proclaim elimination of duties on articles produced in the West Bank, Gaza Strip, and qualifying industrial zones in Jordan and Egypt. To date all QIZs have been established in Jordan.

The steady growth of QIZs testifies to the economic potential of regional economic integration. In addition to the competitive benefit of duty-free status for QIZ exports to the United States, QIZs increasingly offer participating companies the advantages of modern infrastructure and strong export expertise and linkages. This evolution should serve to increase the economic benefits of QIZs. (For a discussion of the U.S.-Jordan Free Trade Agreement, see section A on Free Trade Agreements earlier in this chapter.)

5. Trade and Investment Framework Agreements

In 2003, the United States concluded a Trade and Investment Framework Agreement (TIFA) with Saudi Arabia and started negotiations on TIFAs with Kuwait, Qatar, the United Arab Emirates, and Oman. TIFAs have been previously negotiated with Tunisia, Algeria, Morocco, Bahrain, Egypt, Jordan, and Turkey. Each TIFA establishes a bilateral Trade and Investment Council that enables USTR-chaired representatives to meet directly with their counterparts regularly to discuss specific trade and investment matters and to negotiate the removal of impediments and barriers to trade and investment.

6. WTO Accession

Negotiations on the accession to the WTO of Saudi Arabia, Algeria, and Lebanon continued in 2003. The United States supports accession to the WTO on the basis of a new Member's implementation of WTO provisions immediately upon accession and of a new Member's commercially meaningful market access commitments for U.S. goods, services, and agricultural products.

7. Intellectual Property Rights

Protection of intellectual property rights remains a leading priority in the Middle East region. Lebanon is on the Special 301 Priority Watch List, while Egypt, Israel, Kuwait, Saudi Arabia, and Turkey are on the Watch List.

8. Bahrain Free Trade Agreement

On May 21, 2003, the United States and Bahrain announced their intention to seek to negotiate a Free Trade Agreement (FTA). On August 4, 2003, USTR Zoellick formally notified Congress that negotiations would be launched in January 2004. An FTA with Bahrain will also promote the President's initiative to advance economic reforms and openness in the Middle East and the Persian Gulf and to establish a Middle East Free Trade Area (MEFTA) by 2013. The successful conclusion of a comprehensive FTA will generate export opportunities for the United States, creating jobs for U.S. farmers and workers, while supporting Bahrain's economic and political reforms and enhancing commercial relations with an economic leader in the Gulf. USTR Zoellick had consultations with Congress on the FTA in July 2003, and public hearings were held in November 2003. USTR is pursuing an aggressive negotiation schedule, and negotiations are expected to be finished by the summer of 2004.

H. Asia and the Pacific

Overview

The Southeast Asia and Pacific region continues to enjoy rapid trade and economic growth. This growth is largely the result of a commitment by many of the regional governments to economic reform and liberalization. While there is additional work to be done in opening markets in Southeast Asia and the Pacific, significant progress has been made. The commitment of regional leaders in the Asia Pacific Economic Cooperation (APEC) forum to move forward toward free and open regional trade and investment has been an important factor in spurring this regional trend (see Chapter III for information on APEC). In addition, the Administration is committed to using the Enterprise for ASEAN Initiative (EAI) to further open markets of interest to American farmers, ranchers, manufacturers, and services providers. It also will continue to work to ensure implementation of bilateral and multilateral agreements, including those protecting intellectual property, which is critical to U.S. exporters in high-technology, entertainment and other key sectors.

Highlights of the achievements in this region during 2003 include:

- *Signing of the U.S.-Singapore FTA.* In May 2003, the United States and Singapore signed an FTA, the first comprehensive agreement between the United States and an Asian nation. The FTA's provisions cover not only goods and services, but customs procedures and cooperation, investment, competition policy, intellectual property rights, electronic commerce, transparency, labor and environment. The agreement with the United States' 13th largest trading partner is expected to eliminate trade barriers between the two countries and spur bilateral trade and investment. The agreement also will serve as a benchmark for possible free trade agreements with other countries in Southeast Asia.

- *Conclusion of the U.S.-Australia FTA.* The United States and Australia concluded FTA negotiations on February 8, 2004. The United States expects the FTA with Australia to boost trade in both goods and services and enhance employment opportunities in both countries. In addition to provisions on goods and services, the FTA covers a range of other issues, including investment, intellectual property rights, customs procedures, competition policy, government procurement, labor and environment. The United States believes that this FTA will further deepen its relationship with Australia and cooperation between the two countries in the WTO.
- *Announcement of intent to enter into FTA negotiations with Thailand.* In October 2003, President Bush announced his intent to enter into FTA negotiations with Thailand in accordance with legislative procedures specified by Congress. This action reaffirms the President's commitment under his Enterprise for ASEAN Initiative (EAI) to strengthen trade ties with countries in the ASEAN region that are actively pursuing economic reforms and follows the historic FTA with Singapore.

2003 Activities

The United States advanced both regional and bilateral trade initiatives in the Southeast Asia and Pacific region in 2003 to expand opportunities for U.S. industry, farmers, and ranchers. The United States pursued bilateral FTAs and undertook other bilateral work to strengthen trade ties with the Southeast Asia and Pacific region and eliminate barriers faced by U.S. exporters in this region. Regionally, the United States continued to work with ASEAN countries to make progress on the EAI and with APEC members to reaffirm their commitment to global trade liberalization and the successful conclusion of the Doha Development Agenda, as well as to implement the Shanghai Accord, a series of specific commitments to ensure APEC reaches its free trade and investment goals.

1. Australia

In parallel with the FTA negotiations, which are discussed earlier in this chapter in Section A on Free Trade Agreements, the United States continued the extensive and detailed discussions with Australia on sanitary and phytosanitary (SPS) issues begun in 2002. The two sides continued to make progress on specific issues related to U.S. imports of beef and pet food. The two sides agreed that SPS measures must be based on science and be fully transparent. The Australian government implemented a new administrative framework in early 2002 to enhance the transparency of its SPS regime. Nonetheless, the United States continues to have concerns about the stringency of Australia's SPS regime.

2. New Zealand

The U.S. and New Zealand officials met several times in 2003 to discuss outstanding bilateral trade issues. New Zealand's two-year moratorium on applications for the release of genetically-modified organisms, about which the United States had raised concerns, expired and was replaced by new legislation setting out strict rules for release. The New Zealand government also passed legislation banning parallel imports of new films. The new legislation is a positive step, but additional action is needed to address long-standing U.S. concerns on this issue. In addition, U.S. concerns on other intellectual property issues, including trademarks and pharmaceutical issues remain. U.S. manufacturers' representatives have recently expressed concern that plans to extend Australia's regulatory regime for medical devices and complementary goods to New Zealand could impede the price competitiveness of many U.S. products in the New Zealand market.

The United States will continue working with New Zealand under the TIFA to address bilateral trade issues, as well as in APEC and the WTO to advance our common trade interests.

3. The Association of Southeast Asian Nations (ASEAN)

The Enterprise for ASEAN Initiative (EAI) is discussed in Chapter B on Regional Initiatives.

a. Indonesia

i. General

The United States has worked to bolster its trade and investment relationship with Indonesia, seeking to help strengthen Indonesia's economy and encourage liberalization and other economic reforms that would generate additional trade and foreign investment. Senior U.S. and Indonesian trade officials, including at the ministerial level, met several of times in 2003 to discuss the range of outstanding issues affecting the U.S.-Indonesian economic relationship and other issues covered under our bilateral TIFA. The two sides also discussed ways to enhance Indonesia's investment climate and facilitate trade, including through improved governance and capacity building. They discussed the need to address outstanding issues under the TIFA to resolve bilateral issues and other steps to help lay the groundwork for a free trade agreement, as envisioned by the EAI. The United States and Indonesia also supported the launch of a private study on the impact of an FTA on the two economies, which now is underway and expected to be completed by summer, 2004. Indonesia is the United States' 27th largest trading partner, with $12.2 billion in two-way trade in 2002.

ii. Intellectual Property Rights

The U.S. Government has continued to urge Indonesia to take steps to strengthen its IPR regime. USTR placed Indonesia on the Special 301 Priority Watch List in 2003 due to concerns over continued optical media piracy and weaknesses in Indonesia's IPR enforcement. Indonesia took some noteworthy steps to strengthen its IPR regime over the past year, but significant problems remain. The Indonesian government enacted an extensive revision of its copyright law in July 2002 that came into effect in July 2003 and addressed a number of the United States' concerns. Over the last year it initiated public awareness campaigns and began addressing problems of interagency coordination. In addition, in November 2003 it submitted new draft regulations governing optical media production for Presidential approval. However, these proposed regulations, if signed, still would not firmly commit Indonesia to seize and destroy machinery and materials used in piracy.

Overall, protection of intellectual property rights remains weak and U.S. industry continues to report increases in illegal optical media production lines for both domestic consumption and export. U.S. industry also has raised serious concerns about counterfeiting and trademark violations of a wide range of products. While a limited number of raids against retail outlets for pirated optical media products have occurred, long delays remain in prosecuting intellectual property cases. Sentences continue to be light and insufficient to deter intellectual property piracy, further undermining the criminal penalties established by the new copyright law. The United States worked with Indonesia under our TIFA on an IPR action plan, which the United States first provided to Indonesia in May 2002. The United States continued to urge Indonesia to implement the specific recommendations in the IPR action plan, including steps to improve the legal framework and enforcement mechanisms to protect IPR.

iii. Poultry Imports

Appropriate authorities in the United States and Indonesia have worked together to ensure that U.S. poultry exports meet Indonesian requirements for *Halal* certification, but Indonesia continues to ban imports of U.S. poultry parts. The U.S. government continued to raise this issue with the Indonesian government in 2003 and will work with Indonesia to eliminate the ban.

iv. Textiles

The United States continued to raise concerns about the Indonesia government's Textiles Decree, passed in November 2002. This Decree effectively precludes textile imports into Indonesia other than for use as inputs into other products. The U.S. Government will continue to press the Indonesian government to address its concerns on this issue.

b. Malaysia

i. General

During 2003, the United States and Malaysia consulted on ways to enhance their trade relationship and strengthen their cooperation in regional and multilateral fora. The two sides agreed to negotiate a TIFA, which is nearly completed. The United States will continue to encourage Malaysia to further open and liberalize its economy, which is heavily trade-dependent. In 2002, Malaysia was the United States' 10th largest trading partner with $34 billion in two-way trade.

ii. Intellectual Property Rights

Malaysia has made strides in strengthening its IPR regime over the past several years,, including determined efforts to eliminate optical media piracy. (Copyright legislation was passed a few years ago.) Although Malaysia has made steady progress, the United States has continuing concerns about production overcapacity, much of which appears to make its way to export markets illicitly, and over Malaysia's inability to establish a climate of deterrence by prosecuting IPR offenders and imposing sufficiently deterrent penalties. In the summer of 2003, Malaysia announced plans to implement price controls on optical disks, a proposal about which the United States voiced significant concern. In December, Malaysia announced that implementation would be delayed until April 2004. The U.S. Government will continue to urge Malaysia to drop its price control proposal and to take additional steps to further strengthen its IPR environment.

c. Philippines

i. General

The United States sought to further enhance its trade and investment relationship with the Philippines in 2003, holding two rounds of consultations under the bilateral TIFA. The two sides have used these meetings to make progress in addressing outstanding concerns. In addition, the U.S. government used these meetings to urge the Philippine government to continue liberalizing its trade regime and to reaffirm its support for global trade liberalization concluding the Doha Development Agenda. The Philippines was the United States' 22nd largest trading partner in 2002, with $13 billion in two-way trade.

ii. Intellectual Property Rights

To support the Philippines' efforts to strengthen its IPR regime, the U.S. Government in August 2002 provided the Government of the Philippines with an IPR Action Plan that included specific steps on judicial, legislative, and enforcement issues.

In December, it nearly passed an optical media law. This law, passage of which was a top U.S. priority, is intended to curb the unbridled pirate production of optical media. In addition, the Philippines Bureau of Customs passed regulations aimed at improved enforcement against trade in pirated products.

However, the Philippines government has yet to pass copyright amendments pending in its Congress, which would update the Philippines' law to address electronic commerce piracy. In addition, while the Philippines government stepped up the number of raids, it has been slow to prosecute IPR offenders and reluctant to impose sufficiently deterrent penalties. U.S. industry estimates that the weak IPR environment in the Philippines resulted in $121 million in losses in 2002.

iii. Telecommunications

The U.S. and Philippine governments successfully worked together to begin reopening U.S. access to Philippine telecommunications networks. In February 2003, Philippine telecommunications companies blocked access to their networks to incoming call traffic from certain U.S. and other foreign telecommunications companies that were unwilling to agree to tariff increases. Senior U.S. government officials, including the U.S. Trade Representative and the FCC Chairman, raised concerns over this action with the appropriate Philippine officials. In November, some telecommunications connections between the two countries were restored and ongoing negotiations appear positive. The U.S. government is continuing to monitor this issue closely to ensure that competitive access to these networks is fully restored.

iv. Customs

The Philippines has made progress over the last several years toward bringing its customs regime into compliance with its WTO obligations, but the United States has continued to have concerns about inconsistent application of customs rules and procedures and undue and costly processing delays as well as the role of the Philippine private sector in the valuation process. At consultations in September 2003, the Philippines government outlined steps it has taken to strengthen enforcement and consistency of its customs rules and step up enforcement of IPR piracy at the border. The U.S. Government will continue to closely monitor this issue.

v. Sanitary and Phytosanitary (SPS) Issues

Throughout 2003, the U.S. Government continued to urge the Philippines to abandon a proposal to require quarterly mandatory third-party inspections of meat and dairy production facilities overseas. The measure, as initially proposed in 2002, would disrupt U.S. meat and dairy exports to the Philippines, estimated at $56 million. The Philippines had announced in December 2002 that implementation of the requirement, which was to take effect January 1, 2003, would be delayed. Implementation of this proposal remained indefinitely delayed throughout 2003.

d. Singapore

The United States and Singapore negotiated a bilateral Free Trade Agreement (FTA), which was signed in May 2003 and entered into force on January 1, 2004. Discussion of U.S.-Singapore trade issues had been handled in the context of these negotiations (see U.S.-Singapore FTA).

e. Thailand

i. General

The United States continued to bolster its trade ties with Thailand in 2002, with President Bush announcing in October his intent to enter into FTA negotiations with Thailand, in accordance with the legislative procedures specified by Congress. The announcement followed three Trade and Investment Council (TIC) meetings under the bilateral TIFA and a number of sub-TIC meetings. These meetings were intended to identify and make progress on outstanding bilateral trade issues and take other steps to help lay the groundwork for a free trade agreement, as envisioned by the EAI. Thailand was the United States' 18th largest trading partner in 2002 with $20 billion in two-way trade.

ii. Intellectual Property Rights

The United States has continued to strongly urge Thailand to strengthen its IPR regime. To support Thai efforts, the U.S. Government provided it with an IPR Action Plan that included specific steps on judicial, legislative and regulatory, and enforcement issues. The Thai government has made some progress in implementing these recommendations, but significant and sustained progress is still needed.

The Thai government has not yet passed the Optical Disk Plant Control Act, which is intended to enhance the authority and capabilities of enforcement authorities to take action against pirate optical disk producers. It is drafting implementing regulations to accompany the law once it is passed, and the U.S. government has strongly urged Thailand to ensure that these regulations address some of the weaknesses in the current draft law. The Thai government also failed to introduce an amendment to its copyright law to provide more effective copyright protection and to be consistent with the WIPO Copyright Treaty and the WIPO Performance and Phonogram Treaty, despite indications earlier in the year that it would do so.

The Thai government stepped up enforcement efforts in mid-2003, leading to a noticeable short-term decline in retail piracy prior to the APEC Ministerial meeting in Bangkok in October 2003. However, street-level piracy again appears to be widely prevalent. The United States has strongly urged Thailand to take additional steps to ensure a high-level of enforcement on a sustained basis, which is critical to any serious effort to address intellectual property piracy. U.S. industry estimates losses due to piracy at over $189 million last year.

iii. Customs

Thailand made noteworthy progress in the past year addressing longstanding U.S. concerns regarding its customs rules and procedures. The U.S. Government has supported these reforms, providing Thailand in August with a proposed Customs Action Plan that includes specific proposals for steps to improve the consistency, efficiency, timeliness and transparency of Thailand's customs procedures and regulatory process, and improvement in enforcement at the border. The Thai government has implemented many of these recommendations, including some steps to implement its customs valuation legislation, which is intended to address concerns about Thailand's uneven, arbitrary, discretionary, and slow application of customs rules. It also has increased seizures of imports of infringing goods. The U.S. Government will continue to monitor Thailand's implementation of its customs valuation law and urge it to build on the improvements it has made this year.

iv. Market Access

Thailand maintains relatively high tariffs and a complicated tariff regime, which serve to protect Thailand's agricultural, automotive, alcoholic beverage, textile, and electronics industries. While it continues to reduce selected duties in line with its WTO and ASEAN FTA commitments, its average tariffs remain relatively high. Tariff-rate quotas and arbitrarily applied phytosanitary standards serve as constraints to the import of certain agricultural products. In addition, Thailand has implemented non-transparent price controls on some products and has significant quantitative restrictions, which impede market access.

f. Cambodia

In September 2003, WTO Members voted to approve Cambodia's accession to the WTO. Cambodia is in the process of completing domestic ratification procedures and hopes to become a member of the WTO in early 2004.

The Bilateral Textile Agreement the United States and Cambodia concluded in 1998 and renewed in 2001 is scheduled to expire on December 31, 2004. Once Cambodia accedes to the WTO, the United States will notify the agreement to the WTO under the Agreement on Textile and Clothing. The Agreement will remain in force until its expiration.

g. Normalization of Trade Relations with Vietnam and Laos

i. Vietnam

On July 13, 2000, the United States and Vietnam signed an historic bilateral trade agreement (BTA), concluding a four-year negotiation to normalize trade relations. Upon implementation, the BTA granted Vietnam Normal Trade Relations (NTR) status, that is, the same low tariffs that the United States applies to imports from nearly every other country. The BTA also committed Vietnam to sweeping economic reforms, which created trade and investment opportunities for both U.S.

and Vietnamese companies, and will lay the foundation for a new U.S. relationship with Vietnam.

Vietnam remains subject to the Jackson-Vanik provision, however, which links continued eligibility for NTR treatment to sufficient progress by designated countries on the issue of free emigration. Each year since 1998, the President has granted a Jackson-Vanik waiver for Vietnam, thus clearing the way for Vietnam to receive annually renewed (as opposed to permanent) NTR treatment from the United States.

The second meeting of the Joint Committee established by the BTA was convened at the vice-ministerial level in March 2003 in Hanoi, during which the two sides assessed progress toward implementation of the BTA. While applauding Vietnam's commitment to economic reform, the United States underscored the importance of Vietnam moving quickly to meet the timetables for implementation contained in the BTA. The two countries also discussed Vietnam's pursuit of WTO membership. The next meeting of the Joint Committee will be held in the first quarter of 2004 and will review the first two years of implementation of the BTA.

In April 2003, the United States concluded a textile trade agreement with Vietnam. The U.S.-Vietnam BTA, concluded in December 2001, did not include textile quotas. Indeed, Vietnam is not a WTO member and therefore is not a participant in the WTO Agreement on Textiles and Clothing (ATC), which provides for the phaseout of textile and apparel quotas for WTO members that continue to face textile and apparel quotas. The BTA envisioned that such quotas would be put in place as Vietnam's economy progressed, striking a balance by allowing Vietnam to foster an apparel industry while eventually integrating Vietnam into the global textile and apparel quota system. The textile agreement assists U.S. domestic manufacturers by including Vietnam within the global textile quota regime, and it helps our importers by providing certainty and avoiding the unpredictability of frequent, random, unilateral limits. In the 12 months prior to the introduction of Vietnamese textile quotas, Vietnamese textile exports grew by 1,400 percent. The U.S.-Vietnam textile agreement covers virtually all imports and allows for, on average, 7 percent annual growth. The agreement also allows for the retention of quotas until Vietnam joins the WTO.

The agreement provides increased market access for U.S. suppliers. As part of the agreement, Vietnam lowered its yarn, fabric and apparel tariffs to 7 percent, 12 percent, and 20 percent respectively, and Vietnam agreed to refrain from using non-tariff barriers.

Finally, the textile agreement includes stringent enforcement provisions, including a provision allowing the United States to adjust Vietnam's quotas after an investigation of pre-agreement transshipment, as well as a provision allowing U.S. Customs to visit Vietnamese facilities to control post-agreement wrongdoing.

As part of the BTA, Vietnam committed to make its IPR regime TRIPS-consistent by December 10, 2003. Although Vietnam has improved its legal and enforcement framework for IPR protections, wholesale piracy and counterfeiting continue and enforcement remains inadequate.

ii. Laos

On September 21, 2003, the United States and Laos signed a comprehensive bilateral trade agreement, which was originally negotiated and initialed in 1997, aimed at normalizing trade relations. Laos, unlike Vietnam, is not covered by the "Jackson-Vanik" provisions of U.S. trade law. As with the Vietnam agreement, however, the Laos agreement requires separate legislation enabling the President to grant normal trade relations status to Laos in order to bring into effect the bilateral trade agreement.

The BTA contains IPR provisions that would assist Laos in its IPR enforcement efforts. While Laos' small economy does not yet support a large retail market in pirated or counterfeit goods, small outlets are spreading. While enforcement is weak, some elements of the Government of Laos are interested in creating strong domestic IPR legislation, especially in light of Laos' desire to protect the intellectual property created through Lao handicrafts and native music.

4. Republic of Korea

a. Macroeconomics and Trade

Since experiencing a financial crisis in 1997, Korea has undertaken significant restructuring of its economy. While the Korean Government still maintains a majority ownership in a few of the largest commercial banks that were nationalized during the crisis such as Woori Bank (100 percent) and Korea Exchange Bank (36 percent) and a significant stake in three others (Korea First Bank, 48.5 percent; Hana Bank, 21.7 percent; and Kookmin Bank, 9.3 percent), Korea has made progress on implementing some of its reform commitments during the past five years. Consolidation has reduced the Korean banking sector to 12 commercial banks, less than half the pre-crisis number. Restructuring has largely been a success: NPLs have been reduced from 13 percent in 1999 to 3 percent in 2003; return on equity has increased from 3.5 percent prior to the crisis to 11 percent in 2002. However, the financial sector bailout and restructuring did not come cheaply: as of 2002 Korea has spent KRW155 trillion ($139 billion or 30 percent of GDP), including funds recycled through the support packages, on various support measures.

Korea entered into its first recession in five years during the first half of 2003. Seasonally adjusted real GDP contracted 0.7 percent quarter-on-quarter in the second quarter of 2003, extending from the 0.4 percent drop in the first quarter. The slowdown was brought on by contracting domestic demand combined with slowing external sales. In response, both fiscal policy (a supplementary budget and tax cuts) and monetary policy have been eased somewhat. For the year, the Korean Government anticipates GDP growth may reach 3 percent.

On the trade front, the United States and Korea continued to consult regularly on a variety of issues. Meetings held on a quarterly basis serve as the primary forum for bilateral discussion. During quarterly trade meetings held in 2003, the United States and Korea focused on addressing U.S. concerns in the following areas: automotive, telecommunications, pharmaceuticals, intellectual property rights, and agriculture.

Despite their differences on a number of bilateral trade issues, the United States and Korea continue to cooperate effectively in regional and multilateral fora, including in the context of the Doha Development Agenda and the Asia Pacific Economic Cooperation forum.

b. Telecommunications

Standard-Setting: Increasing Korean Government intervention in the workings of the telecom sector, including in the selection of technologies, continued to be of significant concern to the U.S. Government in 2003. Korean Governmental influence on the choice of sources of equipment and technologies is often apparent in the licensing process for operators and in localization policies for procurement. The Korean Government sometime uses its influence directly but often works indirectly through industry associations and quasi-governmental commissions or other entities. Some U.S. firms with leading-edge technologies have continued to encounter resistance to their efforts to introduce new software and technologies to the market, and some U.S. firms that formerly had a dominant market share have lost significant market share to Korean firms in the past few years. By limiting competition in the Korean telecommunications market, the Korean Government is hampering the ability of Korean firms to develop state-of-the-art, globally competitive products as well as Korea's goal of becoming an economic hub in Northeast Asia.

An increasing priority for the U.S. Government and U.S. industry that has been the focus of a number of bilateral meetings in 2003 relates to Korea's pursuit of domestically created telecom standards which the Korean Government appears inclined to make mandatory. Specifically, the U.S. Government has focused on three key areas, in which developments over the past years have been troubling. The first relates to the wireless broadband Internet platform for interoperability (WIPI) for cellular phones. The U.S. Government's concerns related to WIPI include: inappropriate government involvement in the creation, standardization and deployment of WIPI; continued actions taken by the Korean Government to discourage Korean telecommunications service providers from subscribing to competing foreign standards; and overly-restrictive WIPI specifications which appear to be designed to keep competing foreign systems out of the market.

The second specific area of concern to the United States relates to the Korean Government's announcement that it will reallocate the 2.3 gigahertz spectrum to a new wireless broadband Internet service. Korea has announced that it will allow only one technology to be deployed in this spectrum, but has not yet made a strong case justifying its position. Furthermore, the United States has questions regarding the fairness and transparency of the procedures being used by the relevant Korean standards-setting body.

The final issue relates to location-based services (LBS). The Korean Government has not yet announced its intentions related to LBS. The U.S. Government will continue to monitor developments in this area closely.

Based on actions to date, it strongly appears that Korea is using telecom standards as a protectionist industrial policy. The U.S. Government has used every opportunity to raise its concerns at all levels of the Korean Government. The United States will continue to urge Korea, in its standards-setting processes, to fulfill all of its bilateral and multilateral obligations. In particular, Korea must avoid creating unnecessary obstacles to international trade in the telecommunications sector.

Korea Telecom (KT) Privatization: On April 23, 2002, the Korean Government officially requested that Korea Telecom (KT) be removed from coverage under the 1997 U.S.-Korea bilateral procurement agreement following the complete divestiture of Korean Government shares in the company, which took place in June 2002. Korea has made a similar request to WTO Members to remove KT from coverage under the WTO General Procurement Agreement (GPA). In response, the U.S. Government has expressed serious concerns, regarding whether all government control and influence over the company have ceased (one GPA standard for removal from coverage). Consultations on the matter continue.

c. Motor Vehicles

On October 20, 1998, the United States and Korea concluded a Memorandum of Understanding (MOU) to improve market access for foreign motor vehicles. This MOU followed USTR identification of Korean barriers to motor vehicles as a priority foreign country practice under Section 301. Under this MOU, Korea agreed to: (1) bind in the WTO its 80 percent applied tariff rate at 8 percent; (2) lower some of its motor-vehicle-related taxes and to eliminate others, thereby substantially reducing the tax burden on motor vehicle owners; (3) streamline its standards and certification procedures and adopt a manufacturer-driven self-certification system by 2002; (4) establish a new mortgage mechanism to make it easier to purchase motor vehicles in Korea; and (5) continue to actively and expeditiously address instances of anti-import activity and to proactively educate Korean citizens on the benefits of free trade and competition. As a result of the measures the Korean Government committed to in the 1998 MOU, the USTR terminated a Section 301 investigation and began monitoring the Korean Government's implementation of these measures through formal reviews.

During the 2003 MOU reviews, held in June and October, the United States and Korea assessed progress under the agreement and discussed additional steps Korea will take to implement this agreement. The Korean Government has implemented many of the specific provisions of the MOU. In 2003, Korea established a self-certification system for automotive safety standards. This is a key MOU commitment, and its completion should help alleviate some standards barriers. Korea also simplified and reduced one important automotive tax, made a second purchase of 50 U.S.-produced vehicles for its Police Agency fleet, and endorsed and helped support the 2003 Import Motor Show. However, the U.S. Government remains seriously concerned about the lack of more substantial import penetration in the Korean automotive market. Despite a notable increase in U.S. vehicle sales in Korea in 2003, the total share of foreign vehicles in the Korean market is only slightly above one percent as a result of continued high taxes and tariffs, anti-import sentiments among many Korean consumers, and Korean Government positions vis-à-vis several important standards and certification issues. A key example of problems U.S. manufacturers continue to face in the Korean auto market was DaimlerChrysler's effort to introduce its Dodge Dakota vehicle in Korea. Despite their strong efforts to meet all applicable Korean rules and regulations, the company's attempted launch of the Dakota was repeatedly hindered by the continued use of new interpretations of Korean law imposed in a non-transparent manner. The U.S. Government expects that these kinds of barriers will not arise again in the Korean auto market.

Over the last year, the United States has made specific proposals for addressing these concerns and achieving further progress under the agreement. At the most recent MOU review, held in October 2003, U.S. proposals focused on Korea's fulfillment of the MOU commitment to "steadily reduce the tax burden on motor vehicle owner in the ROK in a way that advances the objectives of this MOU." This is a long-term, but critical objective of the MOU. The U.S. Government stressed that, given the continued complex nature of the Korean automotive tax system, Korea should develop a comprehensive plan as soon as possible to meet this commitment. This would not only help Korea meet its MOU obligation, but would also offer transparency and predictability to auto manufacturers. The U.S. Government and U.S. industry have made specific suggestions on ways to reform the tax system, and also reduce the tariff burden, which the United States intends to discuss in more detail during reviews of the MOU in 2004. The U.S. Government also sought to address specific outstanding standards and certification issues, and the overly high automotive tariff and stressed the need to continue efforts to improve the generally negative perception of foreign vehicles among Korean citizens.

d. Steel

Steel issues are detailed in Chapter V, "Other Multilateral Issues."

e. Pharmaceuticals

Over the past year, U.S. concerns regarding pharmaceuticals trade related mainly to the pricing of innovative pharmaceuticals under Korea's national health insurance reimbursement system and to the lack of transparency in the Korean system. While positive steps were taken in 1999 and 2000 to address U.S. concerns in this sector, the Korean Government began to back away from its previous actions and commitments in 2002. Throughout 2003, a series of government-to-government and government-industry consultations took place in order to address U.S. concerns. While some progress was made, more needs to be done. The U.S. Government looks forward to resolving outstanding issues in 2004.

The U.S. Government's two main areas of concern related to pharmaceuticals are:

Pricing Policy: The change back to an Actual Transaction Price system (ATP) from a Lowest Transaction Price (LTP) system. In August 2002, in a unilateral move away from a negotiated resolution to a long-standing problem, Korea adopted a ministerial ordinance establishing LTP. During discussions prior to this move, the United States had urged Korea to take steps to ensure the full implementation and enforcement of the ATP system whereby both imported and domestically manufactured pharmaceuticals are reimbursed without hospital margins. However, in 2002 Korea announced plans to discard the ATP system and adopt on a one-year trial basis an LTP system in which the reimbursement price of a drug was based on the lowest transaction price from the previous quarter rather than the actual transaction price. There was great concern that this change to LTP would unfairly lower the reimbursement prices for U.S.-made drugs. After a year of consultations with the U.S. Government and U.S. industry (and domestic court cases that went against LTP), Korea decided to discard the LTP system and return to the ATP system as of September 1, 2003. The U.S. Government will be closely monitoring the implementation of the ATP system in order to ensure that it is done in a manner that does not lead to a distortion of the incentives needed to promote innovation and the availability of innovative pharmaceutical products in the Korean market.

Triennial Re-Pricing: The movement on January 1, 2003, to subject patented and bio-equivalent generic drugs to price changes—cuts, in seemingly all cases—while non-bio-equivalent generics were not subject to the price cuts. The proposed scheme appears even more discriminatory in that it will force proportionally larger price cuts on innovative, patented drugs (the specialty of U.S. and other foreign pharmaceutical companies) than on generic drugs (the specialty of Korean companies). The U.S. Government is closely examining these cuts and is continuing to press Korea to examine closely it WTO obligations and consult fully with all relevant stakeholders before taking any further steps.

Transparency: The creation of a transparent science-based reimbursement guideline setting process. The Health Insurance Reimbursement Agency (HIRA) has imposed unduly restrictive reimbursement guidelines on many innovative foreign drugs. (HIRA was established in 2000 to audit medical claims and assess the appropriateness and the economy of health services delivered to insurees). The guidelines establish the indications for which a product can be reimbursed. These guidelines are initially set by the Korea Food and Drug Administration, but can later be modified by guidelines established by HIRA. The process for establishing these modified guidelines is non-transparent and a more independent appeals process should be established. U.S. Government has urged Korea to develop a transparent process for revising reimbursement guidelines as well as adopting an appeals process. Numerous discussions between the Korean Government and industry took place in 2003 on this issue and discussions are ongoing.

The U.S. Government believes that developing policies that improve health care for all Koreans is best pursued by consulting with all domestic and foreign stakeholders, including foreign industry and governments. The U.S. Government will continue to encourage the Korean Government to conduct increased consultations with industry, increase the use of public comment procedures, and increase the use of the Internet to disseminate information.

For 2004, the U.S. Government plans to continue to work with the Korean Government to bring about a more transparent, unbiased, rational, science based health care system that provides predictability for our companies regarding pharmaceutical pricing and reimbursement guidelines.

f. Intellectual Property Rights

The United States continues to have serious concerns regarding adequate protection and enforcement of intellectual property in Korea. In the 2003 Special 301 Report, USTR announced that Korea would be the subject of a Special 301 Out-of-Cycle Review. Under the 2003 Special 301 Out-of-Cycle Review, the United States' decision on whether Korea would remain on the Watch List or be moved to Priority Watch List was based on Korea's taking action in all of the following areas: 1) taking all actions necessary to ensure that the Standing Inspection Team (SIT), responsible for investigating and reporting end user software piracy, is granted police powers at the earliest opportunity; 2) drafting and submitting legislation to the National Assembly that establishes the exclusive right of transmission for sound recordings, including both the full right of making available and the full right of communication to the public; 3) providing additional, new data on Korea's enforcement efforts that is sufficient to more fully evaluate the full range of its enforcement activities. In addition, in order to resolve the film distribution issues, the Korean Government should: 4) Draft and submit legislation to the National Assembly to grant the Korea Media Review Board (KMRB) all authority necessary to stop film piracy; and 5) fully and faithfully implement its agreement on the "WIPI" intellectual property issue.

During 2003, Korea took some steps toward fulfilling its spring 2002 commitments, including facilitating the passage of legislation to provide the Standing Inspection Team with police powers and increasing cooperation between the prosecutor's officers and U.S. right holders to curb software infringement. Although recent legislation drafted by MOCT provided for the right of making available to phonogram producers, the United States was disappointed that the legislation did not include a provision for the right of communication to the public. The U.S. Government will continue to urge Korea to be more forthcoming on this and other IPR issues.

In addition, other significant IPR issues emerged over the last year that required concerted efforts by the U.S. Government. One issue involved alleged infringement of a U.S. industry's intellectual property in the creation/promulgation of a new telecommunications standard (WIPI). Another was related to pirates' ability to illegally register and distribute U.S. videos and DVDs in the Korean market in violation of U.S. companies' copyrights. Also of concern to the United States was the fact that Korea has not taken sufficient new steps to address additional U.S. concerns as outlined in the 2002 Special 301 Report, related to the protection of temporary copies, reciprocity provisions regarding database protection, *ex parte* relief and the lack of full retroactive protection for pre-existing copyrighted works.

In early 2004, the United States, after conducting the Out-of-Cycle Review, decided to elevate Korea to Priority Watch List. (More details at http://www.ustr.gov/releases/2004/01/04?01.pdf)

g. Financial Services

As a condition in the IMF stabilization package, Korea agreed to bind its OECD commitments on financial services market access in the WTO. In January 1999, Korea provided WTO Members with a revised and somewhat improved schedule of financial services commitments that entered into force as of September 1999. The U.S. Government will continue to work with Korea to bring about more liberal treatment of foreign financial services providers.

h. Government Support for Korean Industry

Semiconductor Production and Export: During the past few years, the U.S. Government has expressed strong concerns about instances of possible Korean subsidization of semiconductor production and export that could adversely affect U.S. trade interests. In particular, the U.S. Government sought redress by the Korean Government for its support of Hynix Semiconductor, Inc., Korea's second largest semiconductor manufacturer. The Korean Government did not address the concerns expressed by the U.S. Government and continued to provide financial assistance to Hynix, U.S. industry initiated a countervailing duty (CVD) investigation, and a formal CVD investigation was conducted and completed by the U.S. Commerce Department and International Trade Commission during 2003. As a result of this CVD investigation, countervailing duties of 44.29 percent, equal to the subsidies provided to Hynix by the Korean Government, have been put in place with respect to certain U.S. imports of semiconductors from Hynix.

In 2003, while the CVD investigation was ongoing, a new Hynix bailout package was provided by Hynix creditors which included: a substantial debt forgiveness package in the form of a three-year-plus payback moratorium on 3 trillion Korean won of debt; a significant reduction in interest on the 3 trillion Korean won principal (from 6.7 percent to 3.2 percent); and a new 1.9 trillion Korean won debt-to-equity swap. This new bailout package was approved in December 2002; however, the actual assistance to Hynix was provided in 2003. This new bailout assistance was not included in the CVD investigation but will be examined by the Commerce Department in its first annual review of Hynix subsidies, scheduled to begin in 2004.

In addition, as this report was going to press, the Korean Government announced that it planned to invest one trillion won ($831 million) in research and development of next-generation semiconductors over the next five years. With this investment, the Korean Government stated that it hoped to expand semiconductor export revenue.

The U.S. Government continues to raise its concerns on the issue of subsidization of the Korean semiconductor industry in a number of fora and has noted Korea's obligations under the Subsidies Agreement not to provide subsidies that may cause adverse effects to other WTO Members. The U.S. Government will continue to press Korea to fulfill its international obligations and to move forward with genuine structural reform of its financial sector.

Paper Subsidies: The U.S. paper industry has raised increased concerns regarding targeted Korean Government aid to the Korean coated paper sector. Specifically, U.S. industry alleges that government subsidies have been provided in the form of directed credit, low-cost facility investment loans, tax benefits for facility expansion, and direct government financial support for industrial expansion. These programs serve to keep troubled companies afloat and distort international competition. The U.S. Government raised concerns regarding paper subsidies in numerous bilateral and multilateral fora in 2003 and will continue to pursue this issue with the Koreans in the coming year.

i. Cinema Screen Quotas

Korean Law requires that domestic films be shown in each cinema for a minimum number of days per year. Current law requires that Korean films be shown 146 days of the year, with a potential discretionary reduction to 106 days. The Korean National Assembly adopted a resolution on December 8, 2000, stating that the screen quota system must not be abolished until the domestic market share for Korean films maintains a 40 percent level. Although domestic films have "maintained" a market share close to 50 percent in 2001, 2002, and 2003, there has been very little progress on the issue. Lack of resolution of this "screen quota" issue was one of the primary reasons that U.S.-Korea discussions of a Bilateral Investment Treaty (BIT) stalled in 2001. (See *Bilateral Investment Treaty*) This issue remains unresolved because of a lack of flexibility on the part of various Korean stakeholders. Efforts by the Roh Moo-hyun Administration to encourage Korean filmmakers to find a compromise solution with the U.S. film industry have yet to bear fruit.

j. Bilateral Investment Treaty

In 1998, former Korean President Kim Dae Jung proposed the negotiation of a bilateral investment treaty (BIT) with the United States. The U.S. side aimed to secure Korean commitments on a balanced and open investment regime and provide protections for U.S. investors in Korea. Negotiations held in 1999 made progress related to Korean liberalization of investment restrictions in a number of sectors, but several issues remained unresolved, primary of which was liberalization of the screen quota system. In addition, further progress needed to be made with regard to granting greater access for U.S. investors in telecommunication services and resolving IPR issues, specifically, with respect to retroactive copyright protection for preexisting works and sound recordings. By 2001, both sides agreed that further BIT negotiations would not be productive without resolution of the screen quota issue. (See *Screen Quotas*.)

k. Cosmeceuticals

The Korean Cosmetic Products Act, which became effective in July 2000, separates cosmetic products from cosmeceuticals or cosmetics by function, such as sunscreen, wrinkle cream or skin whiteners. The Act governs the sale and promotion of cosmeceuticals and requires that these products be labeled as cosmeceuticals and not include claims that are beyond proven efficacy. In 2003, the Korean Government took some steps toward reforming the Cosmetic Act, however, the United States continues to have serious concerns (related to the Act). The U.S. Government and U.S. industry fear that the Act, as it currently stands, will continue to slow the pace of product approvals and fails to adequately protect proprietary information. The United States believes that Korea should both simplify its cosmetics regulations and harmonize them with other major cosmetics markets.

l. Agriculture

Implementation of the Biosafety Protocol: On March 28, 2001, the Ministry of Commerce, Industry, and Energy (MOCIE) issued legislation (the so-called "LMO Act") to implement Korea's interpretation of the Cartagena Biosafety protocol. On June 25, 2002, MOCIE released a proposed Presidential Decree and Ministerial Ordinance to the LMO Act. These proposed regulations were notified to the WTO. In May 2003, the U.S. Government and U.S. industry submitted comments and questions to Korea generally requesting clarification of a variety of vague requirements outlined in the proposed regulations. To date, however, MOCIE has not responded to the U.S. Government. Lack of clarity and transparency of the LMO Act regulations could disrupt trade when the regulations become effective.

Environmental Risk Assessment: Environmental risk assessments (ERA) for biotech crops will become mandatory when MOCIE's LMO Act goes into effect (expected sometime in early 2004). On January 9, 2002, the Ministry of Agriculture and Forestry (MAF) issued guidelines for voluntary ERAs of biotech crops used for food, feed, and seed. However, the voluntary ERA program is hampered by lack of clear guidelines and insufficient resources. To date, only ten ERA applications have been submitted for assessments and no ERA's have been completed. The U.S. Government has continued to request that a sufficient grace period with adequate lead-time and minimally restrictive implementation requirements are adopted to avoid major disruptions of trade. However, there has been growing concern that the lack of clear guidance and shortage of resources for conducting ERA's may cause MAF to fail to complete assessments of applications submitted in a timely manner when the LMO Act goes into effect. The Korean Government should address these concerns.

Mandatory Food Safety Assessment: Under the Food Safety Act, issued by Korea's Ministry of Health and Welfare (MHW), the Korea Food and Drug Administration (KFDA) was given the authority to conduct mandatory safety assessments to evaluate biotechnology applications intended for human consumption. Since April 20, 1999, the KFDA has been operating a voluntary safety assessment program of biotech crops for human consumption. In accordance with the revision of the Food Sanitation Act issued in August 2002, safety assessments of biotech crops were to become mandatory on February 26, 2004. The U.S. Government and U.S. industry expressed concerns that the requirement to have completed the mandatory safety assessment prior to February 26, 2004, could result in trade disruptions if resource constraints made it impossible for KFDA to process all applications prior to the deadline.

Recognizing the potential problem, KFDA revised its safety assessment guidelines to provide an additional year for assessments of all biotech crops except soybeans, corn, and potatoes. Safety assessments for soybeans, corn, and potatoes will still have to be completed by February 26, 2004. Assessments for all other biotech crops may be completed by February 26, 2005. To date, ten biotech crops and six biotech additives have undergone and received positive KFDA safety assessments.

Rice: The exception to tariffication that Korea received for rice during the Uruguay Round expires at the end of 2004. Under the minimum market access (MMA) quota for rice in place since the end of the Uruguay Round, the United States has sold 30,000 MT out of the 142,520 MMA available in CY2001, 40,000 MT out of the 171,023 MT MMA available in CY 2002, and 55,000 MT out of the 199,528 MT MMA available in CY 2003. Such sales were only possible after Korea agreed to hold tenders for U.S. #1 grade medium rice. Korea's administration of the MMA quota severely restricts how imported rice may be marketed. The United States has pressed Korea to eliminate restrictions on how the rice MMA quota is administered.

Surging world rice prices in 2003 prompted Korea to implement a "price ceiling" mechanism for rice import tenders. Under the "price ceiling" system, the Agricultural and Fisheries Marketing Corporation (AFMC), the state trading enterprise for purchasing rice, set an internal price ceiling and turned down bidders that offered prices that were higher than the AFMC's internal target price. As a result, completion of several tenders and subsequent deliveries of MMA rice were delayed. Consequently, some of the deliveries to fulfill the 2003 quota will occur in 2004.

Tariffs and Tarriff Classification: U.S. officials have continued to express concern regarding a number of products subject to exceedingly high tariffs and possible inappropriate tariff classifications, including high tariff rates on croaker and Korea's customs classification of citrus pulp pellets. U.S. officials have also urged the Korean Customs Service to reconsider its policy of classifying beef bones with minimal amounts of meat attached as pure muscle meat subject to a tariff of 40.5 percent. If beef bones were classified as offal the applicable tariff would be 18.2 percent.

m. Import Clearance Procedures, Food Standards, and Labeling

After WTO dispute settlement consultations with the United States between 1995 and 1999, the Korean Government revised its import clearance procedures to harmonize them with international practice including: (1) expediting clearance for fresh fruits and vegetables; (2) instituting a new sampling, testing, and inspection regime; (3) eliminating some nonscience-based phytosanitary requirements; and (4) beginning revisions of food related regulations.

In 2003, a new import inspection program implemented by the MHW and the KFDA undermined Korea's earlier efforts to harmonize its import clearance programs with international norms, including WTO national treatment provisions. On January 27, 2003, the new import inspection program was notified to the WTO in G/SPS/N/KOR/123. In comments on the notification, the U.S. Government and other countries expressed concern about a new requirement mandating annual maximum residue limit (MRL) testing of agricultural products on a packing-house basis and the associated testing fee of roughly $1,960. Since domestic agricultural products are only subject to random tests and the Korean Government bears all test costs associated with random tests, national treatment is a serious concern.

No changes were made to address U.S. concerns and the new requirements became effective on August 18, 2003. KFDA, the implementing agency of this new import inspection program, proposed to reduce the MRL testing fees to 278,400 Korean won (approximately $242) from 2,256,000 Korean won (approximately $1,960). However, reduction in the testing fee still does not fully address the underlying national treatment issue. The U.S. Government will continue to press Korea to resolve fully these issues in bilateral and multilateral fora.

Additional work will be needed to bring Korea's food related regulations into conformity with international standards, specifically those related to limited classification of food categories and burdensome testing requirements.

On June 28, 2003, KFDA announced new "Proposed Standards and Specifications for Health Functional Foods." The objective of the so-called "Functional Food Code" is to regulate health foods and nutritional supplements by listing products that can be classified as functional foods and setting standards and specifications for functional foods. Products classified as functional foods can carry "efficacy claims" on their labels. In the proposed Functional Food Code, however, limited categories of functional foods and nonscience-based upper limits on vitamin and mineral content restrict entry of U.S. health foods and supplements into the Korean market. The U.S. Government and U.S. industry submitted comments detailing concern about restrictions on health foods and nutritional supplements that are freely traded in foreign countries. To date, however, KFDA has not addressed U.S. concerns. The U.S. Government will continue to press Korea on this issue.

5. India

a. General

Trade between the United States and India totaled $18 billion in 2003, well below potential because widespread barriers to market access in India, including high taxes and tariffs, differential treatment of imports, and reference prices.

The United States continued its efforts to open India's markets and develop a constructive, long-term trade relationship. We sought to identify areas for cooperation. Discussions focused on WTO matters as well as bilateral trade issues including India's tariff and tax regime, biotechnology, intellectual property rights, and subsidies.

b. Trade Dialogue

USTR Zoellick and Indian Minister of Trade and Industry Arun Jaitley held several meetings this year. USTR also appointed the first-ever Assistant United States Trade Representative for South Asia who is responsible for India as well as other countries in the region. At the specific request of USTR Zoellick, the new AUSTR for South Asia devoted most of his efforts to working to open India's markets, historically among the most civilized in the world. With a consumer class of over 200 million people, India presents enormous export opportunities for the United States. The new AUSTR visited India twice and frequently met with Indian diplomatic and trade officials based in Washington quite frequently in the second half of 2003. He focused especially on reducing India's very high agricultural tariffs and its high tariffs on industrial goods, on resolving several trade disputes—particularly one involving an Indian policy that unreasonably restricts the market for American fertilizer—and on protecting American intellectual property. As part of the United States-India Economic Dialogue, the United States-India Trade Policy Working Group (TPWG), led by USTR and India's Ministry of Commerce, met regularly at the technical and Ministerial levels. To that end, TPSC agencies met with their Indian counterparts twice by digital video conference (DVC) and face-to-face on numerous occasions during 2003. Participants covered the full range of bilateral trade issues during these discussions. A further DVC was devoted to a thorough discussion of intellectual property rights protection and enforcement. Another was devoted to an exchange of information on biotechnology regulations.

c. Intellectual Property Rights

Enforcement of intellectual property rights in India remains problematic, and the country remains on the Special 301 "Priority Watch List." As a signatory to the Uruguay Round of GATT trade negotiations, India was required to comply with most of the obligations of the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) by January 1, 2000, and must introduce and enact a comprehensive patent system for pharmaceuticals and agricultural chemicals no later than 2005. The Indian Government has announced its intention to conform fully to the WTO TRIPS requirements of the Uruguay Round and has stated that it will be fully TRIPS compliant by January 1, 2005.

In June 2002, Parliament passed legislation amending the Patents Act. While the new legislation corrects some of the shortcomings of the 1970 Patents Act, the legislation contains numerous deficiencies and appears to fail to comply with both the letter and spirit of the TRIPS Agreement. Most notably, the following problems pose significant concerns: numerous categories of inventions are not patentable; lack of protection for product-by-process inventions; failure to address the abusive government use and revocation provisions present in the 1970 Act; and failure to recognize importation as satisfying the "working" requirement. Moreover, the law adds a new requirement to patentability, i.e., disclosure of the source and geographical origin of biological material used in an invention. To the extent that these types of requirements are unrelated to obtaining patent protection, they serve no legitimate purpose in a patent system and impose unnecessary burdens on patent applicants. We await the Indian Government's implementation of TRIPS-compliant legislation in time to meet its WTO January 1, 2005 commitment.

The Indian Government has made encouraging statements concerning the implementation of TRIPS-compliant data exclusivity regulations (protection for undisclosed test data). We await Indian Government issuance of such regulations.

While the copyright law generally complies with the TRIPS Agreement, the 1999 amendments undermine TRIPS requirements concerning protection for computer programs. Unfortunately, Indian copyright enforcement efforts are characterized by long delays and low penalties.

The Government of India, along with a "core group" of local industry representatives, academics and IP lawyers has been discussing amendments to the Indian Copyright Act to implement the WIPO Copyright Treaty and WIPO Performances and Phonograms Treaty. The United States has asked India for further information about the schedule for implementation of the WIPO Treaties and the draft Copyright Law amendments.

The United States has continuing concerns over the environment for intellectual property enforcement in India. These concerns include lack of deterrent penalties for counterfeiting and piracy, and unnecessary delays in civil and criminal cases. High piracy rates (particularly for popular fiction and certain textbooks), increasing problems with exports, nascent problems with optical disk piracy, extensive use of expensive civil remedies to address social problems better addressed through socially deterrent criminal measures, are among the IPR enforcement problems U.S. industry is facing in India. CD-R seizures also continue to rise—over 100 percent from 2001 to 2002. Internet piracy is a growing problem. In the trademark area, fast moving consumer goods and other sectors have also complained about high levels of counterfeiting and difficulties in bringing effective enforcement. Counterfeiting in the auto, pharmaceutical, entertainment, consumer goods and apparel industries are examples. Particularly troubling are extensive public health and safety risks posed by counterfeit medicines and auto parts. This major problem is complicated by India's export of counterfeit goods to the Middle East, southern Africa and Europe.

d. Diammonium Phosphate (DAP)

Changes in India's fertilizer price control and subsidy regime have driven U.S. and other foreign phosphate fertilizer exports out of the Indian market. Recently, the Indian Government increased domestic subsidies while offering import subsidies set so low that U.S. producers cannot profitably sell in the Indian market. U.S. phosphate fertilizer exports fell from a peak of 2.3 million tons in 1999 to virtually zero this year.

The United States continues to press the Indian Government to end distorting policies that impede U.S. producers of DAP from competing in the Indian market.

e. Reference Pricing

In August 2001, following allegations of under invoicing by vegetable oil importers, the Government of India imposed reference prices on imports of palm oil and palm products. In September 2002, India added soybean oil to its fixed reference price regime and in December 2002, raised the reference price to a level that substantially exceeds world prices for vegetable oils. The applied tariff for crude soybean oil was already at the WTO bound rate of 45 percent. Given fluctuations of world market prices and India's relaxed norms for revision of reference prices, the effective tariff for crude soybean oil (CSBO) is likely to exceed India's tariff bindings on CSBO. From September 2002 until May 2003, India's effective tariff for CSBO was above 45 percent, since its CSBO reference prices were well above world market prices.

f. Export Subsidies

Since October 2000, faced with massive grain stocks and shortage problems, the Government of India started allocating large quantities of wheat for export at highly subsidized prices. In April 2001, following the success of its wheat exports program, India began subsidizing exports of rice. India did not notify any grain export subsidy programs under its Uruguay Round commitments. In late 2003, record offtake for domestic consumption and heavy exports lowered government-held stocks of wheat and rice, easing domestic pressures on the Indian Government to continue the export of grains at highly subsidized prices. By the end of January 2004, the Indian Food Ministry may consider new export allocations after reviewing grain stock levels.

6. Pakistan

In 2003, the United States strengthened its trade dialogue with Pakistan on issues affecting our trade and investment relationship. Minister of Commerce Humayun Akhtar Khan visited Washington in June and met with Commerce Secretary Evans and Ambassador Zoellick. USTR agreed to negotiate a Trade and Investment Framework Agreement (TIFA). The negotiations were completed expeditiously, and the TIFA was signed during President Musharraf's visit at the end of June.

In preparation for the first TIFA meeting, AUSTR Ashley Wills visited Islamabad in October and was hosted by Minister Khan. Ambassador Wills discussed a number of bilateral trade and investment issues while in Pakistan. During his consultations, Ambassador Wills requested that additional attention be given to Pakistan's significant problems in enforcing intellectual property rights. Just prior to Commerce Assistant Secretary William Lash's visit to Pakistan in August, a U.S. roadmap was presented to the Pakistanis in the summer outlining the improvements we are seeking. The Government of Pakistan has begun to address the intellectual property problems, particularly in the optical disk sector, by planning the creation of an interagency task force.

Throughout the year Pakistan and the United States consulted frequently on the Doha Development Agenda negotiations. Closer collaboration developed between our missions in Geneva.

7. Afghanistan

An interagency working group worked throughout the year to further development of the Afghan Trade Initiative. Further, a U.S.-Afghanistan Commercial Working Group was created. The bi-national group is co-chaired by USTR and the Department of Commerce for the United States, and by the Ministry of Commerce for Afghanistan. The inaugural meeting of the Working Group was held in Chicago on June 9. Trade issues also were discussed between Ambassador Zoellick and Afghan Finance Minister Ghani and between Commerce Secretary Evans and Commerce Minister Kazemi.

In order to stimulate greater Afghan utilization of the U.S. Generalized System of Preferences (GSP) program, a capacity building seminar was held by DVC with Afghan participants. In addition, Afghanistan and the United States will soon conclude an arrangement that grants duty-free treatment under the GSP program to certain textile handicrafts. Finally, the Administration continued its efforts to obtain legislation to permit hand-made carpets to be eligible for duty-free treatment under the GSP.

Afghanistan has requested initiation of the accession process for its membership in the World Trade Organization, and USTR is assisting Afghanistan on what WTO membership entails.

The United States continued to work with Afghanistan and its neighboring governments to remove transit barriers to trade. The interagency task force also focused on providing assistance to Afghanistan to build a strong customs administration in order to better track and increase incoming domestic revenue and to facilitate trade.

8. People's Republic of China

Much has changed in the U.S.- China economic and trade relationship since China began negotiations to join the predecessor to the World Trade Organization (WTO), the General Agreement on Tariffs and Trade (GATT), 17 years ago. In 1986, total U.S.-China trade was only $7.9 billion, and imports from China outpaced U.S. exports to China by $1.7 billion. In contrast, in 2003, total U.S.-China trade is projected to top $170 billion, with imports from China exceeding U.S. exports to China by more than $125 billion. The Administration is focused on increasing U.S. exports as a means to reduce the growth in the deficit.

Two years after acceding to the WTO, China has become the United States' third largest trading partner and the sixth largest market for U.S. exports. Indeed, over the last three years, while U.S. exports to the rest of the world have decreased by 10 percent, U.S. exports to China have increased by 66 percent. China has become a major consumer of U.S. manufactured exports, such as electrical machinery and numerous types of components and equipment, among other goods. Growth in U.S. exports to China of agricultural products has also been robust, and the market share of U.S. service providers in China has been increasing rapidly in many sectors.

U.S. business success in China, however, is not necessarily a demonstration of WTO implementation progress, nor does it necessarily signal that expectations are being fully met. Rather, China's WTO implementation progress must be measured by the degree to which China has begun to institutionalize market mechanisms and to make its trade regime more predictable and transparent. By that score, the shortcomings in China's WTO implementation are noteworthy. Unlike last year, China's uneven and incomplete WTO compliance record can no longer be attributed to start-up problems.

China acceded to the WTO on December 11, 2001, after 15 years of negotiations with the United States and other WTO members. Under the terms of its accession, China committed to implement a set of sweeping reforms designed to implement the WTO's market access, national treatment and transparency standards, to protect intellectual property rights (IPR), to limit the use of trade-distorting domestic subsidies and to make other changes to bring its legal and regulatory system in line with those of other WTO members. For China's leadership, these commitments were primarily intended to consolidate and accelerate the market-oriented reforms responsible for lifting 300 million Chinese citizens out of poverty over the past 25 years. China also viewed joining the WTO as a means to ensure its continued access to export markets. In turn, other WTO members envisioned that faithful WTO implementation by China would reduce the ability of non-market forces, including government policies and officials, to intervene in the market to direct or restrain trade flows.

In its WTO accession agreement, China also agreed to two separate safeguard mechanisms designed to allow WTO members to cope with market disruptions caused by increasing economic integration with China. The first mechanism permits a China-specific safeguard and can be applied to any product being imported from China. The second mechanism applies specifically to textiles and apparel products. At the end of 2003, the Administration took action under the textile safeguard mechanism for three categories of products being imported from China. The Administration will continue to be ready to use all available mechanisms, including the China-specific safeguards when the facts of a particular case warrant.

Meanwhile, as China continued to pursue the implementation of its WTO commitments in 2003, China's second year of WTO membership, a number of positive developments occurred.

China began to take steps to correct systemic problems in its administration of the tariff-rate quota (TRQ) system for bulk agricultural commodities, largely in response to high-level engagement by the Administration. It relaxed certain barriers to soybean trade that allowed U.S. exporters to achieve record sales. It reduced capitalization requirements in certain financial services sectors. It opened up the motor vehicle financing sector. It solved outstanding concerns that had prevented China's membership in the WTO's Committee of Participants in the Expansion of Trade in Information Technology Products.

Despite these gains, 2003 also proved to be a year in which China's WTO implementation efforts lost a significant amount of momentum. In a number of different sectors, including some key sectors of economic importance to the United States, China fell far short of implementing its WTO commitments, offsetting many of the gains made in other areas. Indeed, institutionalization of market mechanisms still remains incomplete, and intervention by Chinese government officials in the market is common. In many instances, China has sought to deflect attention from its inadequate implementation of required systemic changes by managing trade in such a way as to temporarily increase affected imports from vocal trading partners, such as the United States.

China's WTO implementation efforts, it should be noted, have taken place against a challenging political and social backdrop. In 2003, China underwent a major leadership change, passed through a harrowing national SARS epidemic, undertook a sizeable restructuring of the government's economic and trade functions, and confronted a host of dislocations inherent in its transition from a planned economy to a more market-oriented economy. These factors may have presented substantial challenges, but China still needs to fulfill its WTO commitments.

As highlighted in the 2002 Report, which covered China's first year of WTO membership, China's efforts were most problematic in the areas of agriculture, services, enforcement of intellectual property rights and transparency. Although we have seen progress in some of these areas in 2003 as a result of high-level engagement, they still remain areas of serious concern.

At the same time, other areas of concern have developed, such as China's questionable use of certain tax policies to favor domestic production. This year has also seen an increasing use of industrial policies to encourage domestic industries at the expense of imports from abroad or foreign businesses operating in China. This latter phenomenon is particularly apparent in the automotive sector, where a proposed industrial policy threatens to undercut many U.S. industry gains in China's market. In addition, there are a number of important commitments that will face implementation deadlines in 2004, with those involving trading rights and distribution services being the most critical. It will require vigilance by the United States and other WTO members to ensure China fulfills these commitments.

As the slowdown in China's WTO implementation efforts became evident in 2003, the Administration stepped up its efforts to engage senior Chinese leaders. Over the course of the past year, President Bush emphasized the importance of China's WTO obligations in meetings with his counterpart, Hu Jintao, and with China's Premier, Wen Jiabao. United States Trade Representative Zoellick made two separate visits to China for talks on WTO implementation matters with Premier Wen and with Vice Premier Wu Yi. He also raised U.S. concerns throughout the year with his Ministry of Commerce (MOFCOM) counterpart, including most recently at the October 2003 APEC meetings in Thailand. The Secretaries of Commerce and Treasury made their own trips to China, again carrying the message that China's WTO implementation was a matter of the highest priority. Sub-cabinet officials from various U.S. economic and trade agencies also met with their Chinese counterparts in China, Washington and Geneva to work through areas of concern, including WTO implementation issues, on numerous other occasions.

In 2003, the Administration also utilized the newly established sub-cabinet dialogue on WTO compliance and other trade matters (the Trade Dialogue), which brings together U.S. economic and trade agencies and various Chinese ministries and agencies with a role in China's WTO implementation. Trade Dialogue meetings were convened twice in 2003, once in February, led by then Deputy United States Trade Representative Huntsman, and later in November, led by Deputy United States Trade Representative Shiner. The Trade Dialogue meetings have proven to be effective in communicating specific trade concerns and in serving as an early warning mechanism for emerging trade disputes.

A summary of the WTO compliance issues of the most concern to the United States follows. For a more detailed discussion, see USTR's 2003 Report to Congress on China's WTO Compliance, dated December 11, 2003.

Agriculture

China's potential as a market for U.S. agricultural exports was a key factor in U.S. support for China's WTO accession and the grant of permanent normal trade relations status to China. While China's attempts to restrict certain agricultural imports have been an ongoing theme of the first two years of China's WTO membership, high-level interventions by Administration officials have been able to contain much of the commercial impact of these barriers, particularly in 2003. Indeed, from January through September 2003, U.S. exports of soybeans climbed above $1.2 billion—a record—and cotton exports, at $337 million, were 478 percent greater than during the same period in 2002. Many other agricultural products also fared well, as U.S. exports to China totaled $2.9 billion from January through September 2003, representing a 102 percent increase over the same period in 2002.

Again, however, increased sales alone are not indicative of full WTO implementation. China committed to make systemic changes designed to create fairness, predictability and transparency in agricultural trade.

In 2003, China's actual and threatened use of unreasonable rules on biotechnology, most notably in the case of soybeans, and questionable sanitary and phytosanitary (SPS) measures have continued to frustrate efforts of U.S. agricultural traders to develop a consistent market for their exports to China. While many affected U.S. exports increased this year, in part because of high-level interventions by Administration officials, systemic problems with the biotechnology rules and China's SPS administration continue to cloud market access. These and other emerging concerns, such as China's apparent use of subsidies to promote certain agricultural exports, will require continued engagement by the Administration in order to prevent trade disruptions and ensure that China plays by the rules.

China's administration of TRQs for bulk agricultural commodities is another area that has caused serious concern. Since China's WTO accession, the setting of sub-quotas, use of Catch_22 import licensing procedures, allocation of TRQs in commercially unviable quantities and lack of transparency in TRQ allocation and management have combined to limit what should be an expanding market for U.S. exporters, particularly in the case of cotton. In June 2003, however, China agreed to address the United States' most pressing systemic concerns with China's TRQ system. Although the results of this settlement will not be clear until shipments begin to flow in early 2004, China has since taken steps to eliminate separate allocations for general trade and processing trade, eliminate certain unnecessary licensing requirements, and create a new mechanism for identifying allocation recipients. Due to these developments, the United States decided not to initiate WTO dispute resolution on this issue in 2003.

Intellectual Property Rights

In the year leading up to its WTO accession, China did make significant improvements to its framework of laws and regulations covering intellectual property rights. However, the lack of effective IPR enforcement in China is a major obstacle toward a meaningful system of IPR protection. IPR problems are pervasive, covering the widespread production, distribution and end-use of counterfeit and pirated products, brands and technologies. Violations include the rampant piracy of film, music, publishing and software products, infringement of pharmaceutical, chemical, information technology and other patents, and counterfeiting of consumer goods, electrical equipment, automotive parts and industrial products. IPR infringements not only have an economic toll, but also present a direct challenge to China's ability to regulate products that could have health and safety implications for China's population and international consumers. While a domestic Chinese business constituency is increasingly active in promoting IPR enforcement, piracy and counterfeiting remain pervasive. If significant improvements are to be achieved on this front, China will have to close legal and enforcement loopholes and devote considerable resources, political will and high-level attention to this problem.

The United States has had an ongoing dialogue with China on IPR matters for a number of years. In the Administration's view, keys to achieving effective IPR enforcement will be for China to lower thresholds for criminal prosecution, increase criminal penalties for IPR violators to deterrent levels, demonstrate a willingness to increase prosecution and punishment of IPR offenders, increase resources and devote more training for enforcement throughout China, and establish more effective communication procedures among relevant officials of China's courts and investigative units, the Supreme People's Procuratorate and China's lawmaking bodies.

In recent months, the Chinese leadership has signaled a new resolve to address IPR enforcement issues. In October 2003, Vice Premier Wu was appointed to head a Leading Group on IPR issues, which should help to reduce bureaucratic resistance and confusion on IPR enforcement among the numerous Chinese government entities with responsibilities in this area. In remarks following her appointment, she acknowledged China's IPR enforcement problem and explained that China was paying increasing attention to IPR enforcement, not just to implement its WTO commitments but also to attract more foreign investment as it opened up its market and to accelerate China's economic and social progress. She pledged that China would intensify its IPR enforcement efforts and penalize those who commit IPR infringement.

Services

Concerns continued to arise in many service sectors, principally due to transparency problems and China's use of capitalization and other requirements that exceed international norms. The United States and China have cooperated to resolve some of these concerns, but progress has been slow and uneven. Following bilateral discussions, China did begin to take steps to substantially reduce capitalization requirements in the insurance sector. In some cases, such as express delivery services, much progress was made toward resolving regulatory concerns in 2002, but problematic measures have re-surfaced in 2003 and remain under consideration. In other cases, such as China's implementation of its commitments on branching by insurance companies, the United States and China remain at odds despite a longstanding cooperative and otherwise productive dialogue with China's regulators.

Value-Added Tax Policies

China uses value-added tax (VAT) policies to encourage domestic production in a number of industrial and agricultural sectors. In the case of semiconductors, China's policy of providing VAT rebates to domestic semiconductor producers disadvantages U.S. exports and raises serious WTO concerns. In the case of fertilizer, China exempts from the VAT fertilizer that is primarily produced domestically and that competes directly with the principal U.S. fertilizer export, another practice that raises serious WTO concerns. The Administration will continue to press China on these issues and will take further appropriate actions seeking elimination of China's differential tax treatment, including dispute resolution at the WTO, if necessary.

Transparency

An area of cross-cutting concern continues to be transparency. While some Chinese ministries and agencies have taken steps to improve opportunities for public comment on draft laws and regulations, and to provide appropriate WTO enquiry points, China's overall effort is plagued by uncertainty and a lack of uniformity. Some of China's ministries and agencies seek selective comment on proposed regulations and implementing rules from domestic Chinese interests, while excluding participation from foreign businesses active in the China market. The Administration is committed to seeking improvements in this area.

Trading Rights and Distribution Services

Ensuring the unrestricted rights of all Chinese and foreign businesses to engage in importing and exporting was a key WTO accession commitment obtained by the United States and other WTO members, as was China's commitment to fully liberalize the distribution services sector. To date, however, China has fallen behind in its implementation of these commitments, which are required to be phased in over the first three years of China's WTO membership. Foreign businesses, in particular, continue to be beset by a variety of restrictions, which are undercutting market access for the entire range of U.S. businesses active in the China market. With full liberalization in these important areas required by December 11, 2004, Administration officials are actively engaged with their Chinese counterparts in an effort to obtain China's full compliance.

Conclusion

While the U.S.-China economic and trade relationship is growing rapidly, there are a number of systemic concerns that remain, making further improvements in that relationship problematic. The Administration remains committed to resolving the United States' concerns through all available means. The Administration's preference is to resolve those concerns through bilateral consultations in a timely and effective manner. If bilateral efforts are not successful, however, the Administration is fully prepared to enforce U.S. rights through other means, including dispute resolution at the WTO.

9. Japan

The United States redoubled its efforts to promote structural and regulatory reform in Japan, improve market access for U.S. goods and services, and support the adoption and successful implementation of pro-competitive policies throughout the Japanese economy. The United States has been encouraged by positive trends in corporate and financial restructuring and welcomes Prime Minister Junichiro Koizumi's continuing commitment to structural and regulatory reform. While the Japanese economy has been showing encouraging signs of life, it remains weighed down by non-performing loans and deflation and is in need of additional reforms that will address persistent structural rigidities, excessive regulation, and market access barriers. Throughout 2003, the U.S. Government has been working with the Government of Japan to develop and implement concrete steps for Japan to take to further open and deregulate its markets. These measures are designed to help Japan revitalize its economy and generate sustainable economic growth.

In additional to bilateral approaches, the United States relied on a wide range of regional and multilateral fora in 2003, including the WTO and APEC, to advance its trade agenda with Japan. The United States is working to ensure that our trade priorities in these fora, including on agriculture and services, are well coordinated with our bilateral agenda so that the various initiatives are complementary and mutually reinforcing.

Overview of Accomplishments in 2003

U.S.-Japan Economic Partnership for Growth

In 2003, the United States continued to place a high premium on promoting much-needed regulatory reforms and obtained improved access for U.S. goods and services in a number of areas. Under the U.S.-Japan Economic Partnership for

Growth (the Partnership), the United States has been working with Japan to promote sustainable growth in both countries by addressing such issues as sound macroeconomic policies, structural and regulatory reform, financial and corporate restructuring, foreign direct investment, and open markets. While regulatory and structural reform remains of paramount importance, the United States and Japan also addressed new and lingering trade issues in a variety of sectors.

The following provides brief updates of each component of the Partnership along with accomplishments achieved in 2003.

Subcabinet Economic Dialogue: Co-chaired by the NSC/NEC and Japan's Ministry of Foreign Affairs (MOFA), the "Subcabinet" sets the tone and direction of the Partnership, with Deputy/Vice Ministerial level officials meeting on an annual basis to discuss a broad range of bilateral, regional, and multilateral issues. Recommendations from these meetings are given to the respective Governments for use in developing policy. At the third meeting of the Subcabinet in April 2003 in Washington, participants covered a range of issues, including deflation in Japan, establishment of Japan's Industrial Revitalization Corporation, the launch of the Special Zones for Structural Reform, and various regional and global issues. The next meeting of the Subcabinet is expected to convene mid-2004, coinciding with the 2004 annual meeting of the Private Sector/Government Commission, which is described below.

Private Sector/Government Commission: The "Commission" is designed to better integrate the U.S. and Japanese private sectors more fully into the economic work of the two governments. Private sector delegates from Japan and the United States meet annually with the Subcabinet to discuss issues of key importance to both countries. The 2003 Commission meeting was held in Washington in April 2003 to address the topic "Successfully Meeting Economic Challenges in the 21st Century." The private sector provided recommendations for consideration by both governments in four key areas: (1) corporate and financial restructuring; (2) healthcare innovation; (3) corporate governance; and (4) trade and investment. The Commission convened a follow-up meeting in October 2003, where the two governments responded to the April recommendations.

Regulatory Reform and Competition Policy Initiative: Co-chaired by USTR and MOFA, the "Regulatory Reform Initiative" seeks to promote economic growth and open markets by focusing on sectoral and cross-sectoral issues related to regulatory reform and competition policy. Under this Initiative, the United States has made concerted efforts to focus on issues the Koizumi Administration has identified as important areas for reform, such as telecommunications, information technologies, medical devices and pharmaceuticals, energy, and competition policy. Throughout 2003, Working Groups and a High-Level Officials Group met to discuss reform proposals that culminated in the Second Report to the Leaders, which was conveyed to President Bush and Prime Minister Koizumi on May 23, 2003. That report detailed numerous regulatory reform measures that Japan had implemented or would implement.

Investment Initiative: The Investment Initiative addresses laws, regulations, policies, and other measures intended to improve the climate for foreign direct investment (FDI). Led by the U.S. Department of State and Japan's Ministry of Economy, Trade, and Industry (METI), the Investment Initiative meets regularly to resolve investment issues and prepare a joint report for the Leaders' summit. Key topics discussed at the most recent meeting in November 2003 in Tokyo included mergers and acquisitions, and tax, labor, and land policy. The Initiative includes co-sponsored investment promotion seminars in both countries to bring about better understanding and support for FDI from regional government and business leaders. During the talks, the U.S. private sector is given an opportunity to actively participate and directly present their investment concerns to the Government of Japan.

Financial Dialogue: The Financial Dialogue serves as a forum for the U.S. Department of Treasury, and Japan's Ministry of Finance (MOF) and Financial Services Agency (FSA) to exchange information on key macroeconomic and financial sector issues, including non-performing loans. As appropriate, the Report to the Leaders under the Regulatory Reform Initiative includes progress in financial sector liberalization achieved under this Dialogue. The third meeting of this group was convened in November 2003 in Washington.

Trade Forum: The Trade Forum, which is led by USTR and MOFA, was created to foster focused and substantive discussion on a wide-range of sectoral trade issues of interest and concern to both governments. It also serves as an "early warning" mechanism to facilitate resolution of emerging trade problems. Issues raised at the second meeting of the Trade Forum in July 2003, included agriculture, public works, and new U.S. visa and passport regulations. The Trade Forum meets at least once a year.

a. Regulatory Reform

The United States and Japan issued a Second Report to the Leaders under the Regulatory Reform Initiative in May 2003. In that report, Japan agreed to undertake many important regulatory reform measures. Significant achievements were made in various sectors, including telecommunications, information technologies, energy, medical devices and pharmaceuticals, and financial services. Other important progress was made in key areas such as competition policy, transparency and other government practices, legal system reform, revision of Japan's commercial law, and distribution.

Building on progress achieved in the first two years of the Regulatory Reform Initiative, the United States presented Japan on October 24, 2003, with 54 pages of recommendations calling on Japan to adopt a wide range of regulatory reforms. Consistent with the overall objective of the Partnership, these recommendations include reform measures intended to help Japan return to sustainable growth and open markets. Furthermore, the United States placed a special emphasis on issues that Japan has identified as priorities for reform.

The October 2003 recommendations presented to Japan act as the basis for bilateral discussions in a High-level Officials Group and the various Working Groups established under the Regulatory Reform Initiative. The Working Groups have already begun meeting to discuss the recommendations. These discussions will in turn serve as the basis for an annual report to the President and Prime Minister in mid-2004 detailing the progress made under this Initiative, including specific measures to be taken by each Government.

Highlights of the Second Report to the Leaders and key reform recommendations submitted in October are as follows:

i. Sectoral Regulatory Reform

Telecommunications: The establishment of a pro-competitive telecommunications services market in Japan is the primary focus of the United States in pursuing regulatory reform for this sector. However, Japan's telecommunications regulator, the Ministry of Public Management, Home Affairs, Posts and Telecommunications (MPHPT), continues to defer to the interests of NTT at the expense of business and residential users and to the detriment of promoting competition in the telecommunications services market. In this environment, the inability of competitive telecommunications carriers to make inroads into NTT's control of 98 percent of subscriber lines and 58 percent of mobile customers continues to impair the introduction of innovative, low-cost services to business and residential users in Japan's $145 billion telecommunications market, one of the world's largest.

The May 2003 Second Report to the Leaders highlighted measures taken by Japan to promote further competition in this sector. These measures included proposed revision of the Telecommunications Business Law (TBL) to abolish the Type I (facility-based) and Type II (others) business categories and streamline various requirements for competitive carriers. (The revised TBL was eventually passed by the Diet in July 2003.) The report also clarified that NTT East and West will be required to file reports documenting their compliance with conditions attached to the approval of new business offerings, such as interprefectural Internet Protocol (IP)-based services. In the area of mobile communications, the report indicated slow and steady progress towards resolving the issue of whether fixed carriers should have the right to set user rates for termination of their calls on mobile networks. Furthermore, the report noted that NTT DoCoMo, designated since 2002 as a "dominant carrier," reduced its interconnection rates by 5 percent compared to the previous year. During talks in the Telecommunications Working Group, the two governments explored emerging issues by inviting experts from the government and private sector to share their views about the developing IP telephony market, which is expected to have a significant impact on competition.

However, competitive carriers in Japan suffered a setback when in April 2003 MPHPT announced its approval for a 12 percent increase in the rates charged to wireline carriers by NTT East and West for calls transferred at regional switches. This increase was based on a revision of the methodology for calculating the cost of interconnection. The same formula allowed a 3 percent decrease for local switches, resulting in an average increase of 5 percent. These rates will be in effect for two years. MPHPT maintained that the increase was necessary due to NTT's declining traffic and hence, their declining revenues. In meetings of the Telecommunications Working Group, as well as the public comments submitted to Japan throughout the revision process, the United States pressed Japan to rectify the flaws in the methodology, such as the inclusion of non-traffic-sensitive (NTS) costs and the uniform rate for both regional carriers despite widely varying costs for the East and West regions. In the second Report to the Leaders, Japan promised to address these issues as it reviews the methodology for rates which will be applied from 2005.

In the October 2003 Regulatory Reform submission, the United States urged Japan to take bold steps to improve competition in this sector, including: follow through on deregulation of competitive carriers under the new TBL; strengthen regulatory independence, transparency, and accountability; reinforce dominant carrier safeguards; conduct an objective and transparent review of interconnection rates; and investigate mobile termination rates to ensure reasonable rates and competitive neutrality. In addition, the U.S. proposed to continue inviting experts to the Telecommunications Working Group to provide information about emerging communications technologies. The United States recommendations were discussed at the first meeting of the Telecommunications Working Group, which took place in November 2003 in Tokyo. Under the auspices of the Working Group, guest speakers provided information about recent developments in RFID (Radio Frequency Identification) and its implications for spectrum policy.

Information Technologies: The primary objective of the Information Technologies (IT) Working Group under the Regulatory Reform Initiative is to work with Japan to establish a vibrant and competitive IT sector that can benefit both our economies, as well as provide global leadership in this area. Although Japan's electronic commerce (e-commerce) market is one of the largest in the world, its tremendous potential for growth remains unfulfilled because the IT sector is burdened by regulatory and other barriers. Japan has taken significant steps toward, and continues to make progress on, realizing its ambitious plan to become a global IT leader. In 2003, recognizing that IT infrastructure had developed significantly as a result of its efforts, the Japanese Government drafted and released an update of its "e-Japan Strategy," which marked a shift toward more heavily promoting the utilization of IT. Even so, the Japanese Government itself acknowledged through the measures proposed in the "2003 e-Japan Priority Policy Program" that legal and other barriers that hinder growth in the IT sector persist. As Japan responds to the challenges that lie ahead in this pivotal sector, the U.S. Government is working with Japan to establish a regulatory framework that ensures competition, promotes innovation, allows private sector-led regulation where appropriate, and protects intellectual property rights in the digital age. Establishing such a framework will promote the development of IT-related businesses and e-commerce, and thus provide significant opportunities for U.S. firms and their leading technology products and services in a market that is expected to reach nearly $125 billion by 2005. Having entered its third year in fall 2003, the IT Working Group has been a very cooperative and constructive dialogue for advancing these goals.

Throughout 2003, discussions in the IT Working Group focused on protecting intellectual property; removing regulatory and non-regulatory barriers to e-commerce; promoting e-commerce via private-sector self-regulatory mechanisms and technology-neutral, market-driven solutions; and expanding IT procurement opportunities. The recommendations also included a proposal for a cooperative effort in the area of IT-based education. Japan has in turn agreed to take significant steps to promote growth in the IT sector. The specific measures Japan has taken are summarized in the May 2003 Second Report to the Leaders under the Regulatory Reform Initiative.

With regard to strengthening the protection of intellectual property, Japan passed legislation amending the Copyright Law to extend the term of copyright protection for cinematographic works from 50 to 70 years, which will go into effect in early 2004. In addition, Japan passed legislation which strengthens the enforcement of copyright protection by alleviating the burden of proof on rightholders to establish infringement and the amount of damages in copyright infringement cases. Japan also established the Intellectual Property Strategy Headquarters to implement Japan's "IP Strategic Program" that will include measures designed to meet the challenges of strengthening the protection and enforcement of intellectual property rights in the digital age.

Japan also took steps to increase user confidence in e-commerce by confirming that current and future revisions to the regulations allowing the use of electronic signatures will always maintain technological neutrality. Japan reinforced the leadership role of the private sector by agreeing to support the development of private-sector self-regulatory mechanisms for online consumer protection and management of personal data. Japan also enhanced opportunities for e-education technology providers by holding two forums with the United States that promoted IT solutions in primary education.

In addition, Japan recognized the important role of e-government in promoting growth in the IT sector by ensuring that all ministries will adopt concrete measures to ensure non-discriminatory, transparent, and fair procurement of information systems, and by expanding the use and availability of interactive online procurement systems. Japan also agreed to jointly hold with the U.S. Government a high-level U.S.-Japan government/private sector network security forum to raise awareness of key issues, highlight best practices, and strengthen public-private partnerships in promoting network security. This forum took place in September 2003, at which time the governments issued the "U.S.-Japan Joint Statement on Promoting Global Cyber Security," which emphasized the important roles the U.S. and Japan play as global leaders in this area.

Building on these accomplishments and the progress achieved over the past year, the United States made several recommendations in the October 2003 Regulatory Reform submission to reinvigorate Japan's IT sector. These recommendations included removing regulatory and other barriers, strengthening the protection of digital content, promoting the use of e-commerce in the public and private sectors, promoting network security, and facilitating IT procurement reforms. An overarching objective of this year's IT Working Group, incorporated throughout the specific recommendations, is to promote and expand private-sector input and the use of public comment opportunities in the Japanese policy-making and regulatory processes. Specific recommendations include removing existing barriers that impede business-to-business and business-to-consumer e-commerce, such as allowing non-attorneys to provide online mediation and arbitration services for profit (Alternative Dispute Resolution). The U.S. submission also stressed the importance of transparency and coordination among ministries in implementing the Law on the Protection of Personal Information ("Privacy Law"), and sought assurance that companies, particularly those in e-commerce, would not be overly burdened in complying with the law (privacy protection).

With regard to strengthening the protection of intellectual property, the United States made several recommendations to strengthen the protection of digital content and the enforcement system against infringement. These recommendations include adopting a statutory damages system and extending Japan's terms of copyright protection for sound recordings and all other works protected by Japan's Copyright Law. To promote e-commerce use, the United States has urged Japan to support private sector self-regulatory mechanisms for privacy and Alternative Dispute Resolution, as well as to ensure that laws governing electronic transactions are technology-neutral. The United States has also called on Japan to support fair and open procedures for e-government procurement by ensuring transparency, efficiency, security, and private sector-led innovation. The United States conveyed and discussed these recommendations in detail during the first round of talks of the IT Working Group, which took place in November 2003.

Energy: Japan took a major step forward in 2003 towards liberalizing its energy sector. In June of this year, the Japanese Diet passed sweeping legislation that will lead to a further liberalization of Japan's energy sector (the third largest in the world after the United States and China) and should bring the government's regulation of utilities substantially closer to practices in other developed countries. This legislation paves the way for expanding liberalization in the retail electricity sector from 26 percent to 63 percent of the market by 2005 and expanding liberalization in the retail gas sector from 40 percent to 50 percent of the market by 2007. Importantly, as Japan developed this legislation, it provided several opportunities for public comment, fostering the kind of investor confidence that is so important to maintaining a stable, competitive energy market. A truly competitive Japanese energy sector will spur domestic economic growth and increase opportunities for U.S. firms to produce, sell, and trade energy products and services in Japan's electricity and gas markets. It will also provide opportunities for increasing U.S. exports to Japan's electrical generation equipment market.

The energy section of the Second Report to the Leaders concluded in May previewed many of key elements contained in the energy reform legislation that won Diet approval a month later. For example, to foster reliability and transparency in the transmission/distribution electricity sector, vertically integrated electric utilities are prohibited from using transmission information to disadvantage third-party generators. In addition, to prevent cross-subsidization of other utility operations, transmission/distribution accounts must be separate from generation and sales accounts. Players in the transmission/distribution sector are also prohibited from discriminating against other electricity sector participants. Furthermore, Japan will establish a neutral transmission system organization intended to create fair and non-discriminatory rules for the transmission and distribution of electric power.

Important reform legislation measures to improve the natural gas supply were also previewed in the Second Report to the Leaders, such as: providing non-utilities with eminent domain to construct gas supply pipelines; giving third parties access to non-utility as well as utility gas supply pipelines; ensuring fair and transparent gas transportation service through accounting separation of transmission from sales, information firewalls, and prohibition of discrimination against third parties. To facilitate fair negotiations between owners and users of LNG facilities, Japan will also be issuing joint METI/JFTC guidelines on acceptable practices.

Furthermore, in the Second Report to the Leaders, Japan recognized: (1) that the effectiveness of the new reform legislation in ensuring a fair, efficient, and stable energy market depends on vigilant market oversight; and (2) the importance of an enforcement mechanism equipped with the number of staff, expertise, and independence necessary to perform this task.

With passage of the energy reform legislation, Japan has established an important framework for future liberalization. The focus in Japan is now on creating detailed implementing ordinances and regulations that should lead to a genuinely competitive market, increase efficiency, and improve the environment for investment in line with the aims of Japan's energy reform law. Accordingly, the United States made numerous recommendations regarding implementation measures in its October 2003 Regulatory Reform and Competition submission to Japan.

The United States, for example, recommended that Japan take concrete measures to ensure that the Electricity and Gas Market Divisions of METI, which regulate the energy sector, are free from undue political and industry influences. In addition, to ensure adequacy of infrastructure in both the electricity and gas sectors, the United States recommended that Japan undertake studies to evaluate whether there is enough interconnection capability needed to support a competitive power market and to establish incentives for investment in new gas pipeline construction in regions where the network is not sufficiently developed.

Specifically in regard to the electricity sector, the United States recommended that if the accounting separation and information firewalls Japan plans to establish to prevent competitive abuses prove inadequate, METI should adopt operational unbundling to ensure a fair and transparent market. Meaningful government oversight of the neutral transmission system organization is also crucial, and transmission rules should be revised to facilitate greater access to transmission lines for all market participants.

As for the gas sector, the United States urged Japan to establish and strengthen a mechanism to conduct more rigorous rate approval examinations and audits and conduct neutral and fair ex-post facto monitoring. The United States also recommends that Japan promote construction and improvement of pipelines for gas supply use by parties other than general gas utilities and to establish detailed rules to ensure non-discriminatory negotiations between LNG terminal owners and third-party users of LNG terminals.

The United States commends Japan for its recent efforts to further liberalize its electricity and gas sectors. Much still needs to be done, however, as energy prices in Japan are still the highest among OECD members. Moreover, greater liberalization does not always mean greater market access unless a regulatory regime is established that genuinely encourages new players to enter the market. With this in mind, the United States considers the above reform recommendations as conducive to foster Japan's economic recovery, help U.S. firms compete in the Japanese electricity and gas markets, and create new opportunities for competitively priced, high-quality exports to the Japanese market for electrical generation equipment. Based on these recommendations, further discussions on energy issues took place in November 2003 in the Energy Working Group.

Medical Devices and Pharmaceuticals: Japan's regulatory and reimbursement pricing systems slow the introduction of innovative U.S. medical devices and pharmaceuticals in Japan. Japan has recently decided to carry out major reform of these systems that will become fully effective in April 2005. The United States has advocated such reform to speed the introduction of new devices and drugs and to create incentives for the development of innovative products. Although Japan recognizes the importance of reform, its government has in recent years discouraged innovation by significantly cutting the reimbursement prices for devices and drugs. The price cuts are part of Japan's response to the strain on its health care budget arising from an aging society where the number of workers supporting each retiree is declining steadily.

The U.S. Government believes that the Japanese Government's proposed health care reform is a first step toward confronting underlying problems, although Japan must move expeditiously to implement its plans. Japan's proposed reform focuses on transformation of the insurance system, creation of a new health insurance program for the elderly, and a review of the medical fee system.

The U.S. Government has welcomed the Japanese Government's comprehensive approach to pricing reform, as outlined in Japan's "Industry Vision" proposals to improve the competitiveness of its medical device and pharmaceutical sectors. Japan pledges in the Industry Visions to discuss with industry the health insurance coverage of devices and drugs and to implement pricing policies that recognize the value of innovation. The United States was further encouraged by Japan's statement in the May 2003 U.S.-Japan Second Report to the Leaders that it will encourage innovation by implementing the Industry Visions so that better devices and drugs are made available faster. The U.S. Government hopes to make further progress on these issues through the Regulatory Reform Initiative, which is part of the U.S.-Japan Economic Partnership for Growth. In October 2003, the U.S. Government presented its device and drug proposals to Japan under the Initiative and discussed them at a meeting of the Medical Devices and Pharmaceuticals Working Group in Tokyo. The Working Group meets under the framework of both the Initiative and the 1986 U.S.-Japan Market-Oriented, Sector-Selective (MOSS) Agreement. The U.S. proposals encouraged Japan to make full use of pricing rules, including premium-pricing rules, to reward and stimulate advances in drug research and medical technology. The United States also urged Japan to abolish rules that penalize or fail to recognize the value of innovation. In addition, the United States requested that Japan provide U.S. industry with opportunities to provide input and with access to consultations before any change in reimbursement policy such as proposed changes in the Foreign Price Adjustment rule.

The Japanese Government has also taken recent steps that could lead to faster deregulation of medical devices and pharmaceuticals, which would speed the introduction of innovative products in Japan. Japan has revised its Pharmaceutical Affairs Law to create a new agency to oversee premarketing and approval of drugs and devices. The U.S. Government has welcomed the creation of the new Pharmaceuticals and Medical Devices Organization (PMDO), as it is expected to make approvals of drugs and devices faster. However, the United States has urged Japan to implement performance measures to ensure that steady progress is made toward faster approvals. In the Second Report to the Leaders, Japan said it would undertake major regulatory reform and continue discussing its plans with major stakeholders, including U.S. industry. More recently, in the October 2003 Regulatory Reform Initiative submission, the U.S. Government encouraged Japan to speed approvals and maintain a dialogue with industry. The United States also requested that Japan establish a user fee system that is based on performance and transparency, which should lead to faster and better systems for approvals and postmarketing safety.

Financial Services: The Government of Japan has implemented most of its "Big Bang" financial deregulation initiative. Those reforms aimed to make Tokyo's financial markets "free, fair and global" by allowing new financial products, increasing competition within and between financial industry segments, and enhancing accounting and disclosure standards. Big Bang liberalization has substantially improved the ability of foreign financial service providers to reach customers in most segments of the Japanese financial system.

There was additional progress in financial sector deregulation in 2003. The requirement for physical certificates for Japanese Government Bonds (JGBs) and corporate debentures was eliminated on January 6, 2003. This followed the elimination of the requirement for physical certificates for commercial paper on April 1, 2002.

In addition, on May 23, 2003 the Diet passed new securities market legislation to diversify corporate stock and bond distribution channels and increase the number of intermediaries. This legislation reduces minimum capital requirements for securities companies, investment trust management companies and investment advisory companies. On the same day, the Diet also passed major shareholder rule revisions designed to prevent abuse by brokers. The new rules authorize the Financial Services Agency (FSA) to inspect major shareholders of brokerage houses, including non-financial corporations and individuals. Finally, on May 30, 2003, the Diet passed legislation introducing a new sales agent system to permit CPAs, licensed tax accountants, and financial planners to sell corporate stocks to investors as agents of security brokerage houses. The entire securities market reform package will take effect on April 1, 2004.

Japan also amended the Postal Services Corporation Law in July 2003 to allow private investment advisory companies to provide fund management services for Postal Savings (Yucho) and Postal Life Insurance (Kampo). This is a significant breakthrough for foreign investment firms doing business in Japan, who now have the opportunity to manage funds that constitute a significant percentage of individual savings in Japan.

The United States welcomes Japan's progress in increasing the efficiency and competitiveness of its financial markets. In its October 2003 recommendations for regulatory reform regarding financial services, the United States put forward proposals to support further opening and development of the Japanese financial markets, which will allow Japan to take full advantage of international financial expertise and support future Japanese growth. These include: (1) strengthening disclosure rules for investment trust performance by setting standards based on global best practices; (2) taking the measures necessary to make the No-Action Letter process an effective means for promoting regulatory transparency in the financial services sector; (3) increasing the defined contribution (DC) pension plan contribution limits; (4) granting regulatory approval to prototype plans for DC pensions; (5) further improving rules governing Money Management Funds (MMFs); (6) revising the E-Notification Law to include lenders subject to the Moneylending Business Law; (7) working closely with the private financial services community to review current reporting and record-keeping requirements; and (8) subjecting any legislative action for the financial services activities proposed for the Postal Public Corporation to full public notice and comment.

These issues were discussed on November 5, 2003, at the third annual meeting of the U.S.-Japan Financial Services Working Group, a component of the Financial Dialogue of the U.S.-Japan Economic Partnership for Growth.

ii. Structural Regulatory Reform

Competition Policy: A key goal of our regulatory reform efforts is to ensure that steps to deregulate and introduce competition into Japan's economy are not undone by anticompetitive actions by firms and trade associations resistant to such steps. An active and strong antitrust enforcement policy in Japan is needed to eliminate and deter anticompetitive behavior, including stronger measures to dismantle Japan's bid rigging (dango) system and active enforcement against anticompetitive exclusionary practices by dominant firms in deregulated industries.

Japan undertook some important steps in 2003 aimed at strengthening its antitrust enforcement regime. The independence and neutrality of the Japan Fair Trade Commission (JFTC), for example, was protected by changing its organizational status to an independent agency under the Cabinet Office. The JFTC also began reviewing the possible overhaul of the Antimonopoly Act (AMA) to strengthen the JFTC's enforcement effectiveness, examining such issues as an increase in the level and scope of administrative fines (surcharges), the introduction of a corporate leniency policy, bolstered JFTC search and investigative powers, lengthened statute of limitations, and revised criminal accusation procedures. In addition, a number of major steps were taken to address Japan's bid rigging problem. The Bid Rigging Involvement Prevention Act, a law aimed at preventing the complicity of government officials in bid rigging, came into effect in January 2003, and the JFTC immediately used its new powers to prevent a recurrence of bureaucrat-led bid rigging on public works projects in Hokkaido. The Ministry of Land, Infrastructure and Transport (MLIT) supported this new law by publishing on its website a bid rigging countermeasures booklet for use by central government, local government, and quasi-governmental commissioning entities, and by introducing a new contract clause specifying pre-established damages that must be paid by contractors that commit bid rigging.

In its October 2003 Regulatory Reform submission, the United States recommended that Japan enhance deterrence of AMA violations by increasing the level of administrative fines substantially, bringing more criminal prosecutions, and encouraging judges to impose tougher sentences on AMA violators. The United States also urged Japan to strengthen the JFTC's enforcement capabilities, including by introducing a corporate leniency program, giving the JFTC enhanced investigation powers for criminal matters, expanding the staff and budget of the JFTC, extending the statute of limitations for AMA violations, and improving the JFTC's economic analysis capabilities. The United States also recommended that Japan take further measures to address prolific bid rigging, including by prohibiting bid rigging companies from participating in new government contracts for at least nine months, and publicizing the full results of investigations into bureaucrat-led bid rigging at the central or local government level. Furthermore, the submission urged that Japan implement measures to permit the JFTC to enforce the AMA against incumbent dominant firms that engage in anticompetitive exclusion of new entrants in deregulated industries. These recommendations were discussed in detail at a meeting of the Cross-Sectoral Working Group in November 2003.

Transparency and Other Government Practices: The United States continues to press Japan to make its regulatory system more transparent and accessible. While some progress has been achieved in this regard, the system continues to lack the transparency and accountability necessary to ensure that all players have equal access to government information and to the policy-making process. Reforms that increase the transparency of the regulatory process and make the bureaucracy more accountable work to shift greater control to the general public and help curb burdensome discretionary powers of the bureaucracy. Such reforms also help level the playing field for foreign firms, reducing the special advantages traditionally enjoyed by Japan's domestic firms.

Japan took several steps in 2003 to increase the transparency and accountability of its regulatory system. As specified in the Second Report to the Leaders, Japan made a number of pledges to improve its Public Comment Procedure (PCP) in an effort to make it more effective and to encourage more widespread use of this potentially important mechanism. The Ministry of Public Management, Home Affairs, Posts and Telecommunications (MPHPT), for example, requested that all ministries and agencies work to gather a broader range of opinions and information through the PCP when formulating, amending, or repealing a regulation by allowing for sufficiently long public comment periods. Japan is also working to enhance its e-government portal (http://www.e_gov.go.jp/) to, in part, provide greater information on the PCP. In a related development, some ministries and agencies have recently begun to solicit public comments for draft plans that act as the basis for legislation.

In addition, the Second Report to the Leaders included a lengthy section on the new initiative in Japan to encourage deregulation at the local level within Special Zones for Structural Reform. To date, Prime Minister Junichiro Koizumi has approved more than 250 of these zones since the first zones were established in April 2003. This new, innovative approach to deregulation and structural reform can provide important opportunities for Japan to return to sustainable growth. In the Second Report to the Leaders, Japan pledged to continue to take steps to ensure transparency in the development of the zones, in the zone application process, and in establishing procedures to implement the zones. Japan also said that it would encourage foreign firms, including U.S. companies, to submit zones ideas and would assist them in the process.

Building on these measures, the United States recommended in its October 2003 Regulatory Reform and Competition Policy submission that Japan undertake additional improvements in its regulatory system to support its reform overall efforts and ensure that all actors have the same access to government information and the policy-making process. The United States urged Japan to: (1) improve the effectiveness of the Public Comment Procedure (PCP) by requiring a minimum 30-day comment period (repeated MPHPT surveys show that just half of the solicitations for comments provide for less than 30 days); (2) take additional steps to facilitate public input into draft legislation while it is being developed by the government before it is submitted to the Diet; (3) ensure that the process to restructure and privatize public corporations is transparent and that the private sector has opportunities to provide input; (4) implement measures and practices to strengthen the No-Action Letter system, which was established two years ago and has been woefully underutilized; and (5) continue to select and establish the Special Zones for Structural Reform in a transparent manner and place a focus on expanding market-entry opportunities. Based on these recommendations, further discussions on transparency issues took place in November 2003 during the inaugural meeting this year of the Cross-Sectoral Working Group.

Legal Services and Judicial System Reform: The creation of a legal environment in Japan that supports regulatory and structural reform and meets the needs of international business is a critical element for Japan's economic recovery and restructuring. The Japanese legal system must be able to respond to the market's need for the efficient provision of international legal services, and provide a sound and effective foundation for the conduct of business transactions in an increasingly deregulated environment.

Japan took some major steps in 2003 toward modernizing its legal system. Most significant was amendment of the law regulating foreign lawyers to substantially eliminate restrictions on the freedom of association between foreign lawyers and Japanese lawyers. Once those amendments come into effect in late 2004 or 2005, foreign lawyers will be able to enter into partnership arrangements with Japanese lawyers and will be able to hire Japanese lawyers as associates. Law firms composed of U.S. and Japanese lawyers will be able to operate under a single name, and the members will be able to determine the profit allocation among themselves freely. Japan also made progress in the area of judicial system reform, including implementation of measures to reduce by 50 percent the time required to complete court trials, and examining concrete and wide-ranging issues aimed at strengthening judicial oversight of administrative agencies.

In its October 2003 submission, the United States urged Japan to ensure that the amendments allowing freedom of association between foreign and Japanese lawyers come into effect by September 2004. The United States also called on Japan to allow foreign lawyers to form professional corporations and to establish branch offices throughout Japan, just as Japanese lawyers are currently permitted to do, and to allow foreign lawyers to count all of the time they practice in Japan toward the three-year experience requirement to qualify as a licensed foreign legal consultant. The United States also urged Japan to modify standing requirements for judicial review of administrative acts so that all persons who suffer injury as a result of a regulatory action may file an appeal with the courts. These recommendations were discussed in more detail at a meeting of the Cross-Sectoral Working Group in November 2003.

Commercial Law: Reform of Japan's commercial law to permit the use of modern merger techniques is necessary to facilitate merger and acquisition activities by both foreign and domestic firms in Japan. The Japanese economy will also benefit from additional measures to improve corporate governance, since good corporate governance systems will encourage increased productivity and economically sound business decisions as management strives to maximize shareholder value. However, good corporate governance requires active shareholder participation, particularly by large institutional investors such as pension funds and mutual funds, and the encouragement of good information flows through whistleblower protections.

Japan took initial steps in 2003 to introduce modern merger techniques into Japanese law by revising the Industrial Revitalization Law to permit triangular mergers and cash mergers in restructuring plans authorized by the government (see Investment section). Japan also took steps to increase corporate transparency by requiring disclosure of the name, career summary, corporate share-holdings, and nature of their relationship with the company of each member of the board, including executive committee members.

In its October 2003 Regulatory Reform submission, the United States encouraged Japan to build on these initial steps by taking further measures to improve commercial law and corporate governance in Japan. Specifically, the United States recommended that Japan introduce modern merger techniques into its commercial law for general use and that it improve corporate governance by requiring pension fund and mutual fund managers to vote proxies for the benefit of fund beneficiaries and to disclose voting policies and actual voting records. The United States also urged Japan to introduce legislation to protect whistleblowing employees who report violations of securities laws or regulations from retaliation. Further, in order to promote the efficient and economical resolution of commercial disputes, the United States recommended that Japan create an alternative dispute resolution (ADR) regime that permits non-lawyers to act as arbitrators or other neutral roles in ADR proceedings and that allows ADR rules, processes, and standards to be flexibly tailored by the parties to the proceedings. These recommendations were discussed in more detail at a meeting of the Cross-Sectoral Working Group in November 2002.

Distribution: Japan's rigid and inefficient distribution and customs systems restrict market access for imported products and undermine the competitiveness of foreign-made products. With regard to customs, the United States continues to urge Japan to modernize clearance procedures to fully open its market to imported goods. The demand for the rapid delivery of goods and information has produced a number of new industries, including the express carrier industry, that are now seen as vital for the smooth development of the global economy. It is important therefore, to minimize the regulations, procedures, and costs that could inhibit the free exchange of goods and information through the express carrier industry. While more remains to be done, the Japanese Government has implemented several measures and provided a number of assurances in the context of the Regulatory Reform Initiative that will enhance the ability of U.S. express carriers to provide an efficient, speedy exchange of goods and information to benefit the Japanese economy.

In the Second Report to the Leaders, the Japanese Government noted the creation of 12 "international physical distribution special zones" in which overtime charges are reduced and the customs framework for overtime clearance is improved. In addition, on April 1, 2003, the Japanese Customs and Tariff Bureau (CTB) launched a system that enables non-residents to file import duty declarations, etc., and control inventory. Additionally, the CTB committed to examining the feasibility of expanding the U-Clearance system.

U.S. reform recommendations to the Japanese Government in October 2003 recognized that Japan has implemented, and plans to implement, additional positive measures to simplify and automate customs processing, but contained several further recommendations dealing with customs clearance. The submission again recommended that Japan lower landing fees at Narita and Kansai international airports by formulating the level of landing fees in an open and transparent manner, using internationally accepted accounting standards, and basing those fees on the actual cost of providing services. In an effort to improve consumer convenience and expand consumer choice, the United States made a number of recommendations aimed at increasing the acceptance of credit and debit cards in Japan, and enhancing the security of transactions made with those cards. The U.S. Government continues to monitor progress on customs processing procedures and the fair and uniform implementation of the Large Store Location Law. In November 2003, the Cross-Sectoral Working Group met to discuss these and other issues.

b. Bilateral Consultations

i. Insurance

Under the 1994 and 1996 bilateral insurance agreements, Japan took significant steps to deregulate its insurance market. These steps included sweeping measures that resulted in meaningful improvements in the product approval process, greater use of direct sales of insurance products, and a diversification of allowable product offerings. As a result, U.S. insurance companies continue to visibly and substantially increase their presence in both the life and non-life insurance sectors in Japan. Issues of serious concern to U.S. insurers remain that remain include competitive concerns related to Kampo (Japan's postal insurance entity), the review and reform of the Life Insurance Policyholder Protection Corporation (PPC), and unregulated and regulated insurance cooperative (kyosai).

Bilateral consultations under the two insurance agreements were held in Tokyo in November 2003. The talks, which included the participation of the National Association of Insurance Commissioners, covered a broad range of issues that had been highlighted by U.S. industry as key areas of concern.

Under Japan Post, the new public corporation established in April 2003, Kampo continues to provide a range of life insurance products that compete directly with the private sector. In November, Kampo's regulatory body, the Ministry of Public Management, Home Affairs, Posts and Telecommunications (MPHPT) regrettably approved Kampo's request to begin offering a hybrid fixed-term/whole life product in the face of opposition by the insurance industry and Japan's trading partners. The United States has called for MPHPT to revoke its approval or for Japan Post to refrain from introducing the product until a level playing field is established in Japan's insurance market. The United States has urged Japan to ensure that the process of determining the future of Kampo is conducted in a fully open and transparent manner. The United States has also urged Japan to consult and work closely with both domestic and foreign insurers in determining the appropriate approach to reforming Kampo.

During the insurance talks, the United States also raised the issue of the future of the Life Insurance PPC. The United States urged Japan to carry out its commitment to promptly convene the Financial System Council to conduct a thorough review of the safety net system and ensure that subsequent legislation is enacted in time to establish a more efficient, sustainable safety net system before current stopgap measures expire in March 2006. The United States views the FSA's commitment to conduct the review as essential and stressed that the deliberations should be transparent and should involve representatives of interested parties, including foreign insurance companies.

The United States also raised its concerns about regulated and unregulated kyosai. These insurance cooperatives provide a range of insurance products that compete directly with the private sector and occupy substantial market share in the Japanese insurance market. In order to create a level playing field between kyosai and their private sector competitors, the United States has urged Japan to subject all kyosai to the same laws, level of taxation, safety net contribution requirements, reserve requirements, standards, and regulatory oversight as their private sector counterparts.

The United States and Japan also discussed the FSA's implementation of recommendations to streamline Japan's product approval process and increase needed personnel and technical resources. In addition, the United States emphasized its concerns about the case agent system and transparency, particularly "No-Action Letter" procedures. The two countries also addressed a number of new issues that have arisen as Japan continues to restructure its financial system, such as the expansion of sales of insurance by banks.

In addition to the annual consultations, the United States utilizes the U.S.-Japan Regulatory Reform Initiative to put forward several recommendations to promote further reform in Japan's insurance market. The United States made specific recommendations to address the concerns identified above for Kampo, the Life PPC, Kyosai, and transparency in its 2003 Regulatory Reform submission to Japan.

ii. Autos and Auto Parts

Improving access to the Japanese auto and auto parts markets remains an important objective of the United States. While there has been a trend toward closer integration as well as important technological advancements in the global automotive industry over the past several years, the effect of these changes on market access and competition in this sector remains unclear. Unfortunately, Japan's limited market access and weak competitive environment have continued to disproportionately hurt foreign vehicle and auto parts manufacturers in Japan. The United States remains disappointed that, after rising steadily in 1995 and 1996, sales of North American- made vehicles have fallen for the last seven years, with sales in 2003 expected to be substantially less than in 1994. In an effort to contend with these economic conditions and position themselves to better compete in the future, U.S. auto companies have continued to consolidate distribution networks and rethink corporate strategies. The auto parts sector also remains problematic: the U.S. auto parts trade deficit with Japan increased from a record level of $9.5 billion in 1997 to an estimated $11.4 billion in 2003.

In order to address barriers in and improve U.S. companies' access to the domestic Japanese automotive market and Japanese auto plants in the United States, the United States and Japan established the Automotive Consultative Group (ACG) in October 2001. The ACG serves as the focal point for addressing lingering as well as emerging issues in this key sector of both countries' economies. More specifically, the group is designed to assess trends in the industry based on a series of trade and economic data on autos and automotive parts to be provided by both countries and work to identify areas in which specific action can be taken by Japan to address U.S. concerns. The ACG met in January 2003 to discuss deregulation (particularly with respect to the automotive parts aftermarket), increasing transparency in rules and regulations governing the auto sector, and more rigorous application of Japanese competition laws. Future ACG meetings will be held annually in principle.

In addition to meetings under the ACG, the United States is continuing to address broad crosscutting issues impacting the automotive sector under the Economic Partnership for Growth, announced by President Bush and Prime Minister Koizumi in June 2001. This includes expanding opportunities for foreign investment, increasing transparency, and promoting corporate restructuring in the Japanese economy.

iii. Government Procurement

Construction/Public Works: U.S. firms remain largely excluded from Japan's massive ($210 billion) public works market, obtaining far less than one percent of projects awarded. Discriminatory practices inhibit the full involvement of U.S. design and construction firms in this sector, which has become increasingly competitive due to decreases in public works spending. The discriminatory practices continue despite the existence of the 1994 U.S.-Japan Public Works Agreement (Action Plan), under which Japan is obligated to use specified open and competitive procedures for public works procurements valued at or above specified thresholds. The requirements set by these procedures go above and beyond those called for under the WTO Agreement on Government Procurement (GPA). Problematic practices include failure to address rampant bid rigging, use of arbitrary qualification and evaluation criteria to exclude U.S. firms, unreasonable restrictions on the formation of joint ventures, and the structuring of individual procurements so they fall below thresholds established in international agreements. The United States is concerned about these practices, which seriously impede the ability of U.S. companies to participate in Japan's public works sector.

During the Trade Forum in July 2003, the United States urged Japan to eliminate the obstacles that prevent U.S. companies from full and fair participation in its public works sector. The United States and Japan agreed to hold expert-level meetings on construction issues parallel to the Trade Forum, so bilateral sectoral concerns could be addressed in greater detail. The United States welcomed the Japanese Government's announcement of the "implementation of the mixed-type procurement," which allows companies to decide whether to bid solo or as a joint venture. The United States urged the Japanese Government to use this practice for all projects. The United States also encouraged Japan to increase the use of Construction Management and Project Management technology for all public works projects and urged all commissioning entities to use the fair, open, and non-discriminatory procurement procedures of the Action Plan for Urban Renewal and Private Finance Initiative projects. In addition, the United States urged the Japanese Government to ensure that the procurement procedures set forth in the 1991 U.S.-Japan Major Projects Arrangement (MPA) are used for all outstanding MPA projects. In October 2003, Japanese private sector organizations hosted the fifth U.S.-Japan Construction Cooperation Forum (CCF), which focused on facilitating the formation of joint ventures between U.S. and Japanese design/consulting and construction companies for Private Finance Initiative projects.

iv. Investment

Prime Minister Koizumi's January 2003 pledge to double Japan's cumulative FDI in the next five years has led Japan to build on its earlier reforms to encourage FDI. Changing Japanese attitudes toward inward foreign direct investment (FDI), depressed asset values, and improvement in the regulatory environment enabled U.S. and other foreign firms to continue to gain significant new footholds in the Japanese economy, mostly through mergers and acquisitions. Although FDI in Japan remains the lowest among OECD countries, investment has been rising in recent years, especially in the banking/insurance, telecommunications, and machinery sectors. However, FDI flows overall and in these sectors slowed in JFY2002 (ending March 2003) and remained low in early CY2003. FDI in JFY2002 was 2.19 trillion yen ($20 billion at the current exchange rate of $1= 107.6 yen), up slightly from JFY2001 but down almost one third in yen terms from the JFY2000 peak. U.S. direct investment into Japan mirrored overall trends, declining in JFY2002 to 590 billion yen ($5.5 billion), almost 40 percent from JFY2000 levels. Despite these declines, current FDI flows into Japan are still far higher than historical levels (pre-1999).

Japanese and foreign businesses continue to be significantly affected by the implementation of several recent legal changes. The Securities Exchange Law, for example, now mandates consolidated and market-value accounting for listed firms and a new bankruptcy law (Civil

Reconstruction Law) encourages business reorganization, including spin-offs, rather than forced liquidation of assets. In addition, the concept of corporate governance, such as the role of boards of directors, is changing in ways that bode well for increased investments, mergers and acquisitions. Amendments to the Commercial Law now allow, since April 2003, large-scale corporations to choose either Japan's traditional statutory auditor system or executive committee system (i.e., U.S.-style corporate governance). Although the Diet in 2003 amended the Industrial Revitalization Law (IRL) to allow triangular mergers and cash mergers, using parent company stock as merger consideration, for those companies covered by the IRL, it did not address tax considerations for foreign companies involved in such mergers.

Despite the progress achieved over recent years, government and business observers from both countries recognize that much more remains to be done to increase FDI in Japan, and the U.S. and Japanese Governments have agreed to continue to consult on investment issues. The U.S.-Japan Investment Initiative, under the Economic Partnership for Growth, sets forth a framework for bilateral discussions on investment that highlights and resolves possible impediments. The Initiative meets regularly throughout the year and presents an annual report to the President and Prime Minister on the year's accomplishments. During the talks, the U.S. and Japanese private sectors are given an opportunity to actively participate and directly present their investment concerns to the Governments of Japan and the United States. Businesses in both Japan and the United States agree that two new bilateral agreements—an income tax treaty and a social security totalization agreement—concluded in 2003 will benefit investors in both countries.

v. Housing/Wood Products

Discussions with Japan in the housing/wood products area are ongoing. The Building Experts Committee and the Japan Agricultural Standards (JAS) Technical Committees, which were set up under the terms of the 1990 U.S.-Japan Wood Products Agreement, met in Nagoya in October 2003 to discuss a number of housing/wood products-related issues, notably the new regulations pertaining to indoor air quality that took effect on July 1, 2003. Foreign manufacturers, including many in the United States, have been hard-pressed to meet the new requirements. Although Japan announced the amendment to the Building Standard Law in March 2002, information on the process to demonstrate compliance was not made available until May 2003, which left manufacturers with less than two months to have their products tested and gain the necessary approval to allow their continued use. Approval of the first U.S. testing body is still pending. The United States put forth several recommendations at the meeting in October 2003 to facilitate recognition of overseas test data. This will be extremely important in the future as additional chemicals are regulated, thereby potentially impacting more products. The United States will be following up with Japan in the coming months on this issue.

Restrictions on building size and designs, and products still constrain the use of some U.S. building products and systems in Japan that are commonly used in the United States and elsewhere around the world, thereby limiting choice for consumers and artificially inflating housing costs. The United States continues to have serious reservations about the transparency and basis of certain testing methodologies for evaluating fire resistance.

c. Sectoral Issues

i. Agriculture

Japan remains the United States' second largest export market (behind Canada) for food and agriculture products. Despite this, Japan maintains many barriers to imports of these products.

Rice: The United States continues to express ongoing concerns over U.S. access to Japan's rice market. Although the United States has supplied about half of Japan's rice import needs since 1995 when it opened its market under its WTO minimum market access agreement, only a small percentage of U.S. rice ever reaches Japanese consumers as an identifiable product of the United States. Imports of U.S. rice under government-supervised tenders, for example, are destined almost exclusively for government stocks or re-exported as food aid. Only a minor share of U.S. rice imported under the tariff rate quota (TRQ) is allowed to be sold into the private sector immediately upon entry. In addition, very small quantities are, however, sometimes released from government stocks and eventually permitted to enter the industrial food-processing sector. Since Japan tariffied rice imports in 1999, only a minuscule amount has been imported outside of the TRQ, because it would be subject to a duty of 341 yen per kilogram, equivalent to about 790 percent ad valorem.

Beef Safeguard Measure: On August 1, 2003, Japan imposed an emergency tariff measure—a safeguard duty, increasing the duty on imports of chilled beef to 50 percent from the previously applied rate of 38.5 percent. Japan is the United States' largest beef export market, purchasing an average of nearly $1.2 billion worth of fresh, chilled, and frozen beef from 2000 to 2002. The average value of U.S. exports of chilled beef for 2000-2002 was $720 million. While acknowledging existence of the technical trigger for imposing this measure, the United States considers its use under the existing circumstances to be improper. The U.S. position is that such measures were intended to aid domestic producers confronted with import surges. This is not the case in Japan, however, where 2003 beef imports are recovering from severely depressed 2002 levels following the discovery of several animals infected with Bovine Spongiform Encephalopathy (BSE) in 2001. Imposition of this safeguard threatens this recovery and harms not only U.S. beef producers, but also a full range of Japanese beef consumers, including the food service, grocery, and restaurant industries.

The higher tariff is scheduled to be in effect until March 31, 2004 (the end of the Japanese fiscal year). The safeguard could be triggered again in JFY2004 (for frozen or chilled beef) unless the Government of Japan takes action to change the safeguard provision in its annual tariff legislation. Since the imposition of the tariff increase, the U.S. Government has raised this issue repeatedly in bilateral government-to-government meetings as well as public fora in Japan. While the safeguard measure remains in place, the United States will continue to urge Japan to remove the safeguard measure and return the tariff to its previous level.

Sanitary and Phytosanitary Measures: Japan's use of sanitary and phytosanitary measures continues to create many barriers to U.S. food and agricultural goods. The United States is increasingly concerned that these measures are being imposed despite their inconsistency with international standards and in the absence of supportive science.

This was the conclusion of a WTO dispute settlement panel and the WTO Appellate Body in a case involving Japan's requirements on U.S. apple exports, including orchard inspections. The panel and Appellate Body found that these requirements, ostensibly to protect Japanese orchards against fire blight disease, did not have a scientific basis and were not based on a valid risk assessment.

Another prime example is Japan's fumigation requirement on U.S. fruits and vegetables for cosmopolitan pests, which are imposed despite the fact that these are pests that are widely distributed in Japan and are not under official control. The fumigation requirement is particularly detrimental to the quality of these products, many of which sometimes do not survive fumigation and must be destroyed. The United States has raised this issue in the WTO Committee on the Sanitary and Phytosanitary Measures.

The United States continues to work with Japan to resolve this and other SPS concerns in appropriate bilateral and multilateral meetings. In addition, the United States will monitor closely Japan's newly established Food Safety Agency and will take every opportunity to ensure that this agency operates in a manner consistent with Japan's trade commitments and promotes WTO consistent policies that are based on sound science.

ii. Steel

Steel Issues are detailed in Chapter V.

iii. Flat Glass

Barriers to U.S. flat glass sales in Japan persist, in contrast to the high market shares U.S. flat glass manufacturers have gained in other industrialized economies. Japan's three domestic producers constitute an oligopoly that exerts tight control over distribution channels by, for example, maintaining extensive equity and financial ties to distributors. In addition, Japanese flat glass manufacturers adjust prices, capacity and product mix at virtually the same time, contributing to a lack of competition in the market.

The United States has engaged Japan in discussions of these concerns in various bilateral fora over the past decade, most recently in the 2003 Trade Forum held in July under the U.S.-Japan Partnership for Economic Growth. During the Trade Forum discussion, the U.S. Government highlighted the continuing problems that prevent market entry, including the need for tighter enforcement of rules against anticompetitive behavior.

The United States continues to urge Japan to take steps to promote competition in and access to its glass market. The United States also continues to work with U.S. industry on ways to improve market access and enhance competition in this sector.

10. Taiwan

In 2003, the United States and Taiwan continued to work together to address shortcomings in several areas related to Taiwan's WTO commitments, including ensuring market access for rice, improving intellectual property rights protection, and further opening Taiwan's telecommunications services market. In addition, the United States worked with Taiwan bilaterally to ensure market access for pharmaceutical products.

a. Rice

The Taiwan government's management of its rice import system was particularly troublesome this past year and required a number of substantive consultations to achieve access for U.S. rice. In late 2002, Taiwan announced modifications to its rice import system without prior consultation with the United States and other interested WTO members. The United States consulted with Taiwan as 2002 came to a close, but Taiwan's responses did not resolve concerns that the new system would be more trade restrictive. Subsequently, the United States, Australia, and Thailand formally submitted an objection to the WTO in January 2003. In addition, several rice tenders were cancelled by Taiwan in 2003 due to use of a ceiling price, which resulted in delayed market entry. The United States engaged the Taiwan government on numerous occasions in 2003 in an effort to resolve concerns related to the existing rice import system and will continue to do so in 2004. Taiwan is a leading Asian market for U.S. rice exports and, despite problems associated with the rice tender process, U.S. suppliers won a majority of the tenders conducted in 2003. We look forward to continuing to work with the Taiwan government to address remaining concerns with its rice import system.

b. Intellectual Property Rights

The level of intellectual property rights (IPR) piracy in Taiwan remains at a very high level. U.S. concerns were serious enough to warrant continued placement of Taiwan on the Special 301 Priority Watch List for the third year in a row. After the Taiwan authorities declared 2002 to be the "Action Year for IPR Protection," they implemented a "Comprehensive Three Year Action Plan for IPR Protection" to cover the years 2003-2005. While these were welcome steps, the United States continued in 2003 to urge the Taiwan government to further improve its enforcement and legal framework for IPR protection.

In June, Taiwan amended its copyright law which addressed some U.S. concerns. However, several important proposed revisions to the law were modified or deleted by legislators before the amendments were enacted. As a result, the United States continued to request that the Taiwan government submit for legislative approval these outstanding revisions to the copyright law, including Internet-related provisions such as technological protection measures.

As 2003 came to a close, there appeared to be initial signs that Taiwan's efforts to control piracy are leading to a decrease in the incidence of end user piracy of business software and an increase in the number of raids and seizures. However, infringement in other areas, especially of optical media, continues to remain unacceptably high. Further, there is increasing concern with the use of the Internet to distribute infringing product and that Taiwan's overall enforcement and prosecutory efforts need to be implemented quickly, and improved and broadened for the long term.

We will continue to monitor Taiwan's progress in addressing its high piracy rates, focusing in particular on whether the Taiwan government aggressively enforces its laws, actively combats piracy, and takes other concrete actions to reduce all types of IPR violations. We also look forward to working with the Taiwan government on further amendments to its copyright law to conform with international IPR norms.

c. Telecommunications

Two years after WTO accession, Taiwan has yet to establish an independent telecommunications regulatory authority. Furthermore, despite repeated requests from the United States, Taiwan has yet to implement a licensing regime consistent with its WTO commitments to permit foreign carriers to apply for authorization to supply local, long-distance, and international services.

Taiwan's telecommunications regulatory authority, the Directorate General of Telecommunications, and formerly wholly state-owned monopoly ChungHwa Telecom are under the purview of the Ministry of Transportation and Communications. As 2003 came to a close, Taiwan's legislature had approved only one of two bills necessary to establish a new National Communications Commission, an independent regulatory authority. Taiwan is developing criteria regarding the issuance of telecommunications licenses for local, domestic long distance, and international services but continues to delay implementation. Further, capital requirements for comprehensive network services (NTD 16 billion), city-call services (NTD 12 billion), and long-distance/or international services (NTD 2 billion) continue to be excessively high. Comprehensive fixed-line and local network licensees will require a build-up of 400,000 lines but 60,000 lines will be sufficient for initiating basic services. We will continue to monitor whether such requirements are hindering Taiwan's progress toward full market opening of its telecommunications sector in a WTO-consistent manner.

d. Pharmaceuticals

Taiwan's pharmaceutical registration process continues to slow market entry for new drugs that have already been approved in other industrial countries. Taiwan's Department of Health implemented a new requirement for firms to submit validation data as part of the registration and approval process for both new drugs and those already on the market. The United States worked closely with the Taiwan government in 2003 to achieve market access for pharmaceutical products and will continue to do so in 2004.

The United States will also continue to work with Taiwan to ensure that registration data pertaining to pharmaceutical and agricultural chemical products that are submitted to the government for marketing approval are protected from unfair commercial use. This protection, known as "data exclusivity," is a requirement of the WTO TRIPS Agreement and is intended to ensure that registration data is not used by third parties without the original owner's consent for an effective period of time.

Another area of concern in this sector involves pricing, whereby hospitals and doctors in Taiwan buy drugs at discounted prices and are then reimbursed at higher rates, contrary to regulations that reimbursements be made at the purchase price. The U.S. government will continue to work with

Taiwan officials and industry to develop ways in which this systemic problem can be addressed.

11. Hong Kong (Special Administrative Region)

a. Intellectual Property Rights

Hong Kong has made good progress in addressing IPR concerns over the past several years. In 2003, Hong Kong continued to strengthen its IPR enforcement regime, especially in the area of education, to combat copyright and trademark infringement. Due to these efforts, the Hong Kong people are increasingly aware of the importance of the IPR regime to their own industries, notably movies and toys. As 2003 came to a close, the Hong Kong government continued to work on an amendment to refine the "fair use" rules for copyright publications in response to concerns regarding the temporary suspension of criminal provisions. The unauthorized copying of computer programs, movies, music, television programs, and music remains illegal; but in June 2001, Hong Kong's Legislative Council (LegCo) temporarily suspended these provisions for copyright publications. The LegCo liberalized the parallel importation of computer software this year, while maintaining criminal penalties for such imports of "entertainment" copyrighted products like movies and music. The U.S. industry has expressed some concern about the adequacy of new legislation and continues to push for even stronger enforcement. We will continue to monitor this situation and other anti-piracy efforts closely.

b. Telecommunications

Hong Kong completed its liberalization of local fixed telecommunications network services (FTNS) on January 1, 2003. Some U.S. companies are considering applying for licenses, but remain concerned about how interaction with the incumbent service provider (PCCW/HKT) will be regulated. Potential new entrants are also concerned that they would be disadvantaged in comparison with the incumbent. We will continue to closely monitor developments in this sector.

12. Sri Lanka

The United States and Sri Lanka strengthened their already close trade relations in 2003, during which the second and third meetings under the Trade and Investment Framework Agreement (TIFA) were held. A Sri Lankan delegation led by Commerce Minister Ravi Karunanayake and G.L. Peiris, Minister of Enterprise Development, Industrial Policy and Investment Promotion, visited Washington in March. This TIFA meeting focused on the diversification of the Sri Lankan economy and the exchange of views on the Doha Development Agenda.

Deputy USTR Shiner visited Sri Lanka in October for the third TIFA session. Sri Lankan Prime Minister Ranil Wickremesinghe emphasized the importance of trade relations with the United State by leading the Sri Lankan delegation. Sri Lanka used this meeting to express its strong interest in negotiating a comprehensive and ambitious free trade agreement with the United States. In November, the Prime Minister was invited to the United States by President Bush, a meeting at which trade was an important topic.

Through the TIFA process, most outstanding bilateral trade issues have been resolved. At the Cancun WTO Ministerial, Sri Lanka publicly advocated a pragmatic approach for developing countries and urged WTO Members to focus on negotiations rather than rhetoric.

I. Africa

1. SACU FTA

The Southern Africa FTA Negotiations are discussed in Chapter A on Free Trade Agreements.

2. Implementing AGOA

The African Growth and Opportunity Act (AGOA), passed in May 2000 as part of the Trade and Development Act of 2000, is the centerpiece of U.S. trade policy for sub-Saharan Africa. AGOA provides a number of key economic benefits and incentives to promote economic reform and trade expansion in sub-Saharan Africa. The Act also institutionalizes a process for strengthening U.S. trade relations with sub-Saharan African countries by establishing an annual ministerial-level forum with AGOA-eligible countries.

AGOA offers beneficiary sub-Saharan African countries duty-free access to the U.S. market for essentially all products. It extended the existing Generalized System of Preferences (GSP) program for beneficiary countries through September 30, 2008 and added 1,835 products to the 4,650 products already eligible for duty-free treatment under GSP. It eliminated the GSP competitive need limitation for beneficiary sub-Saharan African countries, lifted all existing quotas on apparel products from eligible countries that are determined to have effective measures in place to prevent illegal transshipment, and allows less developed country beneficiary countries to use regional or third-party fabric in apparel imported into the United States under the program. The third-country fabric provision is set to expire on September 20, 2004. In late 2003, legislation was introduced in Congress to authorize the extension of AGOA for a number of years beyond its current expiration date of 2008 and to extend its third-country fabric provision beyond 2004.

AGOA requires the President to determine annually whether sub-Saharan African countries are, or remain, eligible for benefits based on their progress in meeting criteria set out in the Act. These criteria include establishment of a market-based economy and the rule of law, the elimination of barriers to U.S. trade and investment, implementation of economic policies to reduce poverty, the protection of internationally recognized worker rights, and establishment of a system to combat corruption. Additionally, countries cannot engage in: 1) violations of internationally recognized human rights, 2) support for acts of international terrorism, or 3) activities that undermine U.S. national security or foreign policy interests. An interagency AGOA Implementation Subcommittee, chaired by USTR, conducts the annual eligibility review, drawing on information from the public, NGOs, the private sector, and the prospective beneficiary governments. Following the last eligibility review in December 2003, and based on the recommendation of the U.S. Trade Representative, the President signed the Proclamation on AGOA on December 30, 2003 stating that 37[4] sub-Saharan African countries met the Act's requirements for eligibility in 2004. Angola was designated as a new AGOA beneficiary, while the Central African Republic and Eritrea, previously AGOA-eligible, had their AGOA beneficiary status terminated.

As of December 2003, 22 AGOA-eligible countries had instituted acceptable customs measures to prevent illegal trans-shipment and, accordingly, had been certified for AGOA's textile and apparel benefits.

AGOA also provides for the establishment of a U.S.-Sub-Saharan Africa Trade and Economic Cooperation Forum, informally known as "AGOA Forum," to discuss expanding trade and investment relations between the United States and sub-Saharan African countries, and implementation of AGOA. The third meeting of the Forum was held in Washington, D.C. in December 2003 and included participation by the President, the United States Trade Representative, the Secretaries of State, Treasury, Commerce, and Agriculture, the Administrators of USAID and the U.S. Trade and Development Agency, and ministerial-level officials from almost all AGOA-eligible countries. As with earlier forums, including the January 2003 Forum in Mauritius, the private sector and the NGO community organized parallel events during the government-to-government meetings.

4 The list of eligible countries for AGOA and of those that have met requirements for textiles and apparel benefits can be found at http://www.agoa.gov.

Since its passage in 2000, AGOA has had a significant impact on growth and economic development in several beneficiary countries. AGOA-related trade and investment has created over 190,000 African jobs and over $340 million in investments. In the first nine months of 2003, AGOA imports exceeded $10 billion, up 59 percent over the same period in 2002, largely due to an increase in oil imports. Over 92 percent of U.S. imports from AGOA-eligible countries now enter the United States duty-free, under AGOA, GSP, or zero-duty MFN rates. While most U.S. imports from the region continue to be in the energy sector, AGOA has begun to diversify U.S.-African trade. For example, in the first nine months of 2003 non-fuel AGOA imports exceeded $2.0 billion, with apparel imports totaling $870 million, a 42 percent increase over the same period in 2001. AGOA transportation equipment imports were up 24 percent, to $520 million, and AGOA agricultural imports increased 17 percent, to $160 million.

AGOA successes are also creating new commercial opportunities for U.S. exporters, as African exporters explore new input sources in the United States. U.S. exports to the region increased eight percent in the first nine months of 2003, with especially notable gains in agricultural goods, machinery, and transportation equipment.

See Section VI.A.3 for information on trade capacity building activities related to AGOA.

3. Promoting Economic Reform, Growth and Development

AGOA has prompted important economic and social reforms across sub-Saharan Africa and delivered new jobs and opportunities for economic growth and development to the region. AGOA's eligibility criteria create incentives for countries to reform their economies and create an environment conducive to increased trade and investment. The criteria represent global best practices to attract and maintain trade and investment, which are essential for the transfer of technology, and help promote competition and increase exports.

In 2003, the United States again consulted extensively with sub-Saharan African countries on AGOA eligibility requirements. As a result of these consultations, many eligible countries are implementing needed reforms, including measures to combat corruption, accelerate privatization, deregulate key industries, promote more open trade, and strengthen intellectual property and labor law protections. Many countries have ratified ILO Convention 182 on the elimination of the worst forms of child labor, and several are working to change, or have changed, laws on child trafficking and/or worker rights. By bringing increased investment to, and creating new jobs in, sub-Saharan African countries, AGOA is also demonstrating how trade can benefit developing countries.

4. Expanding Bilateral and Regional Trade and Investment Relationships

AGOA successes are helping to strengthen and expand U.S. bilateral and regional trade and investment ties with sub-Saharan Africa. One of the mechanisms for building on and improving U.S. trade and investment relationships in Africa is discussions arising out of Trade and Investment Framework Agreements (TIFAs). The U.S. has TIFAs with three African countries—South Africa, Nigeria, and Ghana—and two regional organizations—the West African Economic and Monetary Union (known by its French acronym, UEMOA), and the Common Market for Eastern and Southern Africa (COMESA).

a. South Africa

The United States and South Africa enjoy a broad and mutually beneficial trade and investment relationship. Two-way trade increased 11.5 percent in the first nine months of 2003, to $5.4 billion. During the same period, U.S. imports from South Africa under AGOA and related GSP provisions increased by 24 percent, led by increases in motor vehicles, chemicals, and apparel. South Africa is the largest U.S. supplier of non-fuel AGOA-eligible products (including GSP items), with sales worth more than $1.2 billion in the first nine months of 2003. Leading imports include platinum group metals, diamonds, motor vehicles, chemicals and apparel. Leading U.S. exports to South Africa include motor vehicles, aircraft, machinery, and medical equipment. Primary agricultural imports from South Africa are fresh fruits, which increased by approximately 50 percent in the first nine months of 2003; the primary U.S. agricultural export is wheat. South Africa and the United States continue to consult closely on issues related to the Doha Development Agenda, despite differences in many areas. South Africa is a member of the G-X coalition of countries that presented a hardcore stance toward the Doha Round at the September 2003 WTO Ministerial in Cancun.

As with many diverse and vibrant bilateral trading relationships, certain disputes have arisen between the United States and South Africa. These include concerns related to South Africa's December 2000 antidumping order against imports of certain U.S. poultry products, as well as ongoing problems related to South Africa's basic telecommunications monopoly, Telkom, and its failure to provide facilities necessary for U.S. value-added network services (VANS) providers to operate and expand. The United States continued to discuss these issues with South Africa in 2003, including in the context of the U.S.-SACU FTA negotiations. The United States is the largest single-country source of new foreign investment in South Africa since the country's 1994 transition to democracy. More than 900 U.S. companies and more than 400 U.S. subsidiaries and franchises are operating in South Africa.

b. Nigeria

Nigeria is the United States' largest trading partner in sub-Saharan Africa, based primarily on the high level of U.S. petroleum imports from Nigeria. Total two-way trade was valued at $8.4 billion in the first nine months of 2003, a 72 percent increase over the same period in 2002, due mainly to a surge in oil imports. Nigeria was the United States' fifth largest supplier of petroleum and the third largest purchaser of U.S. wheat in 2002. Primary agricultural imports from Nigeria are cocoa beans, which increased by over 160 percent in the first nine months of 2003. Nigeria is seeking to utilize AGOA to diversify its export base, especially in the area of manufactured goods. Nigerian exports to the United States under AGOA, including its GSP provisions, were valued at $7.0 billion during the first nine months of 2003, an 87 percent increase over the same period in 2002, due almost entirely to the increase in oil exports. The United States is the largest foreign investor in Nigeria.

The United States is working closely with the Government of Nigeria, through the U.S.-Nigeria TIFA and other initiatives, to promote expanded trade and investment and a more diversified economy. At the last U.S.-Nigeria TIFA Council meeting in June 2002, the United States and Nigeria pledged to work together on critical issues such as the Doha Development Agenda, AGOA implementation, and trade capacity building. The United States is concerned about the government of Nigeria's use of protective import bans on certain products, including sorghum, millet, wheat flour, bulk vegetable oil, and some printed fabrics. The United States is also concerned about significant recent tariff increases on various products, including rice and meats.

c. Ghana

Total two-way trade between Ghana and the United States was valued at $223 million in the first nine months of 2003, a 2 percent decrease over the same period in 2002. Ghana is the seventh largest sub-Saharan African market for U.S. goods. The leading U.S. exports to Ghana are rice, machinery, wheat, and motor vehicles. U.S. imports from Ghana are primarily oil, timber, aluminum, and cocoa. In the first three quarters of 2003, U.S. imports from Ghana under AGOA, including its GSP provisions, were valued at $36.5 million, up 17 percent from the same period in 2002.

Ghana and the United States enjoy a long-standing commercial relationship despite occasional commercial disputes involving U.S.

companies. A number of commercial issues have been resolved or addressed within the U.S.-Ghana TIFA. At the last U.S.-Ghana TIFA Council meeting, in July 2002, discussions focused on outstanding commercial disputes, WTO issues, AGOA implementation, and trade capacity building.

d. COMESA

The United States signed the TIFA with Common Market for Eastern and Southern Africa (COMESA) in October 2001 and has subsequently held two U.S.-COMESA TIFA Council meetings, most recently in June 2003. COMESA is the largest regional economic organization in Africa, with twenty member states and a population of 385 million. It is making great strides in advancing economic integration in the sub-region, including via implementation of the COMESA Free Trade Area, in which nine COMESA members participated in 2003. Fourteen COMESA members are AGOA-eligible and ten qualify for textile and apparel benefits. At the June 2003 TIFA meeting, Ambassador Zoellick and COMESA Secretary General Mwencha discussed implementation of AGOA, measures to enhance agricultural trade, WTO issues, and trade capacity building activities.

e. UEMOA

The eight-member West African Economic and Monetary Union (known by its French acronym, UEMOA) represents one of the most successful efforts to date toward regional integration in Africa. UEMOA has established a customs union, eliminated internal duties, and is addressing key non-tariff barriers. There is a UEMOA central bank and a regional stock exchange. Six of the eight UEMOA member countries are eligible for AGOA. UEMOA has only recently begun to realize benefits under AGOA. UEMOA's largest economy—Cote d'Ivoire, which accounts for over 40 percent of the region's GDP—became eligible for AGOA only in May 2002 and, until late 2003, only one UEMOA country—Senegal—had qualified for AGOA's textile and apparel benefits. Mali, Cote d'Ivoire and Niger qualified for such benefits in December 2003.

UEMOA entered into a TIFA with the United States in April 2002. At the most recent TIFA Council meeting in Washington in December 2003, UEMOA Commission President Toure and Deputy U.S. Trade Representative Shiner discussed AGOA implementation, means to increase trade and investment flows, issues related to the Doha Development Agenda, and trade capacity building.

5. Facilitating Sub-Saharan Africa's Integration Into the Multilateral Trading System

AGOA has also helped to promote sub-Saharan Africa's integration into the multilateral trading system and to encourage support for the new round of global trade negotiations in a region that accounts for more than a quarter of WTO membership. U.S. consultation and collaboration with African Members of the WTO played an important part in the successful launch of the Doha Development Agenda in November 2001. The United States and African WTO Members continued to consult closely in 2003 on issues related to the Doha Development Agenda. Although the United States and the Africa Group in the WTO differed in their views on some areas, including agriculture, non-agricultural market access, and the Singapore Issues, they also worked together to resolve one of the most difficult outstanding issues—TRIPS and Public Health—thereby facilitating developing country access to essential drugs, consistent with WTO rules. The December 2003 AGOA Forum provided an opportunity for U.S. and African trade officials to discuss practical ways to put the Doha Development Agenda back on track following the disappointment of the Cancun Ministerial.